

CHAPTER 1

INTRODUCTION

BACKGROUND

- 1.1 Kerala has been following a unique trajectory of decentralisation by devolving substantial development funds to Local Self Government Institutions (LSGIs) for the preparation and implementation of locally appropriate development projects and programmes. The People's Planning Campaign has attempted to use planning as the entry point to achieve a high degree of democratic decentralisation, ultimately moving towards the realization, in letter and spirit, of the Constitutional goal of "genuine institutions of local self government" as set forth by the 73rd and 74th Amendments. The Campaign has succeeded to a large extent in setting the agenda of decentralisation and pushing its pace. The decentralisation efforts of Kerala have moved from the experimentation phase through a corrective phase into the institutionalization phase. This is the background against which the Second State Finance Commission (SFC) has been set up. Thus the Second SFC has a critical role to play in the consolidation of the gains of the decentralisation experience and in laying a firm foundation for its institutionalization.

APPOINTMENT OF STATE FINANCE COMMISSION

- 1.2 The First State Finance Commission for Kerala as envisaged in Article 243 –I and 243 -Y of the Constitution of India and as provided in Section 186 of the Kerala Panchayat Raj Act 1994 and Section 205 of the Kerala Municipality Act 1994 was appointed on 23rd April 1994. The Commission gave its final report to Government in February 1996. The Second SFC was appointed by Notification No.33384/SFC.A1/99/Fin on the 23rd of June 1999, (Annexure 1.1) initially for a period of one year which was later extended by one more year by Notification No. 48596/Admn/A1/2000/Fin dated 26-7-2000 (Annexure 1.2).
- 1.3 As in the case of the First Finance Commission this is also a three member Commission whose members are:

Dr. Prabhat Patnaik, Chairperson
Professor, Jawaharlal Nehru University,
New Delhi.

Dr. K.M. Abraham, Member
Secretary to Government,
Finance (Resources) Department,
Government of Kerala.

Shri S.M.Vijayanand, Member
Secretary to Government,
Local Administration Department,
(Now renamed as Local Self Government Dept.),
Government of Kerala.

TERMS OF REFERENCE

1.4 The Terms of Reference of the Commission as given in the notification are extracted below:

"The Finance Commission shall review the financial position of the Panchayats and the Municipalities and make recommendations as to -

- (a) The principles which should govern, -
 - (i) the distribution between the State, Panchayats and Municipalities of the net proceeds of the taxes, duties, tolls and fees leviable by the State, which may be divided between them under Part IX and Part IX-A of the Constitution and the allocation between the Panchayats at all levels and the Municipalities 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 Panchayats and the Municipalities;
 - (iii) the grants-in-aid to the Panchayats and the Municipalities from the Consolidated fund of the State.
- (b) The measures needed to improve the financial position of the Panchayats and the Municipalities with reference to,-
 - (i) the scope for local bodies to raise institutional

finance, and suggest a framework for local self-governments to take recourse to such sources along with procedures to be followed and limits, if necessary, to raising such resources;

- (ii) need for sharing the cost of maintenance of assets and institutions transferred to local self-governments, and evolving criteria for it, with due regard to the fiscal position of the State Government and the local self-governments;
- (iii) steps necessary for efficient financial management with particular reference to efficiency in resource mobilization and economy in expenditure;
- (iv) settlement of claims and dues of Panchayats and Municipalities vis-à-vis Government and Governmental agencies;
- (v) Procedures to be followed for smooth flow of funds to local self-governments and for ensuring proper financial accountability."

1.5 Government have gone beyond the Terms of Reference given to the First SFC, and broadened the scope of the Commission's work by expanding the second portion of the Terms of Reference dealing with the measures needed to improve the financial position of LSGIs by clearly stating five specific items. Thus, the Second SFC, besides suggesting devolution of funds and their distribution among LSGIs has to go into the question of financial management including raising of resources, availing

of loans, economy in spending and settlement of debts and dues. Also the Second SFC has been given the task of suggesting procedural refinements to ensure a smooth flow of funds from Government to local governments and for ensuring proper financial accountability.

METHODOLOGY FOLLOWED BY THE COMMISSION

1.6 The Commission has followed a methodology appropriate to the comprehensive task entrusted to it as per the Terms of Reference. Some of the salient features of the methodology adopted by the Commission are outlined below:

- (1) The Commission directly studied the functioning of each of the five types of local government with special reference to financial matters viz., Village Panchayat, Block Panchayat, District Panchayat, Municipality and Corporation by visiting one representative of each type. (Annexure 1.3)
- (2) The Commission held consultations with representatives of local government associations viz., Panchayat Association, Block Panchayat Association and the Municipal Chairmen's Chamber. These consultations brought to the fore various issues relating to the finances of these local governments as recognized and felt by the elected representatives. (Annexure 1.4)
- (3) Detailed discussions were held with the Secretaries and Heads of Department involved in decentralisation. (Annexure 1.5).

- (4) The Commission had a special meeting with the Finance Minister and the Finance Secretary.
- (5) There was an exchange of views with the State Planning Board with particular focus on decentralised plan preparation and implementation.
- (6) The Commission conducted a detailed analysis of the Report of the First Finance Commission and the follow-up action on it and Annexure IV of the State Budgets since the year 1996-97.
- (7) The services of one Consultant each were utilized by the Commission in respect of Panchayats and Municipalities.
- (8) The Commission has entrusted the Institute of Public Auditors of India (IPAI) with the task of doing a thorough study of the budgeting, accounting and audit systems in both the rural and urban local governments so that these can be simplified and modernised. The IPAI is expected to produce detailed manuals on budgeting, accounting and auditing, incorporating the best practices from within and outside the country.
- (9) The Commission has collected data from local governments through a detailed questionnaire. These questionnaires which were in two parts for the Urban Local Bodies (ULBs) and Village Panchayats and in one part for the other local governments were filled up and returned by all the local governments except 14 Village

Panchayats which could not fill up the first part of the questionnaire relating to own income and non plan grants.

SUBMISSION OF THE REPORT

- 1.7 The Commission intends to submit its Report in two parts. This Report deals with the first part of the Terms of Reference relating to devolution and a portion of the second part of the Terms of Reference dealing with maintenance needs and the funds required for meeting them and with procedures related to the flow of funds. The second part of the Report which is expected to be submitted in May 2001 would deal with the remaining items of the Terms of Reference. It would also give further suggestions for increasing local resource mobilization which would be generated after close interaction with the newly elected LSGIs whose tenure these Reports would basically cover.

STRUCTURE OF THE FIRST REPORT

- 1.8 The First Report is structured in eight Sections with twelve Chapters and a summary of the recommendations. The first Section has an introductory Chapter on the constitution of the Second Finance Commission, its Terms of Reference and the Methodology adopted by it and the second Chapter outlines the approach of the Commission to the major Terms of Reference. The second Section has two descriptive Chapters – one giving an overview of local government finances and other summarizing the decentralisation process in Kerala. Section III has just one Chapter analyzing the recommendations of

the First SFC, with reference to their present status of operationalisation. Those recommendations, which need to be followed up further are identified in this Chapter. Section IV deals with devolution of funds from the State Government to the LSGIs. This theme is presented in three Chapters – one dealing with devolution of Plan funds, the next dealing with devolution of funds exclusively for maintenance and the last one in the Section dealing with devolution of General Purpose Grant in lieu of the existing Assigned and Shared Taxes and Non-plan grants-in-aid. The fifth Section has the Chapter on enhancing the own revenues of LSGIs.

- 1.9 Section VI has a Chapter on State Government Finances and another Chapter giving the observations of this Commission on certain issues raised by the 11th Finance Commission. Section VII consists of the Chapter outlining the Procedural Safeguards, including legislative changes, which are required for a proper implementation of the recommendations of this Commission. And the last Section summarizes the recommendations.

CHAPTER 2

OUR APPROACH

FINANCIAL DEVOLUTION

- 2.1 The State Finance Commission is concerned with the devolution of funds from the state government to the LSGIs in its entirety, and not merely with one particular part of the total devolution. There has unfortunately been a general tendency to treat the jurisdiction of the State Finance Commission as being confined to the devolution of non-plan funds, the matter of Plan funds being considered a prerogative of the state government. Even the First State Finance Commission of Kerala had only a few recommendations concerning the Plan, and did not go into the question of devolution of Plan funds. This tendency echoes the practice that has got established at the central level, where successive Central Finance Commissions have adjudicated over the allocation of only one part of the total devolution from the Union to the state governments, leaving the decision regarding the remaining, more substantial, part to the purview of bodies belonging to the central government itself, such as the Planning Commission or the Ministry of Finance. This tendency however cannot be defended on the grounds either of reasonableness or of conformity to the letter and spirit of the 73rd and 74th Amendments to the Constitution on whose basis State Finance Commissions are formed.
- 2.2 Such a separation, and corresponding attenuation of the role of the Finance Commission, is unreasonable on two counts.

First, different categories of devolution are intrinsically interrelated. If more funds are devolved to LSGIs for plan projects, then correspondingly larger provisions have to be made for them for the maintenance and operation of the assets created through such projects. Two separate bodies therefore cannot in any meaningful sense (i.e. without one of them becoming a mere rubber stamp) decide on these two kinds of devolution. The inseparability of the two kinds of devolution necessitates that they fall under the jurisdiction of one body, which can only be the Finance Commission. Secondly, the 73rd and 74th Constitutional Amendments provide for a statutory body to adjudicate on financial matters, namely the State Finance Commission. The spirit of those Amendments therefore requires that the jurisdiction of that statutory body be as comprehensive as possible. The letter of those Amendments too is in conformity with this. The State Finance Commission's task is to "review the financial position" of local bodies. Since any such review can only be in relation to the functional responsibilities of the LSGIs, and these include the responsibilities vested in them for "the preparation of plans for economic development and social justice", it follows that even the letter of those Amendments enjoins upon the SFC a concern with the total financial requirement, both plan and non-plan, of the LSGIs. Our Commission accordingly proposes to take a comprehensive view of financial devolution from the state government to the LSGIs and not confine itself only to non-plan devolution.

- 2.3 Given this perspective, and the fact of the inseparability of different kinds of devolution, a tempting idea is to earmark a certain fixed proportion, say 20 percent, of the total tax revenue of the state government for devolution to LSGIs for both plan and non-plan use. The *inter se* distribution of this amount among the LSGIs could then be determined by some specific criteria, and individual LSGIs could, within limits, be

left free to allocate the funds at their disposal in any manner they choose. This solution is tempting for a number of reasons. First, it is simple and appears more in keeping with the idea of genuine decentralisation which gives freedom of resource use to LSGIs. Secondly, it has intellectual pedigree, having been mooted by some of the first SFCs (including the SFC of West Bengal headed by Dr.Satyabrata Sen). Thirdly, it is in conformity with the trend being initiated by the Central Finance Commission itself. Fourthly, it apparently entails equitable sharing between the state government and the LSGIs: they evenly partake of affluence and penury, without either one of them squeezing the other in any obvious manner. And finally it would seem to be more appropriate in the Kerala context, where, the upkeep of the good infrastructure facilities being very important, the LSGIs should not be constrained by the plan – non-plan distinction. In these respects it would even appear to have an edge over the current practice in Kerala, following the Peoples’ Plan Campaign, of giving a fixed percentage of plan funds (35 to 40 percent) to the LSGIs.

- 2.4 There are two obvious problems potentially associated with the current practice. The first arises from the fact that the LSGIs’ requirement of non-plan funds, as already mentioned, is itself linked to the amount of plan funds made available to them. Ensuring that a certain percentage of plan funds is put at their disposal is therefore not enough; an appropriate amount of non-plan funds must also be made available to them for meeting the current operational costs and the maintenance requirements of the plan assets. A system in which a certain overall share of tax revenue of the state government is passed on to LSGIs, and the latter have a degree of flexibility in deciding how to deploy their share, would be better able to avoid any potential disproportionality between asset creation on the one hand and asset maintenance and operation on the other. The second problem associated with the current practice

arises from the fact that a relative or even an absolute decline in the size of the state's plan outlay leads *ipso facto* to a similar decline in the magnitude of devolution of plan funds to LSGIs and hence in the size of the LSGI plans. This means that a sudden draft on the state government's resources on the non-plan side, or plain non-plan profligacy on the part of the state government, or niggardliness on the part of the Planning Commission, or a financial squeeze imposed by the central government, all of these would invariably impinge on the size of the LSGI plans. If we are concerned that the size of these plans, which cater to the basic requirements of the mass of the people, should be kept insulated from such extrinsic developments, then a devolution formula which gives LSGIs a share of the *state revenue* as opposed to one which gives them a share of the *plan outlay* appears preferable. (To be sure, even with revenue sharing, LSGI plans would still be vulnerable to the profligacy, on the non-plan side, of the LSGIs themselves; but more directly exerted popular pressure, through institutions such as Grama Sabhas and Ward Sabhas together with the imposition of some pre-determined expenditure "norms", could take care of it).

- 2.5 The fear that a plan-outlay-sharing system makes LSGI plans vulnerable to a whole range of extrinsic developments including a financial squeeze emanating from the central government via cuts in grants-in-aid, is not an idle one. The additional fiscal burden imposed on the state government on account of the implementation of the recommendations of the Pay Commission, together with the fact that grants-in-aid from the Central government have tended to stagnate, has had an impact on the growth of the state's plan outlay in 1999-2000 (RE) and 2000-01 (BE), and correspondingly on the growth of plan transfers to the LSGIs, even though the absolute amounts of such transfers remain impressive. The total plan

and non-plan transfers¹ to PRIs as a proportion of the total tax revenue of the state government, which amounted to 7.2 percent in 1996-7, increased to 20.8 percent in 1997-8 when the Peoples' Plan Campaign took effect. The ratio was 19.5 percent in 1998-9, but appears to have declined somewhat thereafter: to 16 percent in 1999-2000 (RE) and 14.1 percent in 2000-01 (BE). Since the proportion of non-plan transfers to the total tax revenue of the state government has remained more or less unchanged, amounting during these five years (in percentages) to 2.07, 2.15, 2.61, 2.2, and 2.61 respectively, it is the ratio of plan transfers to total revenue that appears to have been affected. To be sure, these figures do not tell the whole story, since they exclude the transfers by way of salaries to state personnel who have been assigned to LSGIs; besides, the period is too short, and, for the later years, we are not even talking about Actuals but only about Revised and Budget estimates. Nonetheless, the possibility in the coming years, if the fiscal problems of the central government get compounded, of these problems getting "exported" to the state level, and from there further downwards until they impinge on LSGI plans (or of an exactly similar *denouement* arising from a worsening of the state government's fiscal position for independent reasons), is to be reckoned with.

- 2.6 Though the above discussion constitutes a strong case for moving to a general revenue sharing arrangement between the state government and the local governments, the Commission feels that there are a number of weighty counter arguments which cannot also be ignored. These are summarized below.

¹ The term "non-plan transfers" here refers exclusively to the transfers which figure in the Appendix IV of the Budget, i.e. it does not include the transfer of the proceeds of the shared and assigned taxes, to which the LSGIs are entitled or transfers in the form of payments of salaries and operational expenses on transferred schemes.

- 2.7 Any general sharing of revenue implies that there is a clear demarcation of responsibilities between the state government and the local governments. But actually this is an evolutionary process. Though Kerala has gone beyond any other state in sharing responsibilities with local governments there are areas like the productive sector where only over a period of time can the functional domains be defined with reasonable clarity. Indeed, the local governments which have been initiated into the planning process are themselves just coming to grips with the developmental needs and solutions within their functional domain, and would also require more time for working out the financial needs of various aspects of the responsibilities transferred to them.
- 2.8 Besides, the allocation of 35-40 percent of the Plan funds to the local governments also has a symbolic significance, since it is this move which really gave the big push to decentralisation. Participatory planning has been used as the entry point to make decentralisation genuine. Therefore it is necessary to continue the practice, of sharing Plan funds in this ratio, for some more time, until the institutions of local government have struck firmer roots.
- 2.9 There is a further consideration of some importance. A blanket revenue-sharing arrangement would even suggest a transfer of all obligations of meeting the current expenditure in LSGI-run institutions to the LSGIs themselves. It could for instance imply a transfer of the obligation to pay salaries to the large number of state employees, currently working in LSGI-run institutions but drawing their salaries from the state government, to the LSGIs themselves. These state government employees would overnight become LSGI employees. A blanket revenue-sharing arrangement would also transfer the task of purchasing supplies for LSGI-run institutions, such as medicines for hospitals, and books and consumables for

schools, to the LSGIs themselves. All this would entail, first of all, an enormous and unmanageable administrative burden on the LSGIs. They would have to manage the payroll of a large number of personnel who would now constitute their direct employees. They would have to arrange supplies for the day-to-day running of a host of institutions. These tasks are as onerous as they are unnecessary for LSGIs to perform. A distinction must be drawn between decentralisation of administrative burdens and decentralisation of decision-making. The former is not only not a pre-condition of the latter but may even thwart the latter. Proper sequencing is very important in the decentralisation process. An LSGI system which has not stabilised would be put to severe stress if it takes on the burden of administration in full. For example while it must be the LSGIs which should control officers placed under them, assign them tasks, and ensure their proper performance, this does not necessarily imply that they should bear the burden of recruitment, payment of salaries and dealing with service matters. These tasks consume a lot of time and energy and could detract from LSGI efficiency in carrying out their essential responsibilities. To be sure, there is an obvious contradiction in having personnel who are recruited by one agency but are answerable to another, a contradiction referred to by the Committee on Decentralisation of Powers as “dual control”. But a forcible resolution of this contradiction by simply eliminating one of its poles, either through centralisation as existed earlier or through complete decentralisation entailing the parcelling out of administration, is no answer to the problem.

- 2.10 Even from a financial point of view, making LSGIs responsible for meeting the entire current expenditure obligations in LSGI-run institutions would make little sense. The state government has many more financial options than the LSGIs have. It can borrow. It can introduce new, innovative taxes;

and so on. In the event of an increase in the cost of administration, for example a rise in salaries, the state government can absorb the increase far more easily than the LSGIs in case they are asked to bear the cost of administration under a new dispensation. It was mentioned above that under the current practice of plan-outlay-devolution a sudden need on the part of the state government to spend more on the non-plan side would squeeze LSGIs' plans, and that this strengthened the case for revenue-sharing between the state government and the LSGIs. This argument clearly lacks general validity. It holds only when the increase in the state government's non-plan expenditure need is of a kind that LSGIs would not face when expenditure obligations are transferred to them along with a share of revenue. But if they have to face the same non-plan expenditure need as the state government, they would be worse off in a regime of revenue-sharing. For example if they had to implement Pay Commission recommendations out of their own funds in a regime of revenue-sharing, they would have ended up being worse off than they have actually been under the current dispensation. Of course it may be argued that additional financial options which the state government has, such as borrowing, should be made available to the LSGIs too. We examine this issue later, but, should this be done indiscriminately, then very sharp inequalities could emerge among LSGIs, forcing the backward ones to go under, which would defeat the whole purpose of decentralisation.

- 2.11 Enough has been said to show that any simple rule stipulating the transfer of a certain fixed proportion of total tax revenue from the higher to the lower level, would be inappropriate in the present Kerala context. Accordingly, we reject this approach. The approach we do adopt instead on the question of devolution has six main features which are given below.

- 2.12 First, for reasons discussed in Chapter 6, we are of the view that the current practice of making 35-40 percent of the plan outlay available to the LSGIs to spend on plan projects of their choice should be continued: our precise recommendation is that not less than one-third of total plan outlay (excluding state-sponsored schemes from the numerator) should be given to LSGIs. A feeling has been conveyed to us that the transfer of such substantial amounts of plan funds to the LSGIs has been accompanied by a corresponding slackening of revenue effort by the LSGIs themselves. This feeling is pervasive, though the empirical support adduced in its favour is not very persuasive. But irrespective of whether larger devolution has actually caused a slackening of revenue effort, any slackness in such effort is *per se* unwarranted. Stimulating revenue effort therefore is a must; and we do so by incorporating revenue effort explicitly into the formula determining the *inter se* distribution of plan resources.
- 2.13 Secondly, the question of maintenance of the assets newly created by the LSGIs from the enhanced devolution of plan funds under the Peoples' Plan Campaign, not to mention the assets transferred to them under the Government Order of September 1995, is going to become exceedingly important in the coming years. The resources required for the maintenance of both these types of assets would have to be provided by the state government, even though the maintenance work is actually carried out under the aegis of the LSGIs. In other words, in addition to the devolution of plan funds, the state government has to make available to the LSGIs an amount that would cover the maintenance expenditure on both types of assets. The reasoning behind this is obvious: if the transferred assets had not been transferred to the LSGIs, then the state government would have paid for their maintenance; since they have been transferred the requisite sum should be handed over to the LSGIs to whom these assets have been

transferred. Likewise, if the increased devolution of plan funds had not taken place, the state government would have used these plan funds through its various departments, and would have paid for the maintenance of the assets created through the use of these plan funds. The fact that this devolution has occurred simply means that these assets are now under the jurisdiction of the LSGIs; the state government's obligation to pay for the maintenance of these newly-created assets (and those continuously being created) is not removed thereby. Of course if the transferred or newly-created assets were run on commercial lines, then the expenditure on maintenance could come from their own revenue, exonerating the government from the obligation to provide for their maintenance. But since the bulk of these assets are not commercially operated, and are not meant to be, the obligation on the state government remains. Finally, there are the assets which are neither transferred under the September 1995 Government Order, nor newly constructed out of the higher devolution of plan funds following the People's Plan Campaign. An important segment of this third category is constituted by assets which the LSGIs already owned prior to September 1995. The maintenance expenditure on these assets has come partly from the LSGIs' own funds, including what comes to them as Vehicle Tax Compensation, and to a limited extent from such non-plan, non-statutory grants of the state government as the Village Road Maintenance Grant (when it existed). But the actual maintenance expenditure on these assets has in practice been rather meagre. Adequate expenditure on the maintenance of these assets, given their non-commercial nature, would necessarily require additional financial support from the state government.

- 2.14 We suggest that this additional amount, together with the requisite amounts for the first two categories of assets, should be provided by the state government. In other words, the state

government should provide the entire maintenance expenditure on the pre-existing assets of the LSGIs, on the assets transferred to them after September 1995 and on assets newly-constructed by them out of plan assistance in the period since 1997-8. It need not, however, make any Vehicles Tax Compensation available to the LSGIs. Our approach is to get the state government to transfer a certain total amount for the maintenance of assets to the LSGIs as a whole, among whom it is to be distributed according to certain criteria reflecting maintenance needs. It is essential of course that the LSGIs in turn should not use the amount, handed to them for the maintenance of assets, for all sorts of other purposes; we wish to put this amount beyond their reach for expenditure other than on approved uses.

- 2.15 Thirdly, there are a host of payments made by the LSGIs to meet social obligations, such as pension schemes, unemployment allowance, scholarships etc., for which the funds are provided by the state government. These are grouped together under “Non-Plan” expenditures in the Appendix IV of the state government’s budget. The state government should continue to make appropriate transfers to the LSGIs under this head for them to meet all such obligations.
- 2.16 Fourthly, there is the question of operating costs on transferred assets, as distinct from maintenance. These are of two kinds: salaries of personnel and operating costs on account of current inputs, e.g. medicines for hospitals, books and consumables for schools. The state government is already meeting the operating costs of the transferred assets and should, in principle, continue to do so. A reasoning analogous to that in paragraph 2.13 would suggest that even on assets newly created by the LSGIs after the higher devolution of plan funds, the operating costs would have to be met by the state government, unless of course these assets themselves happen to be

commercially viable. In practice, however, any system where costs are met by one agency while decisions regarding their size are taken by another, runs the risk of profligacy (even if these decisions have to be formally approved by the first agency). This problem has reportedly become quite acute through pressure for the creation of new posts, by the LSGI. It would become even more acute in the coming years unless something is done about it immediately.

- 2.17 An immediate response to the problem may be to say that all new posts at the LSGI level should have to be financed out of their own funds (even as the state government meets the salary component on account of the transferred posts). This however could well lead to a diversion of funds earmarked for plan or maintenance purposes towards meeting a burgeoning salary bill. Even if safeguards against such diversions are provided, it would not be appropriate to take such a drastic step immediately. This can be considered as a possible long-term measure and deserves further discussion. Meanwhile to curb profligacy under the existing arrangement we make the following specific suggestion. For the creation of any new post at the LSGI level, *no matter who is financing it*, there has to be a process of consultation between the state government and the LSGI(s) concerned. After such consultations and before the proposal comes before the cabinet, *clearance must be obtained from an Expenditure Watchdog body*. We do not propose the setting up of a new Watchdog body. We recommend instead that the existing institution of Ombudsman should be used for the purpose. Technical and other help should be made available to the Ombudsman so that they can also take on this additional role.
- 2.18 Apart from this new arrangement we propose, our recommendations regarding operating costs of LSGI assets have four elements: first, all existing salary commitments on

transferred schemes, including wages to temporary employees, must continue to be paid by the state government. Secondly, the current practice of state government funding of medicines and books should be continued exactly as it is, but in all other sectors, the state government should be freed from its obligation of having to meet operating costs. And even in the education and health sectors, all other operating costs, such as rents on buildings, electricity and vehicle running charges, telephone expenses etc. should be met by the LSGIs from their own funds including general purpose grants and upto 10% of maintenance grants. Thirdly, the LSGIs, apart from meeting all these operating costs, should have the freedom to undertake *extra* expenditure at the margin in the education and health sectors, over and above what the state government provides. And fourthly, to enable them to do so, they should be allowed to spend up to 10 percent of the Maintenance Transfer, which is being made available to them, for meeting operating costs.

- 2.19 Fifthly, in addition to the devolution under the above-mentioned heads, there are the transfers on account of taxes and certain non-plan grants from the state government to the LSGIs. There are three broad categories within this head: assigned taxes which are collected by the government to be handed over to the LSGIs (which in the case of PRIs include Basic Tax and Surcharge on Duty on Transfer of Property and for Urban Local Bodies (ULBs) only the latter); shared tax (which is the Motor Vehicle Tax); and a few grants. A plethora of grants makes the system cumbersome and opaque. Likewise even the system of earmarking particular tax revenues for distribution to LSGIs has little to recommend it. Our approach is to do away with this entire cumbersome system and to stipulate that a certain fixed proportion of the tax revenue of the state government is to be handed each year to the LSGIs. The state government in turn can retain the proceeds of the

taxes, which were either “assigned” or shared till now, for its own use. For determining the exact share which is to be so distributed among the LSGIs and also the *inter se* distribution of the amount among the various tiers of LSGIs, we make use of the observed historical shares in the recent past.

- 2.20 We are aware that in recommending a shift away from the system of assigning and sharing specific taxes, we are making a radical departure, since local government finances all over the world have traditionally been based on such a system. While this departure *per se* may not cause control, there may be legitimate grounds for serious misgivings on the following score: tax assignment confers a right on LSGIs which a system of sharing the over all tax revenue appears not to do; it appears to be in the nature of a grant that is open to withdrawal by the State Government at its will. We wish to remove these misgivings by emphasising that the tax share proposed by us should be deemed a matter of right by the LSGIs, sanctioned by appropriate legislation.
- 2.21 Finally, a consideration which we hold to be important and which has informed our entire approach in this report is that the system of transfers from the state government to the LSGIs should be made as simple as possible. Likewise, the formulae for *inter se* distribution of funds should be made as simple as possible.
- 2.22 To sum up, our Commission’s approach is to take the devolution of funds in its entirety and to make recommendations regarding both plan and non-plan devolutions rather than confining ourselves only to the non-plan side, as has become customary at the Centre and in many states. Though we look at devolution in a comprehensive manner, we reject nonetheless the rather tempting idea of a

blanket division of the state government's tax revenue governing devolution. This idea entails fixing a particular share of the total tax revenue of the state government that is made available to the LSGIs as a whole; the amount is distributed among the LSGIs according to some formula and they are then left more or less free to spend their amounts as they like. This idea, notwithstanding its simplicity and appeal, is unworkable in the context of Kerala which has pursued its own unique trajectory of decentralisation, a pursuit that has to be taken by us as a historical datum. Our approach is to stipulate a share of plan outlay that must be handed over to the LSGIs, as is the current practice, and a share of tax revenue to be given as non-plan statutory transfer in lieu of the current complex and cumbersome system of tax-assignments and tax-sharing. In addition to these plan and non-plan transfers, the state government has to keep meeting the salaries of all personnel on the transferred assets, to keep making appropriate transfers to the LSGIs' for meeting a host of social obligations (non-plan payments under Appendix IV of the budget), and to keep defraying the costs of medicines in hospitals and books and consumables in educational institutions under LSGI-jurisdiction. It also has to transfer a certain amount every year for the purpose of meeting the maintenance requirements on LSGI assets. In arriving at the magnitudes of these transfers and their *inter se* distribution among the LSGIs, our objective has been to simplify the system as far as possible, so that the mystery and opaqueness governing the devolution of funds from the state government to the LSGIs get minimised.

RESOURCE MOBILISATION BY LSGIs

- 2.23 The increased plan allocation to LSGIs has generated a euphoria among them regarding availability of funds. There is in fact a pervasive feeling that LSGIs are flush with funds. There are however clear parameters within which such funds

can be spent; they are meant for new development ventures, and, implicitly, for such development ventures as would give adequate returns, both social and economic. It is important to note that local governments have traditional obligatory functions and are often judged on the quality of their performance of these functions, which relate to public health and sanitation, maintenance of infrastructure, and the exercise of regulatory civic functions to ensure good quality of life for the citizens. Now that a lot of new assets have been transferred to the LSGIs and the flow of maintenance funds from the state government cannot but be limited on any reasonable expectations, the need for mobilizing resources becomes very critical. If LSGIs can raise more funds by themselves they can dramatically improve the upkeep of assets transferred to them. An analysis of the resource inflows of LSGIs shows that in the case of Village Panchayats the proportion was broadly 3:2:11 respectively for own funds, non-plan grant-in-aid from the state government including assigned and share taxes, and plan grant-in-aid. The corresponding proportion for Municipalities as well as Corporations was 3:1:2. Own funds therefore constitute a significant amount. The very fact that LSGIs can raise resources including taxes is a symbolic affirmation of their status as institutions of local self government. The right to fix the rates for taxes and other revenues and collect them gives authority and importance to the LSGIs. On the other hand it also demands a considerable degree of responsibility from them, since the tax payers are not only very close to the collection point but are also witnesses to the mode of utilization of the taxes collected. This opens up the possibility of spontaneous tax-compliance as well as of community pressure to pay dues to LSGIs, provided the services of the local governments are perceived to be useful and relevant.

2.24 There are however certain problems with regard to the

mobilization of revenue by LSGIs. The most important problem relates to the tax base, which is rather inelastic and cannot be widened very easily. Moreover, the minimum and the maximum rates for the taxes and most of the non-tax revenues are fixed at present by the state government. In the case of many of the non-tax sources the amounts are fixed by the government through rules, and these, for a variety of reasons, do not get revised in tandem with the rate of inflation. A serious additional problem relating to taxation at the local level is the fact of gross under-assessment. Our interactions with representatives of LSGIs suggest that the present demand is only about half of what can really be collected. The assessment is done in a rather primitive fashion and the process of assessment often tends to be very subjective. To compound this problem the collection efficiency is also low. The traditional mode of collecting from the doorstep is still being resorted to. The enforcement provisions are rarely used.

- 2.25 The Commission believes that the tax base can be expanded *inter alia* through the introduction of Service Tax. Also some non-tax revenue sources can be further tapped. The Commission strongly endorses the view that only the floor rates and amounts need to be fixed by the government. This would allow greater autonomy to the efficient LSGIs to mobilize more local resources. In addition there is urgent need to index the rates to changes in money value. Tax assessment methods can be rationalised essentially by reducing discretion and moving on to a transparent normative basis, like plinth area in the case of buildings, seating capacity in the case of cinemas, presumptive taxes for certain professions and so on. In this respect, some of the recommendations of the first Finance Commission are very pertinent. Collection efficiency is also very crucial, though the drive to collect larger revenues has to come from the LSGIs themselves. To be sure, training and motivating the collecting personnel would help, as would

external incentives of the sort we have provided, by incorporating the revenue effort criterion into the *inter se* distribution of plan funds. But there is no escape from the fact that the LSGIs themselves must internalize the urgency of the need to garner larger revenue.

- 2.26 Though there are provisions in the Kerala Panchayat Raj Act, the Kerala Municipality Act and the Local Authorities Loans Act for borrowing by LSGIs, these provisions are not fully utilized. The Commission believes that as more and more responsibilities get transferred to LSGIs, they have to supplement their own resources and grants-in-aid with borrowings, mainly for schemes which would generate a revenue stream that can help repayment, and for socially relevant schemes for which local surcharges can help in repayment. The question of borrowing and the safeguards required would be dealt with in the second part of the Report.
- 2.27 Raising resources alone is not enough. It is equally important to spend them prudently. For this, there has to be proper financial management. This can be achieved to some extent through improved managerial practices, enshrined in rules regarding the assessment of taxes, the preparation of budgets and the regulation of expenditure. There seems to be a tendency on the part of LSGIs to overspend on items like inauguration ceremonies and to be liberal with the distribution of funds. These need to be curbed through mutually agreed guidelines. The Commission would dwell on these issues in its second report.
- 2.28 With so much of public funds being handled by the LSGIs, the need for enforcing a degree of accountability upon them increases. Of course, since they are close to the people there is some control from below, especially through various

participatory mechanisms, which have already been adopted by the state government. Nevertheless, financial accountability through certain fiscal responsibility provisions as well as through improved maintenance of accounts is very essential. Similarly the presentation of accounts to the public to facilitate social audit also needs special attention. The current procedure by which LSGI accounts are audited leaves much to be desired. There is invariably considerable delay, and the quality of audit too is not particularly good. It is a very routine form of audit and its contribution towards system improvement or towards enabling penal action has been very limited. These need to be totally revamped. The Commission is getting a study done on the maintenance of accounts as well as on the procedures of auditing by the Institute of Public Auditors of India and the second part of the Report would carry detailed recommendations on the subject.

PROCEDURAL SAFEGUARDS

- 2.29 In order to ensure that the recommendations of the Commission are properly implemented, certain procedural safeguards have to be put in place. The most important safeguard is to give legislative sanction to the proposed devolution, by incorporating the share of taxes due to local governments in the Kerala Panchayat Raj Act and the Kerala Municipality Act. These devolved funds would be in three categories: Plan Grant, Maintenance Grant and General Purpose Grant. Each grant would have clear conditions for use which should be issued in the form of Rules.
- 2.30 On the part of the state government it is very important to ensure a smooth flow of funds. The Commission feels that there should be automatic crediting of funds to LSGIs, but these have to be combined with reasonable restrictions on

withdrawal, linking such withdrawals to actual expenditure. Similarly, the funds have to be devolved according to fair and transparent formulae. This is particularly true of the devolution of the maintenance grant, for which a scientific assessment of the maintenance needs has to be made and the results then used for an equitable *inter se* distribution of the funds.

- 2.31 At the local government level there is need for a maintenance plan to be prepared. Also the present tendency to divert funds, earmarked for some particular purpose, towards an altogether different use, needs to be curbed, with penal provisions for such diversion. There should be no diversion whatsoever from Plan Grants or Maintenance Grants.
- 2.32 Simple financial devices can be tried out to improve accountability. For example, by creating a single account to which all the different streams of own income of the LSGIs are credited, one can get a good idea of the actual income for the year. Similarly by limiting the period of validity of cheques to one financial year, the tendency to inflate expenditure through the issue of pre-dated cheques can be contained. The Commission recommends both these procedures, and would be recommending several others of this sort.
- 2.33 It has been noted that there is a considerable time lag in operationalising the recommendations of the State Finance Commission even after they are accepted by the state government. Several departments have to take follow up action, and since amendment to Acts and Rules are required in many cases, progress naturally tends to slow down. But this defeats the very purpose of the Commission's recommendations. Since Finance Commissions come only once in five years, any delay in implementing the recommendations of the Commission reduces their effectiveness. There is need therefore for quick

follow-up action on Finance Commission's recommendations, for which an empowered Committee is necessary.

CERTAIN OTHER ISSUES

- 2.34 Unlike the Central Finance Commissions, there is greater need for continuity in the case of State Finance Commissions. As the local government system is evolving in the country, there is greater need to link up with the recommendations of the previous Finance Commissions. Another factor is that several recommendations are slow to get implemented and in such cases there would be a need for reiteration. This Commission has gone into the recommendations of the First Finance Commission in detail and has studied the status of their implementation. Since it is felt that the implementation without delay of many of those recommendations is of critical importance, they are being reiterated in this Report.
- 2.35 The recently submitted report of the Eleventh Central Finance Commission raises a number of important issues that call for a reaction from our Commission. At least three issues are pertinent here, two of which relate to principles, while the third relates to practice. These issues and our response to each of them are listed below *seriatim*. First, the CFC feels the need for introducing Constitutional amendments in at least three areas: for empowering Parliament to revise the rates of Profession Tax without having to introduce a Constitutional amendment on each occasion; for making it possible to bring forward the dates of setting up of the State Finance Commissions, so that these could be appropriately synchronised with the date of institution of the CFC and their reports could genuinely provide the basis for the recommendations of the CFC; and for removing the provision which makes it obligatory for the CFC to take the SFC reports as the basis for making

its own recommendations. We are in agreement with both the spirit and the letter of the first suggestion. We are in agreement with the spirit, though not the letter, of the second suggestion, since we feel that a *carte blanche* to state governments to set up Finance Commissions when they like may be open to misuse; our own phrasing of the required Constitutional amendment (given in Chapter 11) attempts to overcome this potential problem. On the third of the CFC's Constitutional suggestions however we have differences of both letter and spirit. Though we understand the circumstances (relating to delays or non-compliance with SFC recommendations by state governments) which make the CFC wish to get rid of this albatross round its neck of having to base its own recommendations on those of the SFCs, abandoning this clause altogether would in our view be potentially detrimental to the smooth functioning of our federal system. Our suggestion on the required Constitutional amendment attempts to meet the problem without going to such extremes.

- 2.36 The second issue of principle raised by the CFC is one where we have a basic disagreement, and it relates to their refusal to take any explicit cognisance of the devolution of *Plan funds* to LSGIs. (Indeed their non-recognition of the worth of the Kerala experiment in democratic decentralisation springs essentially from this fact). We are of the view that Finance Commissions should have comprehensive jurisdiction covering both plan and non-plan devolution. It follows from this that if a particular State Finance Commission has interpreted its jurisdiction narrowly and refrained from making any recommendations covering plan funds, then the fact that the state government goes beyond these recommendations to devolve substantial plan funds to LSGIs should be deserving of appreciation rather than unconcern. The index of decentralisation cannot in other words be confined to criteria that stress only conformity to SFC recommendations (which

does not of course mean that such conformity should be given the go by); they have to be more inclusive.

- 2.37 The third issue, one of practice, relates to the task given to us by the CFC to suggest criteria for the *inter se* distribution of Rs.65.92 crores for PRIs, and Rs.15.05 crores for ULBs, which constitute Kerala's share of the total amount (Rs.1600 crores for PRIs and Rs.400 crores for ULBs) made available by it as a special grant for the improvement in civic services. Our recommendation is that these amounts should be distributed on the basis of the population criterion. They should not be counted as a part of plan funds (either in the numerator or in the denominator) in determining the size of the plan grant to LSGIs.
- 2.38 The present state of monitoring of local government finances is very weak. The required data are not available and the quality of data is also very bad. In a situation where substantial funds are being devolved and spent at the level of LSGIs, it is necessary to have regular feed back about the finances of local governments. Much more is required than the mere collection of data in a routine manner; they have to be appropriately interpreted. For this a permanent system has to be developed utilizing the experience of Finance and Local Self Government Departments as also the expert services of the Statistics Department.

CHAPTER 3

AN OVERVIEW OF LOCAL GOVERNMENT FINANCES

3.1

INTRODUCTION

3.1.1 Kerala has 990 Village Panchayats, 152 Block Panchayats and 14 District Panchayats; in the urban areas it has 53 Municipalities and 5 Corporations. Since the First SFC, the following changes have taken place.

- (1) The former Mattannur Panchayat has been converted into a Municipality with effect from 14-11-1996.
- (2) Thiruvananthapuram Corporation has been expanded with the addition of Nemom, Thiruvallom, Kadakampally, Ulloor and Attipra Grama Panchayats.
- (3) Two new Corporations viz. Kollam and Thrissur have been created by adding the following Grama Panchayats.

| Kollam Corporation | Thrissur Corporation |
|---|---|
| <i>1. Kilikollur Grama Panchayat</i> | <i>1. Ollukkara Grama Panchayat</i> |
| <i>2. Sakthikulangara Grama Panchayat</i> | <i>2. Vilvattom Grama Panchayat</i> |
| <i>3. Eravipuram Grama Panchayat</i> | <i>3. Ayyanthol Grama Panchayat</i> |
| <i>4. Vadakkevila Grama Panchayat</i> | <i>4. Koorkancherry Grama Panchayat</i> |
| | <i>5. Ollur Grama Panchayat</i> |
| | <i>6. Nadathara Grama Panchayat</i> |
| | <i>(Part)</i> |

- (4) Two municipalities namely Kalpetta and Koyilandi have been expanded by including wards as shown below from the adjoining panchayats.

Kalpetta - Ward 11 and 12 of Meppadi panchayat

Koyilandi – 3 wards in Arikkulam panchayat

- (5) Five Municipalities viz., Neyyattinkara, Ponnani, Thalasserry, Taliparamba and Kunnamkulam, have been expanded by adding panchayats, as shown below:

| | |
|-----------------------------------|--|
| <i>Neyyattinkara Municipality</i> | <i>Perumpazhuthoor Grama Panchayat</i> |
| <i>Ponnani Municipality</i> | <i>Ezhuvathuruthy Grama Panchayat</i> |
| <i>Taliparamba Municipality</i> | <i>Anthoor Grama Panchayat</i> |
| <i>Kunnamkulam Municipality</i> | <i>Arthat Grama Panchayat (full), Porkulam Grama Panchayat (part) and Chovannur Grama Panchayat (part)</i> |
| <i>Thalasserry Municipality</i> | <i>Kodiyeri (Full)</i> |

- (6) While 19 Village Panchayats have been merged with urban local bodies 20 new Village Panchayats have been created due to the bifurcation of 20 large Village Panchayats having a population of more than 50,000.

3.1.2 Except item No.1, all the changes were brought into effect in September 2000, with the general elections to LSGIs. With this reorganisation of urban and rural local governments, the share of the urban population in the State with reference to 1991 census has gone up to 16.87% from 14.22%. Kerala has fairly big Village Panchayats, the biggest in the country. It has relatively small towns. In fact, other than the five cities it has

only three Municipalities having a population of more than one lakh.

- 3.1.3 The distribution of population among the Village Panchayats is given in Table 3.1

Table 3.1.

Village Panchayats.

| Range of population | No. of Village Panchayats |
|----------------------------------|---------------------------|
| <i>Below 10,000</i> | <i>16</i> |
| <i>Between 10,000 and 20,000</i> | <i>287</i> |
| <i>Between 20,000 and 30,000</i> | <i>426</i> |
| <i>Between 30,000 and 40,000</i> | <i>181</i> |
| <i>Between 40,000 and 50,000</i> | <i>59</i> |
| <i>Above 50,000</i> | <i>21</i> |

- 3.1.4 The distribution of population among Municipalities is shown in Table 3.2.

Table 3.2

Municipalities

| Range of population | No. of Municipalities |
|------------------------------------|-----------------------|
| <i>Below 25,000</i> | <i>6</i> |
| <i>Between 25,000 and 40,000</i> | <i>18</i> |
| <i>Between 40,000 and 50,000</i> | <i>10</i> |
| <i>Between 50,000 and 60,000</i> | <i>6</i> |
| <i>Between 60,000 and 75,000</i> | <i>9</i> |
| <i>Between 75,000 and 1,00,000</i> | <i>1</i> |
| <i>Above 1,00,000</i> | <i>3</i> |

- 3.1.5 The population of the five Corporations may be seen in Table 3.3.

Table 3.3.

Corporations

| | |
|---------------------------|-----------------|
| <i>Thiruvananthapuram</i> | <i>7,04,375</i> |
| <i>Kollam</i> | <i>3,49,348</i> |
| <i>Kochi</i> | <i>5,64,589</i> |
| <i>Thrissur</i> | <i>2,99,042</i> |
| <i>Kozhikode</i> | <i>4,19,831</i> |

- 3.1.6 It would be interesting to compare the distribution of Village Panchayats and ULBs according to area as well. As is evident from Table 3.4, there is much similarity in size between Village Panchayats and ULBs.

Table 3.4

| Area | Village Panchayats | Municipalities | Corporations |
|--------------------------------|--------------------|----------------|--------------|
| <i>Below 5 Sq. KM</i> | <i>6</i> | <i>Nil</i> | <i>Nil</i> |
| <i>Between 5 - 10 Sq.KM</i> | <i>66</i> | <i>4</i> | <i>Nil</i> |
| <i>Between 10 - 15 Sq.KM</i> | <i>127</i> | <i>10</i> | <i>Nil</i> |
| <i>Between 15 - 20 Sq.KM</i> | <i>202</i> | <i>11</i> | <i>Nil</i> |
| <i>Between 20 - 30 Sq. KM</i> | <i>278</i> | <i>13</i> | <i>Nil</i> |
| <i>Between 30 - 40 Sq.KM</i> | <i>124</i> | <i>10</i> | <i>Nil</i> |
| <i>Between 40 - 50 Sq.KM</i> | <i>56</i> | <i>2</i> | <i>1</i> |
| <i>Between 50 - 75 Sq.KM</i> | <i>49</i> | <i>3</i> | <i>Nil</i> |
| <i>Between 75 - 100 Sq.KM</i> | <i>31</i> | <i>Nil</i> | <i>Nil</i> |
| <i>Between 100 - 150 Sq.KM</i> | <i>26</i> | <i>Nil</i> | <i>2</i> |
| <i>Between 150 - 200 Sq.KM</i> | <i>9</i> | <i>Nil</i> | <i>1</i> |
| <i>Above 200 Sq.KM</i> | <i>16</i> | <i>Nil</i> | <i>1</i> |

- 3.1.7 Kerala has a long sea-coast. 89 Village Panchayats, 13 Municipalities and 4 Corporations face the sea.
- 3.1.8 The Village Panchayats were graded in 1983 based on their annual natural income i.e. income excluding all grants-in-aid, contributions and debt heads. The grading at that point of time may be seen in Table 3.5.

Table 3.5

Classification of Village Panchayats as per extant income norms.

| Annual income | Grade | No. |
|--|----------------------|-------------|
| <i>1. Rs.1.75 lakhs and above</i> | <i>Special Grade</i> | <i>350</i> |
| <i>2. Rs. one lakh and above but below Rs.1.75 lakhs</i> | <i>First Grade</i> | <i>435</i> |
| <i>3. Rs.50,000/- and above but below Rs. one lakh.</i> | <i>Second Grade</i> | <i>202</i> |
| <i>4. Below Rs. 50,000/-</i> | <i>Third Grade</i> | <i>14</i> |
| <i>Total</i> | | <i>1001</i> |

- 3.1.9 The grading using the same norms by the First SFC showed 979 Village Panchayats as Special Grade and the remaining four Panchayats as First Grade and Second Grade (two each) on the basis of the data on 987 Village Panchayats available with them.
- 3.1.10 Similarly Municipal Councils were graded in 1993. The classification of the Municipal Councils may be seen in Table 3.6.

Table 3.6.**Classification of Municipalities as per extant income norms.**

| Annual income | Grade | No. |
|--|--------------|-----------|
| 1. Rs. 70 lakhs and above | First Grade | 14 |
| 2. Rs. 40 lakhs and above but below Rs.70 lakhs | Second Grade | 21 |
| 3. Below Rs. 40 lakhs. | Third Grade | 19 |
| Total: | | 54 |

Subsequently Mattannur was constituted as a Municipality in 1996 and Perinthalmanna was upgraded to the status of a Grade II Municipality in 1999.

3.1.11 A few interesting statistical highlights regarding LSGIs are given below:

| | |
|---|--|
| (1) Largest Village Panchayat (area) | Kumili - 795.28 Sq.KM. |
| (2) Largest Village Panchayat (population) | Munnar Grama Panchayat - 70,343 |
| (3) Smallest Village Panchayat (area) | Valapattanam Grama Panchayat -2.04 Sq. KM. |
| (4) Smallest Village Panchayat (population) | Vattavade Grama Panchayat - 4,588 |
| (5) Largest Block Panchayat (area) | Azhutha Block Panchayat- 1062.23 Sq.KM. |

| | |
|---|---|
| (6) Largest Block Panchayat (population) | Kuttippuram Block Panchayat - 17,03,643 |
| (7) Smallest Block Panchayat (area) | Kulanada Block Panchayat - 21.50 Sq.KM. |
| (8) Smallest Block Panchayat (population) | Kattappana Block Panchayat - 15,594 |
| (9) Largest District Panchayat (area) | Idukki District Panchayat - 5090.59 Sq.KM. |
| (10) Largest District Panchayat (population) | Malappuram District Panchayat - 28,13,880 |
| (11) Smallest District Panchayat (area) | Alapuzha District Panchayat - 1250.88 Sq.KM |
| (12) Smallest District Panchayat (population) | Wayanad District Panchayat - 6,54,881 |
| (13) Largest Municipality (area) | Payyannur -54.63 sq.km. |
| (14) Largest Municipality (population) | Alappuzha - 1,74,666 |
| (15) Smallest Municipality (area) | Guruvayoor -6.49sq.km. |
| (16) Smallest Municipality (population) | Guruvayoor-20,216 |

FINANCIAL POSITION OF LOCAL GOVERNMENTS

INCOME OF LOCAL GOVERNMENTS

- 3.2 For the purposes of this Report, income of local governments is discussed in two parts, the first part covering the traditional sources of income, which existed before 1994, and the second part covering the grant-in-aid given by Government to cover the expenditure on additional responsibilities transferred to local governments through the legislative changes made in 1994.

TRADITIONAL SOURCES OF INCOME

- 3.3 These are available only to the Village Panchayats and ULBs. They could be classified into the following categories.
- (1) Tax Revenue
 - (2) Non-tax Revenue
 - (3) Grants-in-aid
 - (4) Loans

TAX REVENUE

- 3.4A Tax Revenue could be further divided into three.
- (a) Own Taxes
 - (b) Assigned Taxes
 - (c) Shared Taxes

3.4A.1 *OWN TAXES*

These are taxes directly demanded and collected by Village Panchayats, Municipalities and Corporations.

- 3.4A.1.1 (i) PROPERTY TAX. Property Tax constitutes the major item of revenue for the Village Panchayats, Municipalities and Corporations, which have a per capita collection of Rs.12.39, Rs.77.62 and Rs. 151.30 respectively. Though amendments have been brought about in the Kerala Panchayat Raj Act and the Kerala Municipality Act in 1999 to introduce plinth area based assessment of Property Tax for both residential and non-residential buildings including commercial buildings, rules and operational instructions have not yet been issued. Therefore, Property Tax continues to be assessed as per the old system based on rental value. In anticipation of switching over to the new method of assessment Village Panchayats have not had any general revision of Property Tax since 1993 and in the case of ULBs where the general revision varies from one Municipality to another there has not been any such revision after 1998. This has prevented the usual periodic increase in Property Tax, which normally works out to be 25% at the time of each general revision.
- 3.4A.1.2 In the case of Village Panchayats, Property Tax is assessed as per rules issued under Section 203 of the Kerala Panchayat Raj Act. The rate is fixed as between 6 to 10% of the annual rental value in the rules. (This has not been amended in consonance with the Act)
- 3.4A.1.3 The rates fixed as per the amended Section 233 of the Kerala Municipality Act are given in Table 3.7.

TABLE 3.7.

PROPERTY TAX RATES IN ULBs.

| | Minimum rates | | |
|-------------------------------------|----------------|--------------|-------------|
| | Town Panchayat | Municipality | Corporation |
| <i>(i) Tax for general purposes</i> | 4% | 5% | 6% |
| <i>(ii) for lighting</i> | 1% | 2% | 2% |
| <i>(iii) for drainage</i> | .. | .. | 2% |
| <i>(iv) for water supply</i> | .. | .. | 1% |
| <i>(v) Tax for sanitation</i> | 1% | 2% | 2% |
| <i>Total</i> | 6% | 9% | 13% |

The maximum rate is 20% for Town Panchayats, 25% for Municipalities and Corporations.

3.4A.1.4 Property Tax constitutes 15 percent of the tax and non-tax revenues of Village Panchayats; the figure for Municipalities is 21.39 and for Corporations, it is 35.32. Property Tax has grown by 40.34% over a period of six years in the case of Village Panchayats. The increase for Municipalities and Corporations is 66.27% and 76.33% respectively.

3.4A.1.5 It is interesting to note that the LSGIs tend to levy lower tax even when they have a range to choose from. The First SFC has given the details relating to Village Panchayats and Municipalities, which can be seen in Tables 3.8 and 3.9.

TABLE 3.8.**Rate of Building Tax in 1985 and 1995 in Village Panchayats.**

| Rate at which Building Tax is levied | No. of Panchayats in 1985 | No. of Panchayats in 1995 |
|--------------------------------------|---------------------------|---------------------------|
| 6% | 703 | 546 |
| 7% | 94 | 120 |
| 7.5% | 4 | Nil |
| 8% | 155 | 217 |
| 9% | 12 | 42 |
| 10% | 33 | 45 |
| <i>Total:</i> | <i>1001</i> | <i>970*</i> |

** Data from 21 Panchayats have not been received.*

TABLE 3.9.**Rate of Property Tax in 1995 in Urban Local Governments.**

| Rate at which Building Tax is levied | No. of Corporations in 1995 | No. of Municipalities in 1995 |
|--------------------------------------|-----------------------------|-------------------------------|
| 10% | .. | 22 |
| 12% | .. | 9 |
| 12.5% | .. | 1 |
| 13% | .. | 3 |
| 14% | .. | 5 |
| 15% | 1 | 7 |
| 15.5% | .. | 1 |
| 16% | .. | 1 |
| 16.5% | .. | 1 |
| 17% | .. | 2 |
| 17.5% | .. | 1 |
| 18% | 1 | .. |
| 21% | .. | 1 |
| 21.25% | 1 | .. |
| <i>Total:</i> | <i>3</i> | <i>54</i> |

3.4A.2

(ii) **PROFESSION TAX.** Profession Tax is levied from individuals and companies by virtue of Section 204 of the Kerala Panchayat Raj Act in the case of Village Panchayats and Section 245 of the Kerala Municipality Act in the case of Municipalities and Corporations. All companies and individuals transacting business or engaged in a profession for at least 60 days in a half year are bound to pay the tax at such rates as are fixed by the concerned local government subject to the maximum rates prescribed by Government. However, Article 276 (2) of the Indian Constitution has fixed the maximum tax leviable per year at Rs.2500/-. Now the 11th Finance Commission has recommended that this provision be taken out of the Constitution and be made part of a Central Act so that its amendment could be easily made.

3.4A.2.1

Based on the report of the First SFC, Profession Tax has been revised in Village Panchayats, (TABLE 3.10). But in the case of ULBs the revision is yet to be carried out. The old rates are still followed, (TABLE 3.11). However, Dearness Allowance is also now included in the calculation of income for assessment of Profession Tax in ULBs as suggested by First SFC.

TABLE 3.10

RATES OF PROFESSION TAX IN VILLAGE PANCHAYATS

| Class | Half-yearly income | Maximum half-yearly tax |
|-------------|---|-------------------------|
| <i>I</i> | <i>Between Rs.12,000 and 17,999</i> | <i>Rs.120</i> |
| <i>II</i> | <i>Between Rs.18,000 and 29,999</i> | <i>Rs.180</i> |
| <i>III</i> | <i>Between Rs.30,000 and 44,999</i> | <i>Rs.300</i> |
| <i>IV</i> | <i>Between Rs.45,000 and 59,999</i> | <i>Rs.450</i> |
| <i>V</i> | <i>Between Rs.60,000 and 74,999</i> | <i>Rs.600</i> |
| <i>VI</i> | <i>Between Rs.75,000 and 99,999</i> | <i>Rs.750</i> |
| <i>VII</i> | <i>Between Rs,1,00,000 and 1,24,999</i> | <i>Rs.1,000</i> |
| <i>VIII</i> | <i>Above Rs.1,25,000</i> | <i>Rs.1,250</i> |

TABLE 3.11
RATES OF PROFESSION TAX IN ULBs

| Class | Half-yearly income (Rs) | Maximum half-yearly tax |
|-------------|--|-------------------------------|
| <i>I</i> | <i>More than 3,600 but not more than 5,400</i> | <i>Rs.9</i> |
| <i>II</i> | <i>More than Rs.5,400 but not more than 7,800</i> | <i>Rs.15</i> |
| <i>III</i> | <i>More than 7,800 but not more than 10,800</i> | <i>Rs.24</i> |
| <i>IV</i> | <i>More than 10,800 but not more than 14,400</i> | <i>Rs.37</i> |
| <i>V</i> | <i>More than 14,400 but not more than 18,000</i> | <i>Rs.50</i> |
| <i>VI</i> | <i>More than 18,000 but not more than 24,000</i> | <i>Rs.75</i> |
| <i>VII</i> | <i>More than 24,000 but not more than 30,000</i> | <i>Rs.100</i> |
| <i>VIII</i> | <i>More than 30,000 but not more than 36,000</i> | <i>Rs.125</i> |
| <i>IX</i> | <i>More than 36,000 but not more than 42,000</i> | <i>Rs.175</i> |
| <i>X</i> | <i>More than 42,000 but not more than 48,000</i> | <i>Rs.250</i> |
| <i>XI</i> | <i>More than 48,000 but not more than 72,000</i> | <i>Rs.500</i> |
| <i>XII</i> | <i>More than 72,000 but not more than 1,02,000</i> | <i>Rs.750</i> |
| <i>XIII</i> | <i>More than 1,02,000 but not more than 1,26,000</i> | <i>Rs.1,000</i> |
| <i>XIV</i> | <i>More than 1,26,000</i> | <i>Rs.1,250</i> |

- 3.4A.2.2 Profession Tax constitutes the second largest source of own income for the Village Panchayats and has the 5th position for the Urban Local Bodies. During the last six years the tax has grown by 101.6%, 110.49%, and 180.26% in Village Panchayats, Municipalities and Corporations respectively. This has been mainly due to the steep increase in salary due to the Pay Commission Recommendations and due to the inclusion of DA in the calculation of income in ULBs.
- 3.4A.3 (iii) **ENTERTAINMENT TAX:** Entertainment Tax is the third largest source of income for Village Panchayats and the second largest source of income for Municipalities and Corporations. In fact in the case of 21 Municipalities, Entertainment Tax constitutes the single largest source of own revenue (Annexure 3.1)
- 3.4A.3.1 Entertainment Tax is an own tax of local governments in Kerala and is collected according to the provisions of Section 3 of the Local Authorities Entertainment Tax Act. Consequent on the recommendations of the first SFC, Additional Tax on Entertainment has been merged with Entertainment Tax and the Kerala Additional Tax on Entertainment and Surcharge on Show Tax Act 1963 has been repealed. Now, as per the unified Act, Entertainment Tax is fixed between 24 to 48% of the price of admission.
- 3.4A.3.2 Though Entertainment Tax constitutes a significant local government income it is to be noted that there are no theatres either temporary or permanent in 331 Village Panchayats. Although Entertainment Tax has grown by 48.98% in Village Panchayats, 54.95% in Municipalities, and 44.21% in Corporations over the last six years, it is seen that gross collection of Entertainment Tax declined

both in Village Panchayats and Municipalities during the year 1998-99 in comparison with the previous year.

- 3.4A.3.3 There appears to be considerable 'escaped' tax in this item. This issue was considered in detail by the First SFC which recalled that both the earlier Municipal Finance Commissions viz., the Naha Commission 1985 and the Mohandas Commission 1993 had recommended that the collection of the Entertainment Tax be based on gross seating capacity and recommended optional switchover to taxation based on seating capacity. Analysis of figures given to SFC by the LSGIs shows that the average collection in Village Panchayats is equivalent to the average occupancy of 9.5%; the average occupancy for Municipalities and Corporations works out to 33% and 35% respectively. In spite of cinemas facing competition from Cable TV, it is felt that the occupancy would have been much higher.
- 3.4A.3.4 Though Entertainment Tax Act has been amended and an enabling provision introduced to tax on the basis of seating capacity the rules have not yet been framed. Also certain issues like general exemptions given to dramatic performances and circus shows, provision for blanket exemptions from tax etc. need a relook in the context of decentralisation.
- 3.4A.4 (iv) **ADVERTISEMENT TAX.** Advertisement Tax has relatively good potential in a consumerist state like Kerala. But the realization of revenue under this head has been quite low. It is seen that only 121 Village Panchayats are collecting Advertisement Tax. It constitutes only 0.34.% of own revenue in Municipalities and 0.62% in Corporations; in the case of Village Panchayats its share is a paltry 0.04%

Advertisement Tax is collected as per the provisions of Sec-

tion 209 of the Kerala Panchayat Raj Act and 271 of the Kerala Municipality Act. The tax is collected based on by-laws framed by the Village Panchayats and ULBs. There are no rules issued by the Government regarding minimum rates or the mode of collection.

- 3.4A.5 (v) SERVICE TAX:** This tax exists only in Village Panchayats. In ULBs it is an inbuilt component of Property Tax. It is provided for in Section 200 of the Kerala Panchayat Raj Act as per which Government is authorised to fix the minimum rates. The revised rules are under examination by the Subject Committee of the Legislature and are expected to be issued soon. The accepted recommendation of the First SFC to have an independent Service Tax has not yet been operationalised. The total collection of Service Tax in all the 976 Village Panchayats for which the data is available comes to Rs.1.89 crores or 0.7% of the own revenue.
- 3.4A.6 (vi) SHOW TAX INCLUDING SURCHARGE:** This tax is levied as per Section 200 of the Kerala Panchayat Raj Act and Section 269 of the Kerala Municipality Act, which empower the local governments to levy and collect Show Tax on every show which includes any entertainment, exhibition, performance, amusement game, sport or race, that is performed in their territory. The Surcharge was collected as per the Additional Entertainment Act and Surcharge on Show Tax Act 1963. Now with the repeal of this Act, Surcharge cannot be realized. But steps to increase the existing rate by 25% have not yet been taken.

The present rates of Show Tax are indicated in Table 3.12.

TABLE 3.12.

RATES OF SHOW TAX.

a) Panchayats

| | Rate of Tax per show |
|--|----------------------|
| 1) <i>Regular cinematograph exhibitions at licenced theatres</i> | <i>Rupees Two</i> |
| 2) <i>Other cinematograph exhibitions</i> | <i>Rupees Ten</i> |
| 3) <i>Regular shows other than cinemas</i> | <i>Rupees Five</i> |
| 4) <i>Other exhibitions</i> | <i>Rupees Thirty</i> |

b) Municipalities

| | Rate of Tax per show |
|---|----------------------|
| 1) <i>Regular cinematograph exhibitions at licenced theatres</i> | <i>Rupees Ten</i> |
| 2) <i>Other cinematograph exhibitions</i> | <i>Rupees Twenty</i> |
| 3) <i>Regular shows other than cinematograph exhibitions conducted at the same place daily.</i> | <i>Rupees Twenty</i> |
| 4) <i>Other shows</i> | <i>Rupees Fifty</i> |

The rates for Village Panchayats have not yet been revised in accordance with the recommendations of the First SFC.

The collection figures of Show Tax including surcharge for the Village Panchayats and for the Municipalities and Corporations are shown in Table 3.13.

TABLE 3.13.

Receipts from Show Tax & Surcharge on Show Tax.

(Rs. in lakhs)

| | 1993-94 | 1994-95 | 1995-96 | 1996-97 | 1997-98 | 1998-99 |
|-----------------------|---------|---------|---------|---------|---------|---------|
| <i>Panchayats</i> | 26.6 | 33.76 | 31.41 | 46.52 | 34.08 | 38.32 |
| <i>Municipalities</i> | 8.22 | 8.37 | 9.61 | 9.62 | 9.75 | 9.15 |
| <i>Corporations</i> | 5.21 | 3.41 | 3.77 | 3.37 | 5.09 | 3.89 |

- 3.4A.7 (vii) CESS ON CONVERSION OF LAND USE:** This is a cess which can be levied by local governments for conversion of land use from paddy field, marshy land, pond or water body into garden or building site subject to the provisions of Kerala Land Utilisation Order 1967 issued under the Essential Commodities Act. Since there are severe restrictions on conversion of land use in Kerala, the collection has been naturally low. In Village Panchayats it was only a meagre sum of Rs.0.64 lakh in 1998-99; in the case of Municipalities and Corporations it was just Rs.5.53 lakh during the same period.
- 3.4A.8 (viii) TAX ON ANIMALS, VESSELS AND VEHICLES:** This is applicable only to ULBs and is levied as per Section 260 of the Kerala Municipality Act 1994 which allows the Municipal Council to levy, based on its resolution, tax on domestic animals etc. This is a very insignificant item and the total collection for Municipalities and Corporations during 1998-99 amounted to Rs.2000/- only.
- 3.4A.9 (ix) TAX ON TIMBER:** This again is a tax applicable only to ULBs. It is collected as per Section 277 of the Kerala Mu-

nicipality Act which allows the Council to collect in the manner decided by it a tax on timber brought into the Municipality at the rate of Rs.24/- per tonne. This has also fallen into disuse and only Kozhikode Corporation which has the traditional timber yard of Kallai within its area is realizing this tax which fetched it a revenue of Rs.97,000/- during 1998-99. This item of revenue has been declining year after year.

- 3.4A.10 (x) SURCHARGES:** Both the Village Panchayats (as per Section 208 of the Kerala Panchayat Raj Act) and ULBs (as per Section 230 of the Kerala Municipality Act) are empowered to levy Surcharges. In the case of Village Panchayats up to 5% Surcharge can be levied on the Property Tax subject to a maximum of two Surcharges and in the case of ULBs a Surcharge not exceeding 10% can be levied on any Tax other than Profession Tax. This Surcharge is to be levied for providing for any specific services or amenity in the case of ULBs and for meeting any extraordinary expenditure by way of implementation of a scheme, plan or project in the case of Village Panchayats. This item has not been tapped in any of the ULBs. For Village Panchayats the total collection during 1998-99 was Rs.5.29 lakh, which works out to just 0.15 % of the Property Tax collected during the same year. It is noteworthy that even with specific quid pro quo, LSGIs have been reluctant to impose Surcharges.

3.4B

ASSIGNED TAXES

These taxes are collected by the Government but the entire revenue is assigned to local governments.

- 3.4B.1 (i) BASIC TAX.** Kerala does not have a traditional system of land revenue. Instead it has a general tax on land known as the Basic Tax. The rates of Basic Tax are given in Table 3.14

TABLE 3.14.**RATES OF BASIC TAX**

| Local Body | Rate |
|---------------------------------------|---|
| <i>Panchayat area</i> | <i>Re. 1/- (if the aggregate extent of land held by a land holder does not exceed 20 ares Ps. 50 per are)</i> |
| <i>Town Panchayat / Municipality.</i> | <i>Rs. 2/- (if the aggregate extent of land held by a land holder does not exceed 6 ares Re. 1/- per are)</i> |
| <i>Municipal Corporation area</i> | <i>Rs. 4/- (if the aggregate extent of land held by a land holder does not exceed 2 ares Rs.2/- per are)</i> |

- 3.4B.1.1 The entire collection is given to the rural LSGIs after deducting a collection charge of 3%. $\frac{3}{8}$ th of the Basic Tax is given to the Village Panchayats, $\frac{3}{10}$ th to the Block Panchayats, and $\frac{1}{5}$ th to the District Panchayats. The remaining $\frac{1}{8}$ th is credited to the Rural Pool. Except in the case of Rural Pool, the distribution is as per the area of the concerned Panchayat. Though Government had accepted the recommendation of the First SFC to give a share of Basic Tax to the ULBs this has not been operationalised so far.

3.4B.1.2 The Basic Tax collected and distributed during the last five years is shown in Table 3.15.

TABLE 3.15.

DETAILS OF BASIC TAX GRANT

(Rs. in crores)

| YEAR | AMOUNT COLLECTED | AMOUNT DISTRIBUTED* |
|-----------|------------------|---------------------|
| 1995-96 | 13.27 | 5.25 |
| 1996-97 | 13.57 | 14.18 |
| 1997-98 | 13.52 | 11.64 |
| 1998-99 | 21.41 | 15.39 |
| 1999-2000 | 22.46 | 6.98 |

* Includes three instalments of old arrears distributed at Rs.8.41 Crore per instalment

3.4B.2 (ii) SURCHARGE ON STAMP DUTY: Under the provisions of the Kerala Stamp Act 1959, for every transaction relating to land, Stamp Duty and Registration fee are levied. As per Section 206 of the Kerala Panchayat Raj Act and Section 270 of the Kerala Municipality Act, Village Panchayats and ULBs are entitled to levy 5% of the amount of the value of the property transacted. But in practice only the pre 1994 rates of Surcharge i.e. 4% for Village Panchayats and Municipalities and 5% for Corporations is levied.

3.4B.2.1 The earlier and the present rates are given in Table 3.16.

TABLE 3.16.

**Rate of Stamp Duty and Surcharge under
the 1960 and 1994 Acts**

| | Stamp duty | Surcharge | Registration fee* | Total |
|------------------------|------------|-----------|-------------------|-------|
| <i>Under 1960 Acts</i> | | | | |
| <i>Panchayats</i> | 6% | 4% | 2% | 12% |
| <i>Municipalities</i> | 8.5% | 4% | 2% | 14.5% |
| <i>Corporations</i> | 8.5% | 5% | 2% | 15.5% |

The above rates were introduced from 1-4-1971

| | | | | |
|------------------------|------|------|----|-------|
| <i>Under 1994 Acts</i> | | | | |
| <i>Panchayats</i> | 6% | 5%** | 2% | 13% |
| <i>Municipalities</i> | 8.5% | 5% | 2% | 15.5% |
| <i>Corporations</i> | 8.5% | 5% | 2% | 15.5% |

* Registration fee is collected by State Government and is not shared with Local Bodies.

** 5% is the maximum rate permitted. At the time of the Report the rate collected remains at 4%

- 3.4B.2.2 In accordance with the recommendations of the First SFC, Government have introduced a system whereby the receipts are shown in the Budget under the Head of Account “0030-Stamps and Registration – 02 Stamps non-judicial 901 – Deduct payment to Local Bodies of net proceeds of Duty on Transfer of Properties” which enables direct payments to local governments of the amounts collected during the financial year. The amount collected and distributed during the last five years is shown in Table 3.17.

TABLE 3.17.

DISTRIBUTION OF SURCHARGE ON STAMP DUTY

(Rs. in lakhs)

| Year | Name of Local Government | Collected | Distributed |
|-----------|--------------------------|-----------|-------------|
| 1995-96 | Village Panchayats | 7144.53 | 3779.20 |
| | Municipalities | 1256.65 | 899.46 |
| | Corporations | 1413.07 | 1570.96 |
| 1996-97 | Village Panchayats | 7045.83 | 5450.90 |
| | Municipalities | 1328.50 | 1367.76 |
| | Corporations | 1124.57 | 811.05 |
| 1997-98 | Village Panchayats | 6093.36 | 6889.22 |
| | Municipalities | 1105.29 | 1217.68 |
| | Corporations | 732.00 | 862.08 |
| 1998-99 | Village Panchayats | 5398.32 | 9258.22 |
| | Municipalities | 1070.85 | 1496.66 |
| | Corporations | 1112.43 | 1500.19 |
| 1999-2000 | Village Panchayats | 8199.47 | 9941.86 |
| | Municipalities | 1111.65 | 1347.87 |
| | Corporations | 997.86 | 1209.91 |

NOTE:- There are time lags between collection and distribution.

- 3.4B.2.3 As per G.O. (Ms) 118/94/LAD dated 02.08.1994 the Inspector General of Registration is empowered to deduct dues to Kerala Water Authority from Village Panchayats, Municipalities and Corporations from the Surcharge on

Stamp Duty and pay them directly to the Kerala Water Authority (KWA). The amounts thus deducted and given to the Water Authority in the last five years are indicated in Table 3.18.

TABLE 3.18

STAMP DUTY DEDUCTED AND PAID TO KWA

(Rupees in lakhs)

Amount deducted

| Year | Village Panchayats | Municipalities | Corporations |
|-----------|--------------------|----------------|--------------|
| 1995-96 | 755.83 | 179.79 | 314.19 |
| 1996-97 | 1362.38 | 272.54 | 182.21 |
| 1997-98 | 1078.97 | 174.60 | 172.41 |
| 1998-99 | 1851.65 | 297.86 | 295.62 |
| 1999-2000 | 1988.38 | 269.58 | 241.99 |

- 3.4B.2.4 Stamp Duty constitutes an important source of revenue of local governments and it constitutes 13.71% of the total Own revenue of Village Panchayats, 9.37% of Municipalities and 17.5% of Corporations during 1998-1999. The proceeds are distributed to ULBs according to the place of registration of the transaction and to Village Panchayats on population basis (other than the 25% credited to the Rural Pool).

3.4C

SHARED TAX

3.4C.1 **MOTOR VEHICLES TAX.** This is the only shared tax and it is called Vehicle Tax Compensation (VTC) and is given to local governments as per Section 19 of the Motor Vehicles Taxation Act 1976.

3.4C.1.1 20% of the net collection of Motor Vehicles Tax is distributed among Village Panchayats and ULBs as per road length according to the formula based in unit length of roads given in the Table 3.19.

TABLE 3.19

CALCULATION OF ROAD UNITS FOR DISTRIBUTION OF VTC

Basic Unit = 1 Km. of gravelled road (Unit cost Rs.3000/-)

UNIT VALUE OF OTHER TYPES OF ROADS

| | | | | |
|------------------------|---|--------------------|---|-------------------|
| <i>Cement Concrete</i> | : | <i>Double Lane</i> | = | <i>1.6 units.</i> |
| <i>Cement Concrete</i> | : | <i>Single Lane</i> | = | <i>0.8 units</i> |
| <i>Black topped</i> | : | <i>Double Lane</i> | = | <i>10.6 units</i> |
| <i>Black topped</i> | : | <i>Single Lane</i> | = | <i>5.3 units</i> |
| <i>Metalled road</i> | : | <i>Double Lane</i> | = | <i>7.5 units</i> |
| <i>Metalled road</i> | : | <i>Double Lane</i> | = | <i>3.7 units</i> |

Actual collection of Motor Vehicles Tax and the actual distribution during the last five years can be seen in Table 3.20.

TABLE 3.20

COLLECTION AND DISTRIBUTION OF MVT TO LSGIs

(Rs. in lakhs)

| Year | Gross Collection | Net Collection | Amount distributed | Percentage |
|-----------|------------------|----------------|--------------------|------------|
| 1995-96 | 21694 | 21043 | 2500 | 11.88 |
| 1996-97 | 22109 | 21445 | 4348 | 20.28 |
| 1997-98 | 27425 | 26602 | 5148 | 19.35 |
| 1998-99 | 29261 | 28383 | 4990 | 17.58 |
| 1999-2000 | 37120 | 36006 | 7885 | 21.90 |

3.4C.1.2 Over the years there used to be substantial arrears in the payment of Basic Tax, Surcharge on Stamp Duty and Vehicles Tax Compensation. Based on the recommendations of the First SFC, Government released Rs.150 crores in three instalments as a one-time settlement of dues under Basic Tax, Surcharge on Stamp Duty and VTC.

NON-TAX REVENUE

3.5 Non-tax revenue of Village Panchayats, Municipalities and Corporations could be classified as follows:

- (1) Licence fee
- (2) Gate fee
- (3) Rent from Property
- (4) Income from Property other than rent.

- (5) Permit fee
- (6) Registration fee
- (7) Service/User charge
- (8) Other sources

3.5.1 LICENCE FEE : This constitutes the most important source of non-tax revenue. The following are the important items for which licence fees are collected by local governments.

- (i) Trade Licences
- (ii) Licences under prevention of Food Adulteration Act.
- (iii) Licences under the Kerala Cinemas Regulation Act.
- (iv) Licencing of Private Slaughter House.
- (v) Licencing of Private Markets
- (vi) Licences under the Kerala Places of Public Resorts Act
- (vii) Licencing of Private Parking and Halting Places
- (viii) Licencing of Private Burial and Burning Grounds
- (ix) Licencing of Technical Experts
- (x) Licencing of Domestic Animals
- (xi) Licencing of Animal Stalls kept for commercial purposes.
- (xii) Licencing of Special Trades like Butchers, Fishmongers, Poulterers, Commission Agents and Brokers.

3.5.2 GATE FEES : These are fees, which are normally farmed out by auction to the highest bidder who is then given the right to regulate entry based on certain fees. The major sources of gate fees are –

- (1) Public Market
- (2) Public Parking and Halting places
- (3) Public Slaughter Houses

3.5.3 INCOME FROM PROPERTY: Rent. This is an important item of non-tax revenue for urban local bodies and urbanized Village Panchayats. Rents could be classified based on the type of property.

1. Rent from buildings
2. Rent from lands
3. Rent from cloak rooms and comfort stations

3.5.4 INCOME FROM PROPERTY OTHER THAN RENT: This can be classified into three.

- (i) Proceeds from sale of right to collect river sand.
- (ii) Proceeds from sale of right to fish.
- (iii) Proceeds from sale of usufructs.

3.5.5 PERMIT FEES: Permit fees are of two kinds.

- (1) Fee for Building permits

- (2) Fee for permits for the construction, establishment or installation of factories, workshops or work places where electricity is used.

3.5.6 REGISTRATION FEES: This can be grouped as follows:

1. Registration of Hospital and Para medical institutions.
2. Registration of Tutorials.
3. Registration of Births and Deaths.
4. Registration of Contractors (only in ULBs)
5. Registration of lodgings (only in Malabar area - under the Madras Public Health Act).

3.5.7 SERVICE/USER CHARGES: These relate to charges collected for use of utilities and amenities provided by the LSGIs.

3.5.8 INCOME FROM FERRIES: As per the Kerala Panchayat Raj Act and the Kerala Municipality Act and as per the various Ferries Acts, function of providing ferries has been transferred to the Village Panchayats and ULBs. This income could be either by auctioning of the right to ply ferries or by charging from users.

3.5.9 FINES AND PENALTIES: These are realized by the LSGIs when there is a contravention of regulations or there are belated payments. A study done in Municipalities shows that there is serious laxity in the enforcement of penal provisions [Annexure 3.2]

3.5.10 SUNDRY ITEMS: These miscellaneous sources of revenue could be listed as follows:

- (1) Proceeds from auctioning of meat stalls (done in a few Village Panchayats only).
- (2) Interest on deposits.
- (3) Endowments.
- (4) Return on investments like shares.
- (5) Contributions/donations.
- (6) Hire charges of vehicles/machinery.
- (7) Income from cattle pounds.
- (8) Income from Libraries.
- (9) Sale of Forms.
- (10) Sale of unserviceable articles and fallen trees.
- (11) Other items which cannot be classified.

3.5.10.1 The details regarding the rates for each of the important sources of non-tax revenue are given in the Annexures in Chapter IX relating to the existing and suggested rates.

The percentage share of important items of non-tax revenue is given in Table 3.21.

TABLE 3.21.

**SHARE OF IMPORTANT ITEMS OF NON-TAX REVENUE IN TOTAL
NON-TAX REVENUE.**

| Item | Village Panchayat | Municipality | Corporation |
|--|-------------------|--------------|-------------|
| <i>D & O Licence</i> | 4.45 | 3.32 | 7.51 |
| <i>PFA License</i> | 0.20 | 0.10 | 0.26 |
| <i>Cinematograph Licence</i> | 0.08 | 0.04 | 0.02 |
| <i>P.P.R. Licence</i> | 0.03 | 0.03 | 0.07 |
| <i>Building Permit fee</i> | 1.48 | 5.73 | 22.56 |
| <i>Market Fees, for Public Market</i> | 3.44 | 4.44 | 4.53 |
| <i>Public slaughter house-gate fee</i> | 0.20 | 0.56 | 0.76 |
| <i>Public Halting place fee</i> | 1.09 | 4.12 | 2.31 |
| <i>Rent on Buildings</i> | 11.03 | 32.74 | 29.49 |
| <i>Fines/Penalties</i> | 0.26 | 2.44 | 1.76 |
| <i>Ferry Service</i> | 0.49 | 0.01 | 2.05 |
| <i>River sand</i> | 33.00 | 2.75 | Nil |
| <i>Fisheries</i> | 1.01 | Nil | nil |

3.5.10.2 Diagrammatic depiction of shares of major sources of income in respect of Village Panchayats, Municipalities and Corporations can be seen in figures 3.1 to 3.6.

Village Panchayat

Figure 3.1

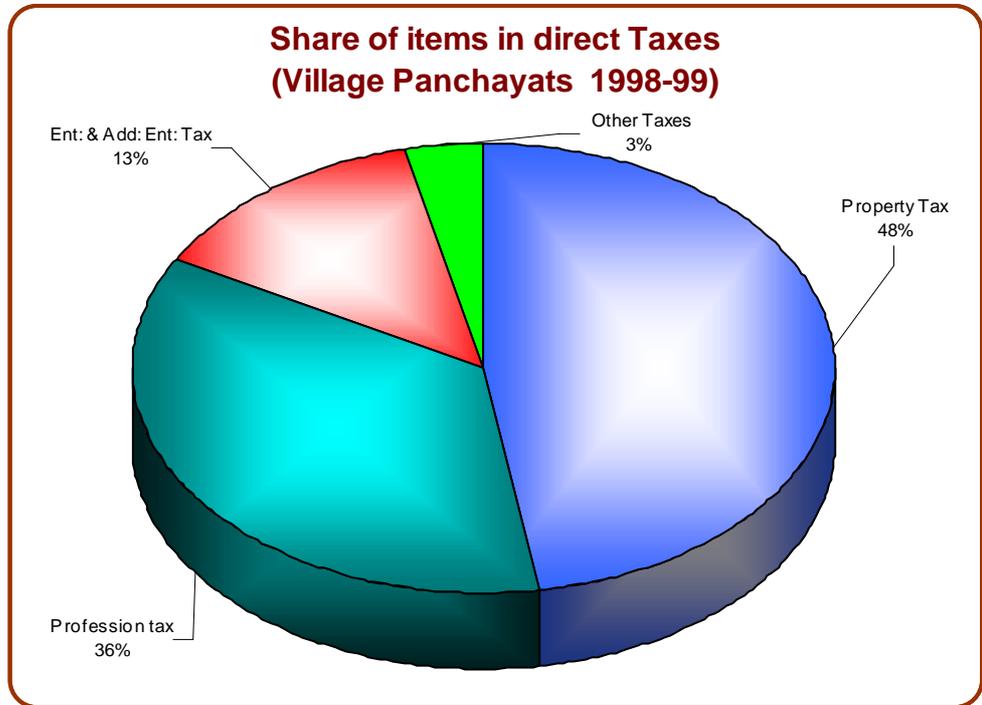
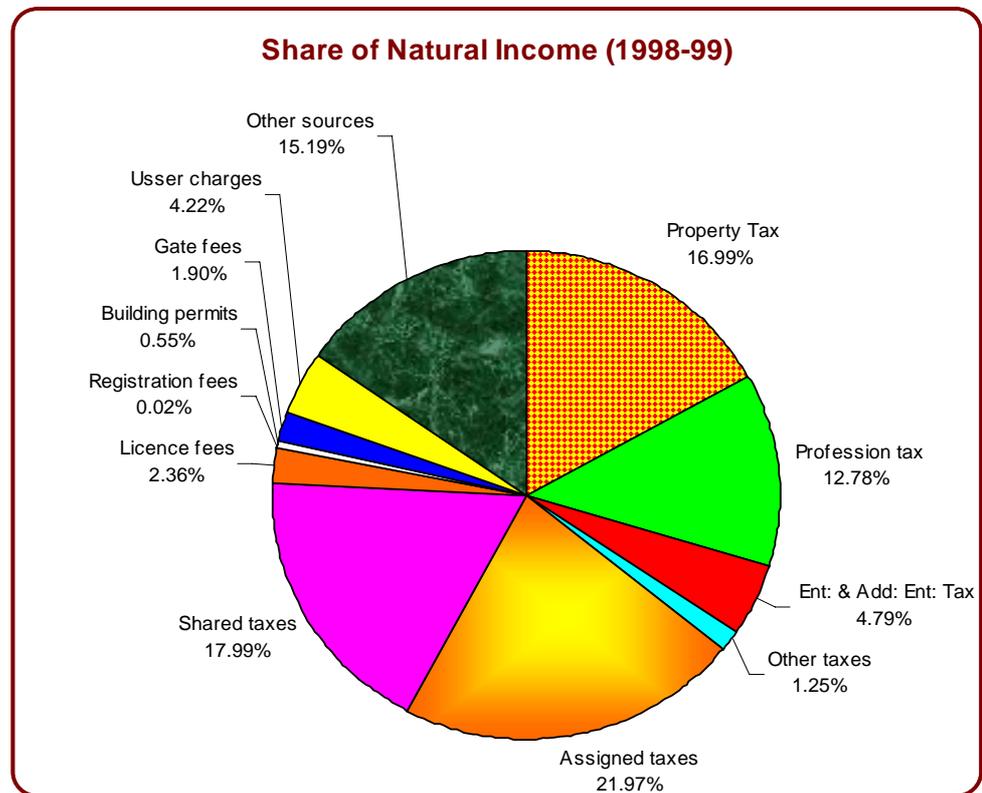


Figure 3.2



Municipality

Figure 3.3

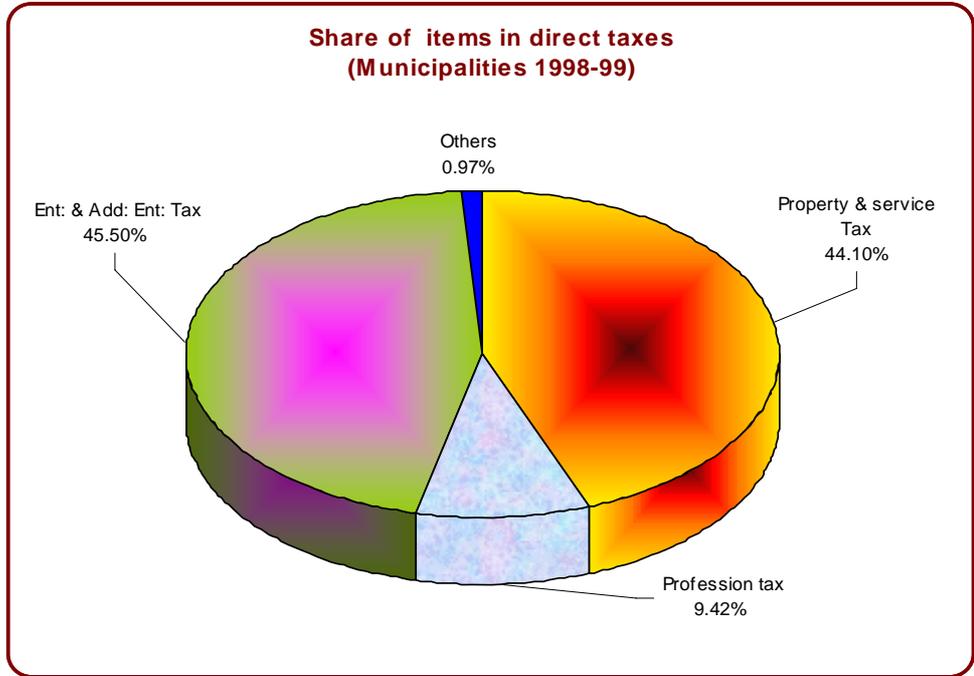
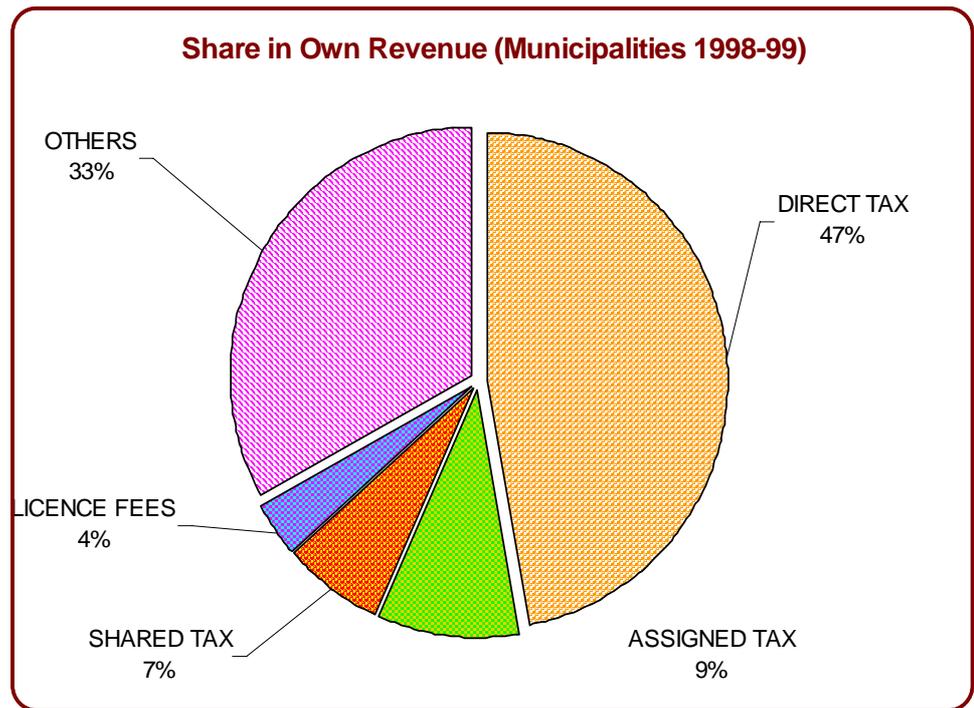


Figure 3.4



Corporation

Figure 3.5

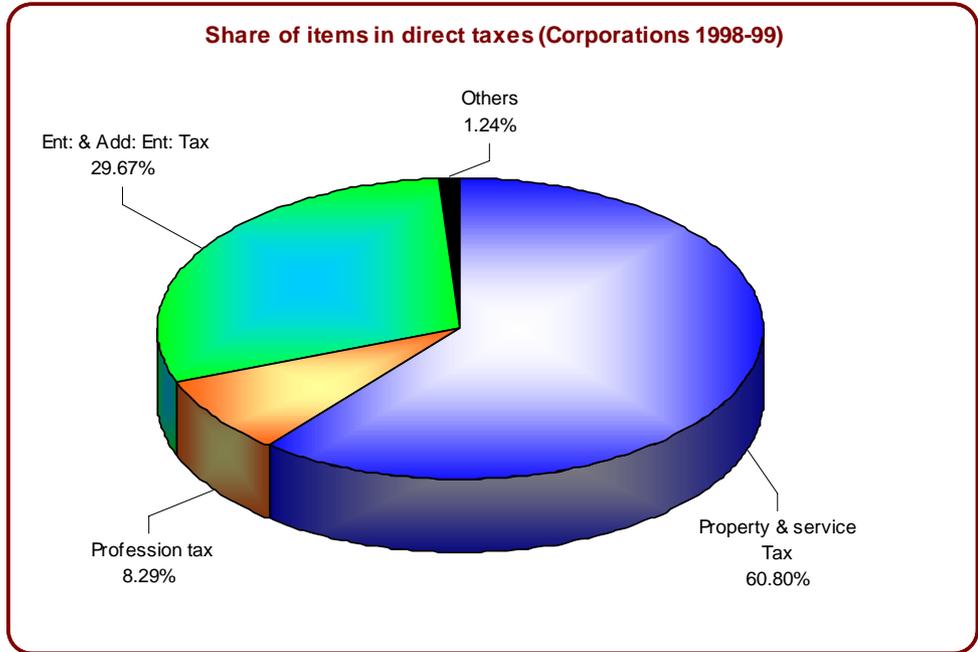
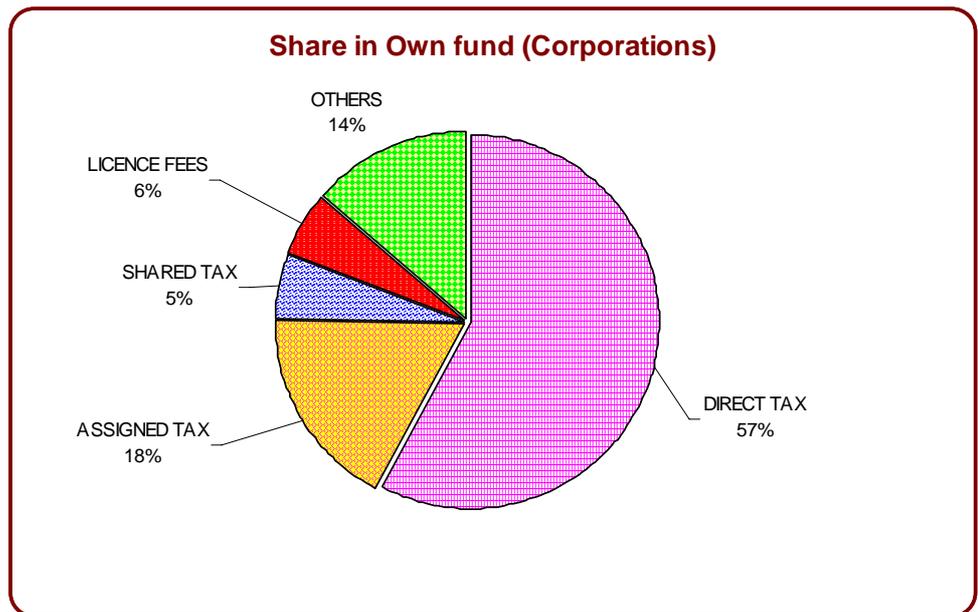


Figure 3.6



GRANT-IN-AID FROM GOVERNMENT

- 3.6 In the case of Village Panchayats, now there are only two Non-Plan Grants-in-aid from Government viz., Rural Pool and Level Crossing grant-in-aid. Rural Pool has been created by pooling the 14 specific purpose grants-in-aid, which were in vogue earlier, 25% of the surcharge on Stamp Duty and 1/8th of the Basic Tax. The amounts released to Village Panchayats after the constitution of Rural Pool are shown in Table 3.22.

TABLE 3.22.

GRANTS-IN-AID FROM THE RURAL POOL

(Rupees in Crores.)

| <i>Year</i> | <i>1998-99</i> | <i>1999-2000</i> | <i>2000-2001 (Budgeted)</i> |
|---------------|----------------|------------------|---------------------------------|
| <i>Amount</i> | <i>16.43</i> | <i>29.66</i> | <i>25.5</i> |

- 3.6.2 The grant for Level Crossing is given only to five Village Panchayats to meet the additional burden on them due to existence of manned Level Crossings whose establishment costs need to be shared with the Railways.
- 3.6.3 In the case of ULBs there are two grants – General Purpose Grant and Specific Purpose Grant. General Purpose Grant is a per capita grant calculated as follows:

| | |
|----------------------|----------------------|
| Corporation | @ Rs.2/- per capita. |
| Major Municipalities | @ Rs.2.50 per capita |
| Minor Municipalities | @ Rs.3/- per capita |

It is governed by the General Purpose Grant-in-aid Rules 1962. The amounts released under this head during the last five years are shown in Table 3.23.

TABLE 3.23

DISTRIBUTION OF GENERAL PURPOSE GRANTS

(Rupees in lakhs)

| | 1994-95 | 1995-96 | 1996-97 | 1997-98 | 1998-99 | 1999-2000 |
|-----------------------|---------|---------|---------|---------|---------|-----------|
| <i>Municipalities</i> | 71.31 | 71.31 | 64.49 | 64.42 | 64.51 | 64.48 |
| <i>Corporations</i> | 30.17 | 30.17 | 30.17 | 30.17 | 30.17 | 30.17 |

- 3.6.4 Specific Purpose Grant is given for identified purposes like running of Maternity and Child Welfare Centres, Nursery Schools, Poor Homes, and carrying out Town Planning and Town Survey operations, Anti Mosquito operations etc. This is governed by the Specific Purpose Grant-in-aid Rules. Actually it is a commitment by Government to share a portion of the running expenses of the selected services mentioned above, at the rate of half for Corporations and Major Municipalities and 2/3rd for Minor Municipalities. Actually the amount provided for specific purpose grant is far less than what is required as per rules. Originally the Grant-in-aid was given only with the prior approval of the Government. But during the last few years it is given more or less as a general-purpose grant.

The amounts released to Municipalities and Corporations during the last five years are shown in Table 3.24.

TABLE 3.24.**DISTRIBUTION OF SPECIFIC PURPOSE GRANT-IN-AID***(Rupees in lakhs)*

| | 1994-95 | 1995-96 | 1996-97 | 1997-98 | 1998-99 | 1999-2000 |
|-----------------------|---------|---------|---------|---------|---------|-----------|
| <i>Municipalities</i> | 71.75 | 64.53 | 78.27 | 109.85 | 98.80 | 91.85 |
| <i>Corporations</i> | 70.82 | 67.99 | 88.42 | 51.04 | 13.50 | 46.50 |

3.6.5 In addition to the above mentioned grants, there are two kinds of special grants given to both Village Panchayats and ULBs. 96 Primary Schools and 21 High Schools are run by Village Panchayats and 3 Primary Schools and 2 High Schools are run by ULBs. The Education Department gives a grant-in-aid for running these schools, which are treated as Aided Schools as per the Kerala Education Rules.

The amounts given during the last three years are summarized in the Table 3.25.

TABLE 3.25.**Grant-in-aid given to local governments for running Schools***(Rs. in lakhs)*

| Year | Village Panchayat | Municipality | Corporation |
|---------|-------------------|--------------|-------------|
| 1996-97 | 1.36 | NIL | NIL |
| 1997-98 | 2.18 | NIL | 0.63 |
| 1998-99 | 4.16 | NIL | 0.23 |

Similarly, libraries run by Village Panchayats and ULBs are affiliated to the Kerala Grandhasala Sangham, which gives grant-in-aid as per the size of the library. The grant-in-aid given during the last three years are noted in Table 3.26.

TABLE 3.26.

Grant-in-aid given to local governments for running Libraries

(Rs. in lakhs)

| Year | Village Panchayat | Municipality | Corporation |
|-------|-------------------|--------------|-------------|
| 96-97 | 5.29 | 1.94 | 0.52 |
| 97-98 | 14.99 | 1.92 | 0.58 |
| 98-99 | 4.95 | 2.34 | 0.73 |

LOANS

- 3.7 In the case of Village Panchayats, loans can be taken with prior Government permission from the Kerala State Rural Development Board (RDB) or Commercial Banks. With the acceptance of the recommendation of the First SFC, Government decided to restructure RDB. Now it does not give loans and is engaged in completing the construction projects taken up earlier. However, the Village Panchayats owe Rs.7.98 crores to RDB by way of overdues. In addition in the last two years Village Panchayats have been taking Housing Loans from HUDCO and Co-operative Bank, jointly with the Block and District Panchayats. LSGIs in Kollam have borrowed Rs.80 crores from HUDCO in 2000-2001. Similarly LSGIs in Thiruvananthapuram have availed themselves of Rs.89.62 crores from the State Co-operative Bank. These loans are for

house construction for families Below the Poverty Line. They are guaranteed by the Government and repayment of interest would be from future Plan funds and repayment of the principal amount is taken care of by fixed deposits which would multiply over a period to the amount needed for repayment. ULBs have also taken these special loans.

- 3.7.2 In the case of urban local governments the major sources of loans are the Kerala Urban Development Finance Corporation (KUDFC), HUDCO and Commercial Banks. In addition there are loans from Government. Institution-wise distribution of loans taken by ULBs during the last five years is given in Table 3.27.

TABLE 3.27.

LOANS AVAILED BY ULBs

Loan released by KUDFC

(Rupees in lakhs)

| | 1995-96 | 1996-97 | 1997-98 | 1998-99 | 1999-2000 |
|-----------------------|---------|---------|---------|---------|-----------|
| <i>Corporations</i> | 2.7 | NIL | NIL | 50.00 | 16.15 |
| <i>Municipalities</i> | 223.37 | 241.80 | 115.00 | 77.03 | 650.76 |

Loan released by HUDCO

| | 1995-96 | 1996-97 | 1997-98 | 1998-99 | 1999-2000 |
|-----------------------|---------|---------|---------|---------|-----------|
| <i>Corporations</i> | 81.00 | 57.74 | 110.58 | 23.35 | NIL |
| <i>Municipalities</i> | 23.35 | 451.12 | 196.29 | NIL | 67.00 |

Loan Released by Commercial Banks

| | 1995-96 | 1996-97 | 1997-98 | 1998-99 | 1999-2000 |
|-----------------------|------------|------------|------------|------------|--------------|
| <i>Corporations</i> | <i>NIL</i> | <i>NIL</i> | <i>NIL</i> | <i>NIL</i> | <i>NIL</i> |
| <i>Municipalities</i> | <i>NIL</i> | <i>NIL</i> | <i>NIL</i> | <i>NIL</i> | <i>75.00</i> |

FUNDS NOT USABLE FOR ITS ROUTINE FUNCTIONING BY LOCAL GOVERNMENTS

- 3.8** Both Village Panchayats and Municipalities have certain items of funds, which cannot be used by them and are kept normally in the Debt Heads. The major items are, Earnest money Deposit, the Securities, Library Cess, Taxes deducted at source, contributions to Provident and Pension funds (for ULBs), Advances etc.

GOVERNMENT GRANTS-IN-AID FOR TRANSFERRED RESPONSIBILITIES

- 3.9** New forms of grant-in-aid are being given to all local governments since 1995 to discharge the new responsibilities transferred to them. These can be grouped into two.
1. General Plan grant-in-aid for local development projects.
 2. Specific-purpose grant-in-aid for transferred responsibilities - Plan and Non-Plan.

3.9.1 GENERAL PLAN GRANTS-IN-AID. Government have been giving Plan Grants-in-aid for preparing local level development schemes. This is a practically untied grant, with the specification that at least 40% of the grant-in-aid given to Panchayat Raj Institutions should be spent on the productive sector and not more than 30% can be spent on infrastructure; in the case of ULBs, the figures are 30% and 40% respectively. (In addition, for taking up Housing and Water supply Schemes up to 10% can be diverted from the productive sector by any LSGI). The amounts given to various LSGIs during the last four years are shown in Table 3.28.

TABLE 3.28.

PLAN GRANT-IN-AID DEVOLVED TO LSGIs

(Rupees in crores)

| Year | District Panchayat | Block Panchayat | Village Panchayat | Municipalities | Corporations |
|-----------|--------------------|-----------------|-------------------|----------------|--------------|
| 1996-97* | 28.00 | 15.00 | 100.00 | 54.00 | 15.00 |
| 1997-98 | 123.94 | 108.70 | 420.49 | 62.34 | 33.53 |
| 1998-99 | 142.67 | 135.02 | 549.54 | 81.90 | 40.87 |
| 1999-2000 | 148.39 | 144.41 | 568.81 | 88.16 | 44.03 |
| 2000-2001 | 153.06 | 148.79 | 579.91 | 89.56 | 44.67 |

* In 1996-97 Plan Grants were called untied Funds

Since 1998-99 the grant-in-aid is devolved as per the formula given in table 3.29.

TABLE 3.29.

FORMULA FOR DEVOLUTION OF PLAN GRANTS

Weightage (Percentage)

| Indicators | Grama Panchayat | Block Panchayat | District Panchayat | Municipalities/ Corporations |
|---|-----------------|-----------------|--------------------|------------------------------|
| 1. Population (excluding Scheduled Castes/ Scheduled Tribes) | 65 | 65 | 55 | 75 |
| 2. Geographical Area (Excluding Area under Forests) | 5 | 10 | 15 | 5 |
| 3. Area Under Paddy | 5 | — | — | — |
| 4. Own Income (Grama Panchayats) | 10 | — | — | — |
| 5. Composite Index of Agricultural Labourers, Persons Engaged in Livestock, Fisheries etc. and Marginal Workers | 15 | 25 | 20 | — |
| 6. Composite Index of Backwardness, Houses without Latrines and Houses without Electricity. | — | — | 10 | 20 |
| Total: | 100 | 100 | 100 | 100 |

3.9.2 SPECIFIC PURPOSE GRANTS-IN-AID FOR TRANSFERRED RESPONSIBILITIES: Kerala has followed a unique system of earmarking funds to various LSGIs as part of the budgetary process by introducing a minor Head '191' along with various Heads of Account operated by different departments. Thus a local government entitlement has been created. Once the minor Head 191 is shown, the funds are

non-divertible by the departments for other purposes. These funds could be broadly classified as follows:

- i Grant-in-aid for implementing transferred Plan schemes both State sponsored and Centrally sponsored.
- ii. Grant-in-aid for implementing specific programmes under non-plan, particularly welfare pensions.
- iii. Non-plan grant-in-aid for running/maintaining institutions/offices transferred to local governments.
- iv. Establishment grants for Block Panchayats and District Panchayats.

3.10

GRANT-IN-AID FOR STATE AND CENTRALLY SPONSORED PLAN SCHEMES

The State sponsored and Centrally sponsored schemes transferred to various local governments as provided for in the Budget for the year 2000-2001 are summarized in Annexure - 3.3.

3.11

GRANT-IN-AID FOR SPECIFIC PROGRAMMES UNDER NON-PLAN

The details of non-plan grant-in-aid for specific programmes as given in the Budget for the year 2000-2001 are summarized in Annexure - 3.4.

3.12

NON-PLAN GRANT-IN-AID FOR RUNNING/MAINTAINING THE OFFICES/INSTITUTIONS TRANSFERRED TO LOCAL GOVERNMENTS

For the assets and institutions transferred to local governments, Government meets the salary component as well as the opera-

tional expenses like supply of medicines in hospitals. However, office expenses and maintenance costs are given as non-plan grants to LSGIs. The comparative figures for the last four years for Health, Education and Public Works Departments who have transferred most of their assets to LSGIs can be seen in Table 3.30.

TABLE 3.30

NON-PLAN GRANT-IN-AID TO LSGIs

(Rupees in lakhs)

Non-Plan Grant-in-aid for all local governments together

| Name of Dept. | 1996-97 | 1997-98 | 1998-99 | 1999-2000 | 2000-01 |
|-----------------------------|----------------|----------------|----------------|----------------|----------------|
| <i>1. Health</i> | <i>2.27</i> | <i>2.59</i> | <i>2.69</i> | <i>3.10</i> | <i>2.78</i> |
| <i>2. General Education</i> | <i>367.00</i> | <i>481.00</i> | <i>484.00</i> | <i>484.00</i> | <i>536.00</i> |
| <i>3. PWD</i> | <i>1451.97</i> | <i>1597.17</i> | <i>1756.69</i> | <i>1932.16</i> | <i>2317.99</i> |

This clearly shows that the funds given to LSGIs are inadequate vis-à-vis the maintenance requirements. This underlines the need to rationalize allocation of funds for establishment purposes and maintenance purposes in respect of the institutions and offices transferred to local governments.

3.13

NON-PLAN ESTABLISHMENT GRANT FOR BLOCK AND DISTRICT PANCHAYATS

For meeting the establishment costs including salary and related expenses of staff from the Panchayat Department deployed specifically to the Block and District Panchayats, honorarium and travel

expenses of elected members and other office expenses, a grant-in-aid is paid to them. This grant-in-aid, which was fixed in 1996, has not been changed since then, even though the salaries of staff have increased considerably after the 1997 Pay Revision and the honorarium of elected members was enhanced based on the recommendation of the Committee on Decentralisation of Powers. As of now each District Panchayat gets an annual grant of Rs. 16.43 lakh and each Block Panchayat gets Rs. 4.01 lakh. Figures collected from District Panchayats and Block Panchayats show that this provision is highly inadequate resulting in diversion of other grants-in-aid for meeting establishment cost. (Table 3.31).

TABLE 3.31
RECEIPT AND EXPENDITURE OF THE ESTABLISHMENT
GRANTS FOR DISTRICT PANCHAYATS/BLOCK PANCHAYATS

District Panchayat

| Year | Receipt | Expenditure | Balance |
|-----------|----------|-------------|-----------|
| 1996-97 | 23000000 | 23974005 | -974005 |
| 1997-98 | 23000000 | 27673952 | -4973952 |
| 1998-99 | 23000000 | 30759337 | -7759337 |
| 1999-2000 | 23000000 | 37830869 | -14830869 |

Block Panchayat

| | | | |
|-----------|----------|-------------|-------------|
| 1996-97 | 57000000 | 44354743.3 | 12645256.7 |
| 1997-98 | 61000000 | 5381-667.57 | 7189332.43 |
| 1998-99 | 61000000 | 66897540.97 | -5897540.97 |
| 1999-2000 | 61000000 | 66952677.54 | -5952677.54 |

EXPENDITURE OF LOCAL GOVERNMENTS

EXPENDITURE FROM TRADITIONAL SOURCES

3.14 Expenditure from the traditional sources of revenue can be classified into three.

1. Establishment costs
2. Expenditure on obligatory duties.
3. Expenditure on development works.

The expenditure on these three categories and their sub-categories over the last six years for Village Panchayats, Municipalities and Corporations is summarized in Table 3.32.

TABLE 3.32

EXPENDITURE PATTERNS IN VILLAGE PANCHAYATS AND ULBs.

ESTABLISHMENT COSTS

(1) *Salaries*

(Rupees in lakhs)

| | 93-94 | 94-95 | 95-96 | 96-97 | 97-98 | 98-99 |
|--------------------------|---------|---------|---------|---------|---------|---------|
| <i>Village Panchayat</i> | 3562.49 | 4175.21 | 4906.10 | 6026.30 | 6597.46 | 8123.88 |
| <i>Municipality</i> | 2493.27 | 2707.06 | 3022.38 | 3589.28 | 4163.96 | 4443.18 |
| <i>Corporation</i> | 153545 | 154393 | 176603 | 199559 | 233709 | 238184 |

(2) Office Expenses

| | 93-94 | 94-95 | 95-96 | 96-97 | 97-98 | 98-99 |
|--------------------------|--------|--------|--------|--------|---------|---------|
| <i>Village Panchayat</i> | 403.52 | 467.67 | 512.74 | 717.61 | 1002.08 | 1164.68 |
| <i>Municipality</i> | 192.12 | 215.58 | 259.26 | 333.14 | 424.79 | 366.96 |
| <i>Corporation</i> | 91.35 | 105.73 | 139.08 | 160.93 | 162.62 | 162.58 |

OBLIGATORY DUTIES**(1) Public Health/Sanitation (excluding salary)**

| | 93-94 | 94-95 | 95-96 | 96-97 | 97-98 | 98-99 |
|--------------------------|--------|--------|--------|--------|--------|--------|
| <i>Village Panchayat</i> | 72.60 | 393.89 | 496.77 | 729.15 | 810.94 | 810.32 |
| <i>Municipality</i> | 116.45 | 110.99 | 141.68 | 192.80 | 169.56 | 175.23 |
| <i>Corporation</i> | 143.65 | 177.02 | 173.01 | 210.83 | 225.90 | 250.16 |

(2) Water Supply/drainage

| | 93-94 | 94-95 | 95-96 | 96-97 | 97-98 | 98-99 |
|--------------------------|--------|--------|--------|--------|--------|--------|
| <i>Village Panchayat</i> | 168.00 | 210.00 | 264.00 | 634.98 | 717.00 | 584.98 |
| <i>Municipality</i> | 169.77 | 383.77 | 363.37 | 531.34 | 548.22 | 573.76 |
| <i>Corporation</i> | 250.78 | 465.09 | 850.01 | 714.14 | 876.58 | 863.99 |

(3) Street Lighting

| | 93-94 | 94-95 | 95-96 | 96-97 | 97-98 | 98-99 |
|--------------------------|--------|--------|---------|--------|---------|---------|
| <i>Village Panchayat</i> | 808.32 | 831.43 | 848.65 | 997.63 | 1266.52 | 1164.16 |
| <i>Municipality</i> | 327.95 | 353.23 | 3888.57 | 455.98 | 507.37 | 577.22 |
| <i>Corporation</i> | 265.70 | 254.63 | 354.73 | 399.62 | 462.35 | 337.79 |

DEVELOPMENT WORKS

(1) Roads

| | 93-94 | 94-95 | 95-96 | 96-97 | 97-98 | 98-99 |
|--------------------------|---------|---------|---------|---------|---------|---------|
| <i>Village Panchayat</i> | 2126.47 | 2475.49 | 2853.82 | 3813.90 | 6138.24 | 3103.77 |
| <i>Municipality</i> | 1265.34 | 1468.65 | 1802.19 | 2684.68 | 3045.27 | 2698.92 |
| <i>Corporation</i> | 692.62 | 1066.45 | 767.64 | 1162.16 | 1445.21 | 1575.94 |

(2) Buildings

| | 93-94 | 94-95 | 95-96 | 96-97 | 97-98 | 98-99 |
|--------------------------|--------|--------|--------|---------|---------|---------|
| <i>Village Panchayat</i> | 259.79 | 216.44 | 206.99 | 225.00 | 486.34 | 339.34 |
| <i>Municipality</i> | 823.97 | 883.53 | 978.85 | 1253.98 | 1446.51 | 1367.37 |
| <i>Corporation</i> | 126.96 | 221.33 | 446.97 | 395.11 | 434.13 | 1414.36 |

(3) Other amenities

| | 93-94 | 94-95 | 95-96 | 96-97 | 97-98 | 98-99 |
|--------------------------|--------|--------|--------|--------|---------|--------|
| <i>Village Panchayat</i> | 705.08 | 528.95 | 499.99 | 711.49 | 1106.64 | 935.60 |
| <i>Municipality</i> | 216.22 | 144.53 | 170.48 | 177.69 | 332.86 | 174.51 |
| <i>Corporation</i> | 171.25 | 177.83 | 193.34 | 185.60 | 205.51 | 166.54 |

3.15

SUMMING UP

In order to get a full picture of the income and expenditure of Village Panchayats, Municipalities and Corporations (except in respect of plan grants), a detailed summary is presented in the form of Annexures as shown below:

- 3.5 Relating to Village Panchayat
 - 3.5.1 Total receipts (excluding grant-in-aid for peoples' plan campaign of Village Panchayats 1993-94 to 1998-99)
 - 3.5.2 Abstract of Total receipts of Village Panchayats under own revenue
 - 3.5.3 Percentage share of taxes to total Direct Tax Revenue
 - 3.5.4 Percentage increase of taxes over previous year
 - 3.5.5 Percentage increase of own revenue over previous years
 - 3.5.6 Share of taxes in total own revenue
 - 3.5.7 Share of each item under own revenue
 - 3.5.8 Total expenditure of Village Panchayats for the years 1993-94 to 1998-99 (excluding plan grant-in-aid for peoples' plan campaign)
 - 3.5.9 Per capita expenditure of Village Panchayats
- 3.6 Relating to Municipalities
 - 3.6.1 Total receipts (excluding grant-in-aid for peoples' plan campaign) of Municipalities 1993-94 to 1998-99
 - 3.6.2 Abstract of Total receipts of Municipalities under own revenue
 - 3.6.3 Percentage share of taxes to total own tax revenue
 - 3.6.4 Percentage increase of taxes over previous year
 - 3.6.5 Percentage increase of own revenue over previous years
 - 3.6.6 Share of taxes in total own revenue

- 3.6.7 Share of each item under own revenue
- 3.6.8 Total expenditure of Municipalities for the years 1993-94 to 1998-99 (excluding plan grant in aid for peoples' plan campaign)
- 3.6.9 Per capita Expenditure of Municipalities
- 3.6.10 Total Receipts and Expenditure of Municipalities at a glance
- 3.7 Relating to Corporations
 - 3.7.1 Total receipts (excluding grant-in-aid for peoples' plan campaign of Municipal Corporations 1993-94 to 1998-99)
 - 3.7.2 Abstract of Total receipts of Municipal Corporations under own revenue
 - 3.7.3 Percentage share of taxes to total own tax revenue
 - 3.7.4 Percentage increase of taxes over previous year
 - 3.7.5 Percentage increase of own revenue over previous years
 - 3.7.6 Share of taxes in total own revenue
 - 3.7.7 Share of each item under own revenue
 - 3.7.8 Total expenditure of Municipal Corporations for the years 1993-94 to 1998-99 (excluding plan grant in aid for peoples' plan campaign)
 - 3.7.9 Per capita Expenditure of Municipal Corporations
 - 3.7.10 Total Receipts and Expenditure of Municipal Corporations at a glance.

- 3.15.1 For meeting the establishment costs as well as performing the obligatory duties the Village Panchayats and ULBs can use tax revenue other than shared tax, non-tax revenue, specific purpose and general purpose grants (in the case of ULBs) and Rural Pool (in the case of Village Panchayats). The degree of self sufficiency of various LSGIs can be gauged from Table 3.33.

TABLE 3.33

SELF-SUFFICIENCY OF LSGIs

| Expenditure categories | No. of local governments having sufficient funds | | |
|--|--|-----------------------------------|----------------------|
| | Village Panchayat | Municipality | Corporation |
| 1. Salaries & Office expenses. | 964 | All the Municipalities | All the Corporations |
| 2. Salaries, Office Expenses, Water Charges and street light charges. | 862 | All the Municipalities | All the Corporations |
| 3. Salaries, office expenses, water charges, street light charges and sanitation services. | 849 | All the Municipalities (Except 4) | All the Corporations |

- 3.15.2 General picture of self sufficiency for establishment as well as obligatory functions as revealed by expenditure percentage for various categories of establishment and obligatory functions is given in Table 3.34

TABLE 3.34

SELF-SUFFICIENCY OF LSGIs

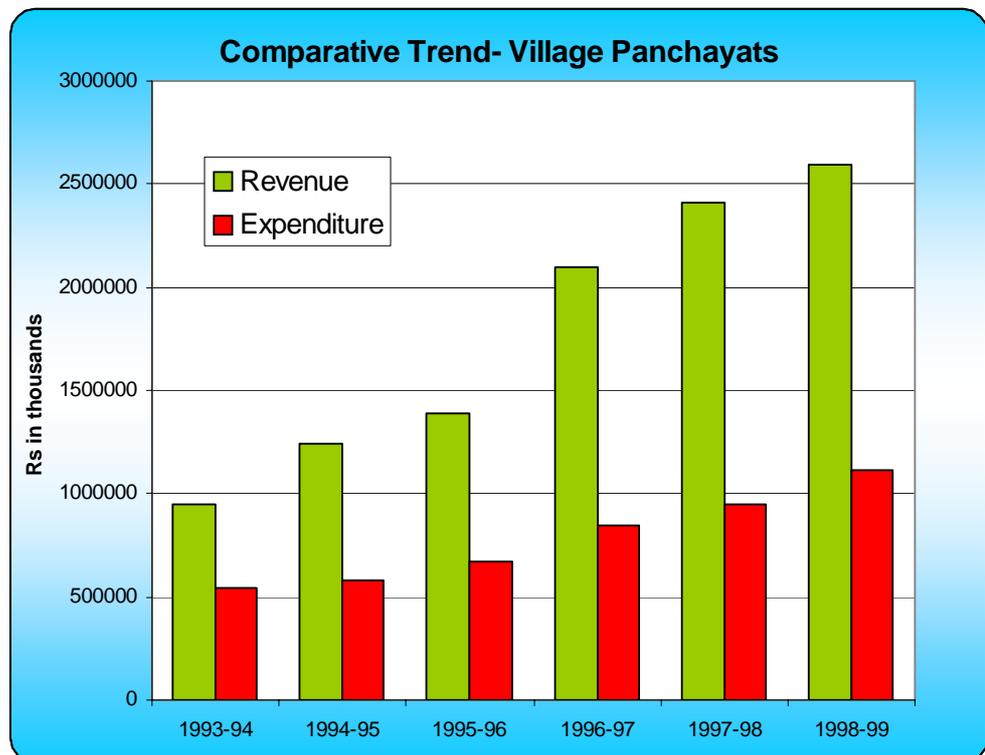
| Expenditure categories | Village Panchayat | Municipality | Corporation |
|--|-------------------|--------------|-------------|
| <i>1.Salaries & Office expenses.</i> | 37.75% | 48% | 39% |
| <i>2.Salaries, Office Expenses, Water Charges and street light charges.</i> | 40.26% | 56% | 48% |
| <i>3.Salaries, office expenses, water charges, street light charges and sanitation services.</i> | 42.85% | 58% | 52% |

- 3.15.3 The comparative trend of increase in revenue in relation to increase of expenditure on establishment as well as obligatory duties over the last six years is given in figures 3.7, 3.8 and 3.9 for Village Panchayats, Municipalities and Corporations respectively.

Village Panchayats

| | <i>1993-94</i> | <i>1994-95</i> | <i>1995-96</i> | <i>1996-97</i> | <i>1997-98</i> | <i>1998-99</i> |
|--------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <i>Revenue</i> | 943466 | 1240114 | 1385650 | 2099477 | 2413635 | 2597877 |
| <i>Expenditure</i> | 541924 | 577845 | 669400 | 845360 | 943309 | 1113131 |

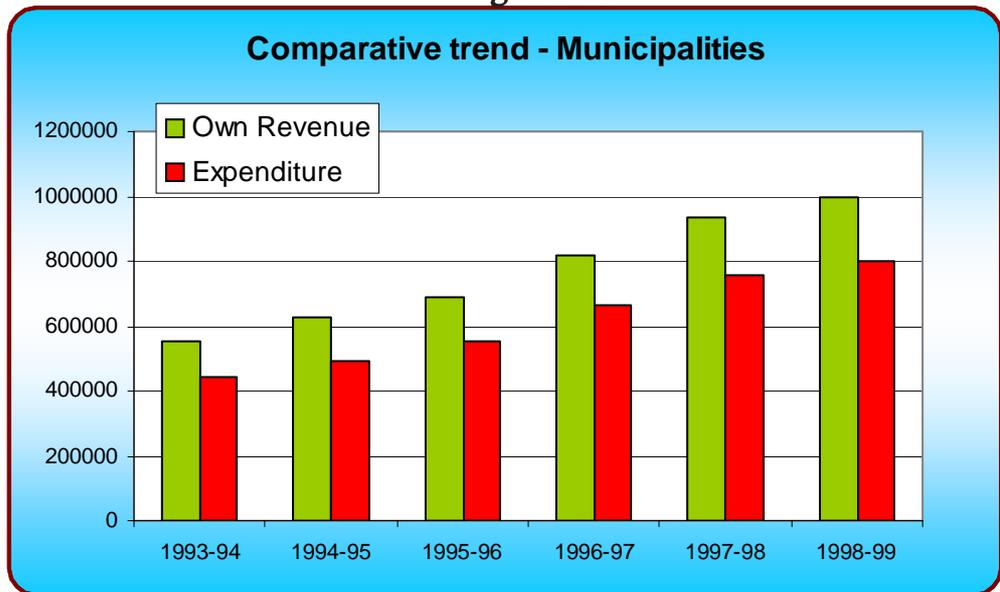
Figure 3.7



Municipalities

| | 1993-94 | 1994-95 | 1995-96 | 1996-97 | 1997-98 | 1998-99 |
|--------------------|---------|---------|---------|---------|---------|---------|
| <i>Own Revenue</i> | 556459 | 629976 | 688885 | 819992 | 934930 | 999261 |
| <i>Expenditure</i> | 443519 | 494497 | 552927 | 667023 | 758832 | 798043 |

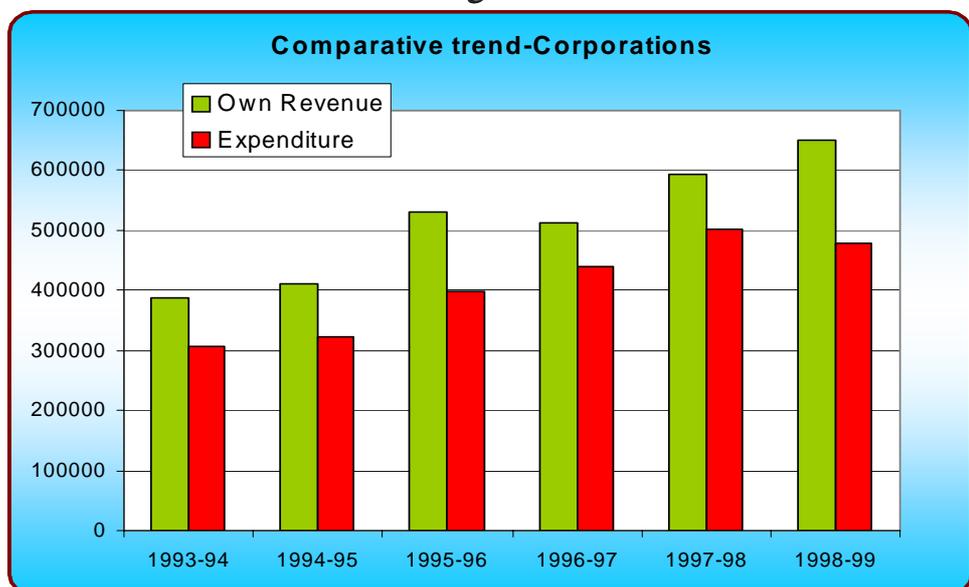
Figure 3.8



Corporation

| | 1993-94 | 1994-95 | 1995-96 | 1996-97 | 1997-98 | 1998-99 |
|--------------------|---------|---------|---------|---------|---------|---------|
| <i>Own Revenue</i> | 386603 | 411067 | 529989 | 511777 | 592810 | 650393 |
| <i>Expenditure</i> | 306960 | 321740 | 397427 | 440371 | 503455 | 479813 |

Figure 3.9



CHAPTER 4

THE DECENTRALISATION PROCESS - A SUMMARY

- 4.1 Consequent on the 73rd and 74th Amendments to the Constitution, Kerala passed two new legislations in 1994, viz., The Kerala Panchayat Raj Act 1994 and the Kerala Municipality Act 1994. They listed out the functional responsibilities of the three tier Panchayat Raj Institutions and the Urban Local Bodies in the Schedules of the Acts. However, most of the subjects listed were quite general in nature and it cannot be said that there was an attempt to consciously and clearly demarcate the functional domains of LSGIs in the sense of sharing developmental governance responsibilities with the State and Central Governments.
- 4.2 However, this deficiency was covered to some extent through the Government Order No.GO(P)189/95/LAD issued in September 1995 which provided for the transfer of a large number of institutions and staff to the different LSGIs. This order indicated the policy framework for defining the functional areas to be assigned to local governments. Also the order brought out the key feature of decentralisation in the State i.e., the strengthening of Village Panchayats and the Urban Local Bodies. Only a limited number of institutions and staff were transferred to the Block Panchayats and District Panchayats. The details of the transfer are summarized in Annexure 4.1
- 4.3 But due to want of effective operational instructions and due to lack of sufficient resources, the LSGIs could not realize their

entitlements to any significant level.

The budget presented in 1996 February, can be considered as the next important milestone in the decentralisation process. It expanded the concept of untied funds. It was in 1990 that for the first time a small amount was set apart for Village Panchayats as a plan scheme for which they could draw up their own schemes according to local priorities. This scheme, which had an allotment of Rs. 28.58 crores in 1995-96, was stepped up to Rs.155.72 crores and extended to all LSGIs, both urban and rural. The budget enshrined two important procedural innovations. First the idea of a separate budget document for local governments was brought into effect. To this was added the innovation of giving the specific Head of Account “191” which indicated grants to LSGIs and which allowed Heads of Department to transfer credit the amount only to the LSGIs. Any other way of drawing the grants was prevented by this procedural device. Thus the local governments got legislative approval for their resource allocation and a separate sub system of grants in aid, which could flow only to LSGIs, was created. The second innovation relates to bringing certain departmental Plan schemes into the special system and they were the forerunners of the so called “State-sponsored schemes” which still constitute about a tenth of Plan grant-in-aid to LSGIs. Such schemes are implemented by LSGIs according to the guidelines issued by the State or Central Governments.

- 4.4 The most important landmark in the decentralisation process of the State is of course the momentous decision taken in July 1996 to earmark 35 to 40% of the Plan resources to LSGIs and the launch of the People’s Plan Campaign in August 1996 to provide a framework for decentralisation, flesh it out and infuse life into it.

4.5 Thus considerable resources were handed down to the LSGIs through this policy decision of the Government and proper utilisation of the resources was attempted through the mechanics of People's Plan Campaign. The funds transferred to LSGIs as part of this government decision are indicated in Table 4.1

TABLE 4.1
TOTAL PLAN GRANTS TO LSGIs

| Year | State Plan Size (in lakhs) | Village Panchayat | Block Panchayat | District Panchayat | Municipality | Corporation | Total | Percent of Plan size |
|-----------|----------------------------|-------------------|-----------------|--------------------|--------------|-------------|----------|----------------------|
| 1997-98 | 285500 | 50686.42 | 38715.98 | 18885.64 | 1525.1 | 1384.58 | 111197.7 | 38.95 |
| 1998-99 | 310000 | 61460.7 | 23254.15 | 17061.74 | 10174.18 | 5848.23 | 117799 | 38.00 |
| 1999-2000 | 325010 | 63925.3 | 20049.28 | 16973 | 8953 | 4434.42 | 114335 | 35.10 |
| 2000-2001 | 353500 | 63637.38 | 18459.61 | 16667.47 | 9802.56 | 5673.79 | 114240.8 | 32.32 |

4.6 The availability of resources enabled the local governments to realize their functional responsibilities by formulating and implementing developmental projects in respect of functions assigned to them.

4.7 **PEOPLE'S PLAN CAMPAIGN:** Decentralised local level planning has been used as the engine for harnessing public action in favour of decentralisation. In order to shake the system and force the process, a campaign approach has been followed. This campaign has succeeded in setting the agenda for decentralised development.

- 4.8 The People's Plan Campaign has succeeded in providing a concrete methodology for participatory plan for local level development. The salient features of this methodology are described below, stage by stage.
- 4.8.1 Needs identification:** Through a meeting of Grama Sabha/Ward Sabha (in the case of urban local bodies), the felt needs of the community are identified. There is a period of environment creation to mobilise maximum participation in the Grama/Ward Sabhas. Statistics reveal that about 10 to 12 percent of the population has participated in the Grama/Ward Sabhas held as part of the People's Planning Campaign. The Grama/Ward Sabha meetings are held in a semistructured manner with plenary sessions and sub-group sessions dealing with specific developmental issues. The decisions are minuted and forwarded to the Village Panchayats and ULBs.
- 4.8.2 Situation analysis:** Based on the demands emanating from the Grama/Ward Sabha and based on developmental data, both primary and secondary, exhaustive Development Reports have been prepared and printed in the case of every LSGI in the State. These reports describe the status in each sector of development with reference to available data, analyze the problems and potential and point out broad strategies for future development.
- 4.8.3 Strategy setting:** Based on the Grama/Ward Sabha feed back and the Development Report, a one day seminar is held at the local government level in which participation of experts, elected members, representatives nominated by Grama/Ward Sabhas, and practitioners from among the public is ensured. These Development Seminars decide the broad priorities and the general thrust of developmental projects to be taken up for a particular year.

- 4.8.4 Projectisation:** The ideas thrown up by the above three stages are translated into projects by Task Forces at the LSGI level. For each LSGI there are about 12 Task Forces dealing with different sectors of development. Each Task Force is headed by an elected member and is convened by the concerned government official. The Vice Chairman of the Task Force is normally a non-government expert in the sector. The projects are prepared in the suggested format outlining the objectives, explaining the benefits, describing the funding and detailing the mode of execution and the phasing of the project.
- 4.8.5 Plan finalisation:** From among the projects, based on the allocation communicated, the concerned LSGI finalizes its plan for the year and this plan is submitted to the District Planning Committee (DPC) through the Expert Committees.
- 4.8.6 Plan vetting:** The Expert Committees at the Block/Municipal and District level vet the projects for their technical viability and consonance with the government guidelines on planning and costing and forward them to the DPC.
- 4.8.7 Plan approval:** The DPC gives the formal approval to the plans after which the LSGI can start implementation. It is to be noted that the DPC cannot change the priority of an LSGI. It can only ensure that government guidelines are followed. Administrative approval for implementation is given project-wise by the concerned LSGI. Every local government has unlimited powers of Administrative Sanction subject only to the limits of its financial resources.
- 4.8.7.1** The most noteworthy feature of the decentralised planning process is the freedom to plan and prepare projects according to

local priorities using the Plan grant-in-aid, which is devolved to the LSGIs in a practically untied form. The only restriction on the LSGIs is that they have to spend at least 40% (30% in the case of ULBs) on the productive sector – meaning agriculture and allied activities, industries, self-employment etc., and not more than 30% (40% in the case of ULBs) on infrastructure. A general stipulation that 10% of the funds have to be spent on women’s development projects is also there. The Special Component Plan/Tribal Sub-Plan component for each LSGI is indicated clearly. Also upper-limits of subsidy for beneficiary oriented schemes has been fixed by Government after consultation with the LSGIs. Thus one third of development schemes in the State are conceptualized, formulated and implemented by LSGIs. The physical achievements of LSGIs in the three years starting from 1997-1998 are captured in Annexures 4.2.1, 4.2.2 and 4.2.3.

- 4.8.7.2 Another important feature of the People’s Planning Campaign has been the effective capacity building efforts taken up. In the first year a cascading system of training was introduced to enable quick outreach to the cutting edge level. About 600 Key Resource Persons (KRPs) were identified at the State level both from Government and outside, representing various disciplines. At the district level about 10,000 District Resource Persons (DRPs) and at the local government level about 100,000 Local Resource Persons (LRPs) were selected. All the DRPs and LRPs and a good number of KRPs were selected by the LSGIs themselves from government officials, professionals and activists. The massive training programme ensured that at the level of a Village Panchayat or ULB, there would be nearly 100 persons sensitized on the objectives and methodology of decentralised planning. These Resource Persons have taken an active part in spearheading the campaign as well as intervening in critical stages of the Plan preparation and implementation cycle.

- 4.8.7.3 In order to fortify and simplify the training system from the second year, handbooks on various development sectors were prepared by expert panels and circulated widely among the LSGIs and Resource persons. These handbooks outline the problems and possibilities of the sector and contain model projects, which can be adapted according to local needs. Thirteen such sector-specific handbooks have been prepared so far; in addition twelve handbooks have been prepared on topics dealing with operational procedure.
- 4.8.7.4 Now the focus is on strengthening the capacity of the Task Forces on various sectors. Institutions like Medical College, Agricultural University, Centre for Water Resource Development and Management (CWRDM) etc., are being utilised to provide high quality technical training to members of Task Forces in their respective disciplines. In addition, LSGIs, which have evolved successful models, are now utilised to train sister LSGIs by exposing them to the models evolved.

4.8.8 *PROCEDURAL REFORMS*

With the objective of promoting people's participation and introducing transparent and norm - based decision making to reduce probabilities of malfeasance, certain basic procedural reforms have been introduced. Three such reforms deserve special mention.

(1) EXPERT COMMITTEES

- 4.8.8.1 A major innovation is the setting up of Expert Committees. Originally a Volunteer Technical Corps (VTC) was set up as part of the People's Planning Campaign at Block and District levels.

This consisted of experts in various fields who responded to the call of Government to render voluntary professional services in the cause of local level development. These VTCs were converted into Block/Municipal Level Expert Committees (BLEC/MLEC) and District Level Expert Committees (DLEC) by adding to its membership professionals from Government. These Expert Committees are given a three-fold role. Firstly they are expected to provide technical advice to the LSGIs whenever requested. In this respect they act as Technical Resource Groups for LSGIs to tap. Secondly they are empowered to technically vet the projects of the LSGIs before they are sent to the DPCs for approval. Here the Expert Committees function as the Technical Advisory Groups of the DPC. However these Expert Committees are not empowered to change the priority of an LSGI; they can only insist on following of technical standards, adherence to mandatory Government instructions and proper costing and phasing of various programmes. The third function of the Expert Committees is to give Technical Sanction for works, which require such approval. In this role they function as the Technical Support Group of the LSGIs. For technical sanction, sub groups consisting of at least three experts are formed in which as far as possible the Government professional is the Convenor and the non-government professional is the Chairperson. This system of technical approval is faster, cheaper and more transparent. In the case of Village Panchayats without engineers, the engineer members of these Expert Committees are allowed to perform the role of the engineers on payment of a small fee not exceeding 2.5% of the estimate of a work for the full range of functions.

(2) SELECTION OF BENEFICIARIES

- 4.8.8.2 Selection of beneficiaries for various individual and group oriented development programmes, particularly relating to anti

poverty and minimum needs programmes for people below poverty line is an important activity of LSGIs. Without infringing on the basic autonomy of LSGIs, the Government have prescribed a due process for beneficiary selection. The key elements of this process are fixing of definite and transparent eligibility criteria for each scheme as well as prioritisation criteria among those eligible for such scheme. The prioritisation criteria have to be given weightages in the form of points or marks. These criteria have to be published and application forms invited after widespread publicity. In fact, full-page advertisements are issued by Government alerting the people about impending beneficiary selection and exhorting them to approach the LSGIs. Each application received has to be acknowledged. Thereafter it has to be enquired into either through officials or preferably through a committee of officials and non-officials and marks awarded for each criterion and totalled. A draft priority list based on these marks has to be prepared and taken to the Grama/Ward Sabha in which the applicants from that particular ward also participate. The marks have to be justified in the Grama/Ward Sabha and altered if decided by the Grama/Ward Sabha. Once the Grama/Ward Sabha approves the list, the priority cannot be changed by the LSGIs. In order to ensure equitable distribution of benefits among the different wards of a Village Panchayat/Urban Local Body, ward-wise physical target is prepared in proportion to eligible applicants. Even for selection of beneficiaries to schemes sponsored by Block Panchayats and District Panchayats it is the Grama Panchayat, which is to perform the function through its Grama Sabhas in the manner prescribed above. All records relating to selection of beneficiaries have been declared as public documents. This insistence on due process has considerably reduced patronage and nepotism in the selection of beneficiaries.

(3) EXECUTION OF PUBLIC WORKS

4.8.8.3 In a fundamental shift from the existing method a set of rules

for execution of public works by LSGIs was issued. It provides for community contracting of works through committees of beneficiaries along with stringent provisions to guard against benami contractors masquerading as conveners or nominees of beneficiary committees. The rules provide for compulsory transparency with all records relating to a public work right from preliminary estimates, up to final bills and payment vouchers, being declared as public documents for any one to peruse or take copies. The rules also insist on preparation of a summary of the estimate in layman's language and exhibition of this summary as well as details of execution at the work site. In addition the process of technical approval is sought to be demystified so that government could, through an executive order, bestow powers of technical sanction on institutions as well as committees of government or non-government professionals. This radical feature provides for easy access to technical expertise. In pursuance of these rules the government have decided on a programme of preparing a separate public works manual for local governments with updated specifications and standards and more accountable and people-friendly methods of preparation of estimates, taking measurements of public works and finalizing bills. This ambitious programme when it is carried to its logical conclusion is expected to improve the execution of public works by reducing chances of corruption and facilitating social audit.

4.9

ISSUES TO BE ADDRESSED

Even while a comprehensive methodology for local planning and a system of procedural safeguards have been put in place, there are issues of concern which need to be addressed. The setting up of institutions of genuine local self governance is still in the nascent stage. It is in this phase that a careful nurturing is needed which includes weeding out undesirable elements and rectifying distortions which creep into the implementation process, despite the safeguards in place. In this respect, the important issues which are relevant for the long term sustainability of the

decentralisation process, some of them interrelated, are summarised below.

1. There is a need to enhance the quality of peoples' participation. Gram Sabhas and Ward Sabhas have to move away from being primarily 'benefit deciding' mechanisms to institutions for meaningful dialogue on developmental priorities and for channelising public contribution for the common good. All sections of the public have to be attracted to these institutions.
2. The elaborate provisions for transparency are being only minimally utilised. Unless there is a powerful check from below, there is every likelihood of misutilisation of the vast powers conferred on the local governments. Hence there is an urgency for setting up systems of social audit.
3. The persistent malfeasance and corruption is disconcerting. A major threat to decentralisation is the corruption involved in the execution of public works through 'benami' contractors, defeating the very purpose of participatory development. It has to be recognised that while on the one hand, decentralisation increases the number of players involved in governance and thereby deepens democracy, on the other hand, there is a risk of new collusive practices emerging if the procedural safeguards are not strictly enforced.
4. The quality of planning needs to be upgraded to prevent thin spreading of resources, to reduce beneficiary oriented schemes, to foster productivity increasing schemes, to better inter-tier integration of plans and to mobilise additional resources through credit linkages.
5. Though most of the officials have been transferred to local governments, their active involvement in the planning phase

is rather limited. Unless these officials, especially the professionals take an active interest in the planning process and assume ownership of the plans and serve as the vital link between the people and the plan, it will not be possible to consolidate and iteratively refine the quality of the plans in their areas of expertise.

6. More than implementation of schemes using Government funds, decentralisation implies improved quality of services. This would mean that LSGIs are able to manage the staff under their control in such a way that there is a felt improvement in the quality of services rendered by them to the public. Such a thing has not happened so far. It is on the performance of LSGIs in this area that the public will ultimately judge the gains of decentralisation.
7. The managerial efficiency of LSGIs leaves much to be desired. There is tremendous scope for improving office management, human resources management and financial management in LSGIs.
8. Local resource mobilisation by LSGIs is an area where further improvements are definitely possible.
9. For achieving good governance through LSGIs, the newly created institutions like Ombudsman have to live up to the expectations with which such institutions were designed and put in place. This would require that these institutions acquire greater sensitivity to problems of the people and move closer to them.

4.10

REDEFINITION OF FUNCTIONAL DOMAINS OF LOCAL GOVERNMENTS

- 4.10.1 As the People's Planning Campaign progressed and empirical evidence flowed in from the field on the areas of strength of

LSGIs, the Government accepted the recommendations of the Committee on Decentralisation of Powers (popularly known as the ‘Sen Committee’ named after its Chairperson late Dr. S.B.Sen) and decided on a rational allotment of functional responsibilities among them. Thus the Kerala Panchayat Raj and Municipality Acts were radically restructured to go beyond the 11th and 12th Schedules of the Constitution by attempting to define clearly the functional areas of the different tiers and types of LSGIs as precisely as possible.

- 4.10.2 The 11th and 12th Schedules of the Indian Constitution actually do not carve out the functional domains of LSGIs. They only list developmental areas where, if so decided by the state government, LSGIs could have a role in planning for economic development and social justice and in the implementation of such plans. But Kerala has demarcated the functional domains of LSGIs with a great degree of clarity. The Kerala Acts classify functions as mandatory functions, general functions and sector-wise functions. The functions assigned to the three tier Panchayats and Urban Local Bodies are given in Annexure 4.3. In areas related to infrastructure and management of public institutions, the functional differentiation is sharp and clear, but in productive sectors it is difficult to clearly earmark functions separately for each tier. Only through experience can the natural functional area in such sectors get defined. There is a clear recognition of the existence of a role-range for LSGIs – Agent, Adviser, Manager, Partner and Actor – with the objective being to reduce the agency role and expand the autonomous – actor role.

4.11

FURTHER TRANSFER OF STAFF TO LOCAL GOVERNMENTS

After the amendments to the Acts the Government decided to

transfer the district level offices to the District Panchayats and rationalise the staff structure for better service to other tiers of local governments. Of particular relevance, is the decision to provide additional engineering support as per which, there would be three Engineering Circles under Superintending Engineers, each District Panchayat will get an additional division under an Executive Engineer, all the Block Panchayats would get an Assistant Executive Engineer each and 573 Assistant Engineers would be deployed among Village Panchayats in such a manner that 203 large Village Panchayats would get one engineer each and others at the rate of one engineer for two Panchayats. For the Urban Local Bodies one Superintending Engineer each would go to the two new Corporations, one Executive Engineer to each of the 12 Grade I Municipalities and one Assistant Executive Engineer to each of the remaining 41 Municipalities.

4.12

EXTENT OF DECENTRALISATION – AN ASSESSMENT

- 4.12.1 The quantum of resources transferred and the range of responsibilities assigned to LSGIs and the strength of staff placed under their control give an idea of the extent of responsibilities assigned to LSGIs. As each year progresses there is clear evidence of Government withdrawing from areas allotted to the LSGIs so that the constitutional mandate of setting up institutions of self government is realized within a short period of time.
- 4.12.2 The extent of decentralisation is encapsulated in the following statements.
- (1) In the Health sector all institutions other than medical colleges and big regional speciality hospitals have been placed under the control of the LSGIs.
 - (2) In the Education sector, in rural areas the high schools

have been transferred to the District Panchayats and the primary and upper primary schools have been transferred to Village Panchayats; in urban areas, all schools have been transferred to the ULBs.

- (3) The entire responsibility of poverty alleviation has gone to the LSGIs; all the centrally sponsored anti-poverty programmes are planned and implemented by them.
- (4) As regards Social welfare, barring statutory functions relating to juvenile justice, all the responsibilities have gone to LSGIs. The ICDS is fully implemented by Village Panchayats and Urban Local Bodies. Care of the disabled, to a substantial degree, has become a local government responsibility.
- (5) In the Agriculture and allied sectors, the following have become the de facto and de jure local government functions.
 - a) Agricultural extension including farmer - oriented support for increasing production and productivity.
 - b) Watershed management and minor irrigation.
 - c) Dairy development.
 - d) Animal Husbandry including veterinary care.
 - e) Inland fisheries.
- (6) Barring highways and major district roads, connectivity has become a local government responsibility.
- (7) The whole of sanitation and almost the entire rural water supply have moved over to LSGIs.

- (8) Promotion of tiny, cottage and small industries is mostly a local government task.
- (9) All the welfare pensions are administered by the LSGIs.

Thus it is clear that, in terms of governance, more than half is with the LSGIs.

- 4.12.3 As of now government pays the salary and meets other operational costs particularly in health institutions. All the other responsibilities of providing new infrastructure and equipment to attain the minimum standards and of maintaining the assets transferred have become the burden of the LSGIs. For example 282 Krishi Bhavan offices, 2561 Lower Primary Schools; 962 Upper Primary Schools, and 6911 Anganwadis have been transferred to the Village Panchayats alone. In addition the Village Panchayats have to provide new buildings to 2040 Family Welfare Centres, 207 PHCs and 9199 Anganwadis.
- 4.12.4 Thus, in Kerala, LSGIs now share several responsibilities in varying degrees with the state government. And naturally, to perform these responsibilities, they deserve the proportionate share of state government resources.

CHAPTER 5

The First State Finance Commission

INTRODUCTION

- 5.1 The first State Finance Commission which was set up along with the enactment of the Kerala Panchayat Raj Act 1994 and one month before the enactment of the Kerala Municipality Act 1994 started functioning from 23rd April 1994 and submitted its report on 29th February 1996. The context in which the First SFC functioned needs to be noted. Till October 1995 there were no elected bodies. The Village Panchayats and Municipalities were run by Administrative Committees, which consisted of the elected members who were there before the expiry of the term of office; and in the Corporations, District Collectors were posted as Administrators. And in Kerala there were no District Panchayats or Block Panchayats before 1995.
- 5.2 Elected local governments assumed office on the 30th of September 1995 and powers and functions as envisaged in G.O.(P)89/95/LAD were transferred on 2nd October. The fact that the First SFC had to give its Report within five months of the functioning of the newly elected local governments and before the contours of Government policy on decentralisation became clear notionally placed several constraints on it. It was too early for the Commission to determine the quantum of responsibilities which actually would move out of the State Government into the hands of the local governments.

SIGNIFICANCE OF THE RECOMMENDATIONS OF THE FIRST STATE FINANCE COMMISSION

5.3 In spite of the constraints, the first SFC broke new ground in several ways. They are listed below:

- (1) It made a number of suggestions with the objective of increasing the magnitude of financial devolution from the State Government to local governments. A very significant recommendation was the one to earmark one percent of the State Government's current revenue for transfer to the rural and urban pools to be set up for the purpose. Even though the recommendation as such was not accepted by the State Government, this idea of a fixed percentage from the State Government revenue being devolved to local governments was a novel one in the Kerala context and it constitutes an important principle informing the Report of the Second State Finance Commission.
- (2) Implicit in the suggestion for setting up the rural and urban pools was an attempt to change the inter se distribution of resources among the LSGIs. It attempted to move away, even though in a small manner, from the 'place of collection' to the population criterion, which was a step towards greater equity.
- (3) The First SFC highlighted the importance of the maintenance of assets of LSGIs, both own and transferred assets. The problem of reduced allocations for maintenance due to the squeeze on non-plan allocation is becoming acute day by day. This would be very critical for local government functioning in future as most of the social infrastructure assets having direct interface with the public have been placed under the control of LSGIs. The

Commission had laid down the principle that the maintenance requirements should be calculated on the basis of the current replacement cost and not on historic cost. Though the State Government did not accept the suggestion it has certainly influenced the Second SFC in its assessment of the maintenance needs, to quantify the devolution required for reasonable maintenance of assets transferred to LSGIs as well as of new assets created by them using plan funds.

- (4) The First SFC made innovative recommendations for rationalization of tax collection to avoid inefficiency and leakages. Taxing of buildings on plinth area, levying entertainment tax related to seating capacity and occupancy ratio, preparing tax maps etc., are very significant recommendations, which the Second SFC fully endorses.
- (5) The First SFC enunciated the principle of moving away from tied non-plan grants to untied non-plan grants, a very essential ingredient of financial autonomy for LSGIs. By virtue of its recommendations 16 tied grants were amalgamated into the Rural Pool and a similar attempt has been initiated for urban areas.
- (6) Though the First SFC confined itself largely to non-plan devolution, significantly enough, it suggested transfer of at least 25% of the Centrally Sponsored Anti Poverty Programmes, thus hinting at the principle that local governments could implement plan programmes and the SFC could deal with plan transfers.
- (7) A very important contribution of the First SFC was laying down transparent formulae for various kinds of devolution.

Thus grants to local governments were brought into the realm of entitlements and all forms of discretion which were used earlier to discriminate among LSGIs, were taken away with the acceptance of the report of the First SFC.

- (8) The First SFC had rightly stressed the need for continuous data gathering on local government finances. The Second SFC reiterates this need.
- (9) The First SFC gave a comprehensive picture of the local government finances by providing an update, which was a very difficult thing to do in the absence of proper data. The analysis of the finance of Village Panchayats and Municipalities - the distinguishing features and their rationale, the problems and the potentialities, the distortions and their correctives - has proved very useful.

STATUS OF IMPLEMENTATION OF THE RECOMMENDATIONS OF THE FIRST SFC

- 5.4 The recommendations of the First SFC could be classified into four groups.
 - (1) Devolution of funds to local governments.
 - (2) Augmenting resources of local governments.
 - (3) Rationalisation of fiscal systems of local governments.
 - (4) Miscellaneous issues.
- 5.5 Out of the 69 important recommendations, 63 were accepted by the Government. A good number of recommendations involved amending the concerned legislations and rules. Naturally this

has proved to be time consuming. Also some of the recommendations had to be implemented by departments other than the Local Self Government Department. Therefore at this point of time some of the recommendations of the First SFC including very important ones like rationalization of property tax, tax mapping etc., have not been fully operationalised even though they were accepted by the Government. The status of implementation of the various recommendations of the First SFC can be seen in Annexure 5.1.

RECOMMENDATIONS OF THE SECOND SFC FOR OPERATIONALISING THE RECOMMENDATIONS OF THE FIRST SFC

- 5.6 The Commission strongly feels that the accepted recommendations of the First SFC should be operationalised immediately with no further delay. It is necessary to implement them in full, as some of the recommendations of this Commission are built on the recommendations of the predecessor Commission. This Commission would therefore reiterate the following recommendations of the First SFC and call for quick, special follow-up to carry the implementation process to the logical end.
- (1) The rules for levying Property Tax may be notified and the assessment work started in January 2001 itself. Some general suggestions in this regard are given in Chapter 9.
 - (2) In the case of Profession Tax in respect of self-employed professionals like Doctors, Lawyers, Accountants etc., the First SFC had suggested slab rates. This has not been implemented. Second Finance Commission has separately recommended slab rates for presumptive taxes, which would cover these categories.

- (3) Service Tax may be levied as an independent tax by the urban and rural local governments. Further legislative action is needed.
- (4) Operational instructions need to be given in the form of rules and guidelines in respect of collecting Entertainment Tax based on seating capacity. The Second SFC would further elaborate on this in the second part of its Report.
- (5) Rules for levy of Advertisement Tax in Village Panchayats and Municipalities may be issued at the earliest along with model byelaws. A few guidelines are indicated in Chapter 9.
- (6) The First SFC had suggested revision of rates of fees and other similar non-tax sources. This has been partially implemented. The Second Finance Commission is recommending thorough revision in Chapter 9.
- (7) Steps to finalise the minimum land value for use in registering sales may be taken immediately.
- (8) Further action may be taken to charge licence fee from Cable TV Operators. As regards the question of collecting Entertainment Tax from Cable Operators the Second Finance Commission's view is that it should be done through necessary legislative amendments.
- (9) The suggestion for amending the Building Tax Act to ensure that the tax is paid to the concerned local government would become infructuous once government accepts this Commission's recommendation for a general sharing of tax revenue.
- (10) The tax mapping should be done immediately in all local

governments and the unique premises numbering system followed.

- (11) The First SFC had suggested that the Rural Development Board be made into a financing agency and that soft loans should be given both by the Rural Development Board and the Kerala Urban Development Finance Corporation. This matter will be dealt with in detail by the Second Finance Commission in the second part of its Report. However, it is suggested that a single financing agency would do for all LSGIs, both urban and rural.
- (12) Though building exemption has been taken away, compounding is still being resorted to in the process of regularization of constructions made on or before 1-1-2000. 50% of the fee thus realized should go to the concerned Village Panchayat and Municipality.
- (13) The question of Village Panchayats and Municipalities levying daily fee for use of poramboke may be examined and decided by Government without further delay.
- (14) The rationalization of Revenue Village and Village Panchayat/Municipality boundaries may be done in such a way that each such LSGI has one or more full revenue villages within its boundary i.e., no revenue village would lie within more than one Village Panchayat or Municipality.
- (15) As suggested by the First SFC a special Cell has been created in the Finance Department. This Cell should be revamped and assigned the task of regular monitoring of the finances of LSGIs, both income and expenditure.

- (16) The recommendations of the First SFC were accepted in 1997. Strictly speaking they should have been made effective from 1-4-1996. However they are legally in force since 1-4-1997. Therefore any shortfall in devolution, below the accepted level in respect of assigned and shared taxes should be made good by the government.

CHAPTER 6

THE DEVOLUTION AND *INTER* SE DISTRIBUTION OF PLAN FUNDS

- 6.1 The decision to transfer 35-40 percent of plan outlay to LSGIs, who are then left free to spend the amount on plan projects formulated by themselves, has been a historic one. While panchayats as active institutions exist in several other states in the country, notably in West Bengal which played a pioneering role in activating them and in Karnataka, the Kerala model of democratic decentralisation is unique in so far as it has three specific features not found elsewhere: the first is the quantitative magnitude of devolution; nowhere else is such a high proportion of plan funds handed over to the LSGIs. The second and related feature is the freedom accorded to LSGIs to make plans according to their own priorities. There exists of course a system of vetting of local plans at higher levels, which is essential for avoiding unnecessary duplication, for ensuring complementarities, and for enforcing compliance to state government guidelines. But subject to such general constraints, the priorities informing any local plan are respected. The third feature has to do with the fact that there is a clear demarcation of responsibilities between the state Government and the LSGIs. These three features make the Kerala practice the first authentic attempt, anywhere in the country, at planning from below. Not surprisingly, it has unleashed, by all accounts, unprecedented enthusiasm among people, attracted much attention from other states, aroused a great deal of curiosity all over the world, and earned wide acclaim in intellectual circles as representing a breakthrough in conception, a breakthrough

which has even been hailed as “a synthesis of Gandhi and Marx”.

- 6.2 There can be little doubt that Kerala’s ability to achieve this breakthrough can be attributed to the fact that it was a part of the Peoples’ Plan Campaign. The significance of this Campaign, and the array of measures of democratic decentralisation which followed in its wake (of which the devolution of 35-40 percent of plan outlay to LSGIs is only one), have been described in an earlier chapter. Here we would like to reiterate our belief that a minimum share of plan funds of this order of magnitude should continue to be transferred to the LSGIs every year. While we recommend this for the next five years which constitute our jurisdiction, we hope this practice would be carried forward thereafter too. To be sure, there are several problems associated with the present practice of decentralised planning. Some of these are discussed below. But these in no way negate the worth and legitimacy of the experiment, which should be seen not merely in narrowly economic terms as an alternative, more effective, model of planning, but more importantly as a means of deepening democratic structures in our country.
- 6.3 Any estimate of the actual percentage of devolution of plan funds to the LSGIs is sensitive to the definitions used. In 1999-2000 for instance the plan grant-in-aid as a proportion of state plan outlay was supposed to be 31.4 percent (Rs.1020 cr. compared to Rs. 3250 cr.). But this ratio goes up, if we include state-sponsored schemes, to 35.5 percent (Rs. 1154.4 cr. compared to Rs. 3250 cr.). The term “state-sponsored schemes” came to be used from 1997-98 to denote two categories of schemes. Each of these categories is a part of the state plan but is implemented by LSGIs. The first category consists of certain national and state level schemes especially in health, poverty alleviation etc. These are likely to continue for some time. The second category consists of those schemes which were originally covered under the departmental allocation in the state plan but were transferred

to LSGIs in the transitional phase. These would decline naturally with the passage of time, and have been doing so. The total outlay on state-sponsored schemes has in fact been declining, from Rs.276 cr. in 1997-8 to Rs.166.50 cr.in 1998-9, to Rs.134.40 cr.in 1999-2000 (RE). As long as state sponsored schemes exist the outlay on such schemes should not be counted as part of total devolution, but should be treated as an additionality: counting them as devolution causes a hiatus between the actual and apparent magnitudes of funds left to the domain of LSGI decision-making. (What appears for instance as 35 percent devolution actually means less, as we have seen for 1999-2000). Our recommendation is that a minimum of one-third of the state's plan outlay in any year should be statutorily transferred to the LSGIs, and that in computing this ratio the transfers on account of state-sponsored schemes should be excluded from the numerator. This is convenient for framing appropriate legislation and corresponds on present reckoning to over 35 percent plan outlay, including state-sponsored schemes in both the numerator and the denominator¹

- 6.4 We now come to the problems associated with transferring such huge amounts of plan funds to LSGIs. Among the many problems that can be identified we would focus on four broad sets of problems here. Two of these will be discussed here only cursorily since they would be taken up in the second part of our report. The first of these is the absence of an adequate permanent institutional framework for decentralised planning, which makes the exercise a “voluntaristic” one, not de-linked from a

¹. The figure 35-40 percent was originally arrived at through some studies which showed, on the basis of historical data for the state, that the proportion of plan outlay which could in principle fall within the province of district-level planning (including planning by tiers below) was around this. It has acquired an added legitimacy from practice which induces us to stick to this figure.

“Campaign mode”. An example of this absence of an institutional framework is the fact that the decision to transfer 35 percent of plan funds to LSGIs has itself till now been only an administrative decision, reversible at any point of time. It has been without any statutory basis whatsoever (a lacuna that we hope our recommendation would remove). But more generally, planning of any kind requires trained personnel. A cadre of trained personnel appropriate for this kind of planning, has not yet been fully created. Decentralised planning has had to make do with whatever personnel are available from voluntary organisations and the ranks of locally available experts. Some no doubt would see a virtue in the present state of affairs: the Campaign mode arouses popular enthusiasm, while shrouding decentralised planning within an institutional framework would lead to bureaucratisation, ossification, and “routinisation”, all of which are inimical to the spirit of popular participation. In short the fear may be expressed that the very process of institutionalising decentralised planning would rob it of its authentic democratic character, i.e. would make people passive objects all over again, from being, in howsoever limited a fashion, active subjects. While this fear is not without justification, it is nonetheless the case that voluntarism is essentially impermanent, that the “Campaign mode” can never be sustained for long, so that eschewing institutionalisation eventually means throwing the baby out with the bathwater. The need is to combine active popular participation with an appropriate institutional framework which would make the existing government staff, both professionals and generalists, fully involved. The process of bringing into being an appropriate institutional framework for decentralised planning is currently underway in the state. Ensuring that active popular participation in planning is not destroyed as this framework comes into being will be one of the challenges before decentralised planning in the coming years.

6.5 The second problem relates in a broad sense to the issue of

corruption. Corruption, without a doubt, exists in several different forms in the decentralised planning system. But then so it did, even earlier, i.e. prior to the increased devolution of plan funds. There is no reason to believe that the scale of corruption in the use of plan funds has increased in any way after devolution; indeed several knowledgeable observers have the impression that it might have decreased. Its continued existence nevertheless is a source of concern. The fact of popular participation, and hence vigilance, should have the effect of reducing at least certain types of corruption. On the other hand however the absence of an appropriate institutional framework for decentralised planning would provide scope for corruption. Putting it differently, a comparison of the earlier planning *system* with an alternative *system* of decentralised planning with popular participation would associate a much lower level of corruption with the latter. It follows that if corruption exists on a by-no-means-modest scale in the present dispensation, then this is at least partly due to the fact that the *system* of decentralised planning, complete with its own institutional framework with its new checks and balances, has not yet been put in place. Once the institutional framework for decentralised planning is erected, the scale of corruption should come down significantly. The recent appointment of an Ombudsman is an example of an institutional framework gradually coming into place, which should reduce the scope for corruption. A more elaborate discussion of these issues together with specific suggestions will be made in the second part of our report.

- 6.6 The third problem springs from the type of plan projects which small bodies, such as the panchayats, are intrinsically capable of undertaking on their own. These typically are tiny projects catering to local needs. Transferring substantial plan funds to them would necessarily result in a proliferation of such projects. While this would not be a bad thing at all for a certain period of time (since centralised decision-making typically ignores local

needs, and has done so in our country), a continuous replication of such projects, with progressively lesser and lesser social usefulness, can scarcely be justified, especially when resources are being taken away from larger state-level projects which might be essential for the state's economic health. Putting it differently, a devolution of 35 percent of plan funds continuing not just into the immediate, but also into the more distant, future would be justified only if the composition of projects on which this amount is spent can be made to keep changing in consonance with the changing requirements of the people. This in turn requires that the LSGIs should be capable of overcoming their narrow, "small bodies" horizon. Village panchayats, for instance, should in the next phase be prepared to collaborate with one another to undertake meso-level projects, or even macro-level projects. In short the transfer of resources to the lower level should not mean a perpetual entrapment in mini-projects of progressively decreasing rationale. One can go further. The LSGIs have to break out at some stage not only from their narrow micro-project preoccupation, but also from their almost exclusive role of being purveyors of welfare goods and services to the people. To be sure, the need for such goods and services can hardly be overemphasised, but the word to note is "exclusive". Even for providing a larger flow of welfare goods and services to the people at a later date, the LSGIs may have to take on a more diversified role, aimed at augmenting the means at their disposal. Many of them of course provide help at present to deserving *private individual* producers in their respective areas, but this has not generally been a source of revenue for them. It has been an extension of the welfare-purveyor role. They have to pay greater attention to means augmentation possibilities while rendering such help. In addition, LSGIs can also boost their resources by eliminating the wastes and "leakages" that entrusting public work programmes to middlemen entails, and by undertaking innovative output augmenting local projects which can yield larger revenues as well. Taking up government contracts for civil construction

for a reasonable centage charge is a possibility work exploring. The third problem for decentralised planning would arise therefore if the LSGIs do not show sufficient flexibility to transform and broaden their nature. If they continue to remain mere conduits for distributing welfare goods and services, then even this role cannot be sustained in the not-unlikely event of a worsening of the fiscal squeeze experienced by the central or the state government, for then, as this squeeze gets “passed downwards”, they would find themselves increasingly bereft of resources.

- 6.7 The fourth problem concerns the inadequacy of the LSGIs’ own tax effort. It is often asserted that there has been a slackening of the LSGIs’ tax effort as larger plan funds have been made available to them. While hitherto- published research attempting to establish this slackening hypothesis is not convincing, the view that such a slackening has actually occurred is widely held in knowledgeable circles. Time-series data do show a lower level of revenue in recent years compared to what a long-term trend fitted to earlier data would project, but this *per se* does not constitute proof of slackening. Besides, this shortfall relative to trend pre-dates the increase in devolution that came with the Peoples’ Plan Campaign. But whether or not there has been an actual slackening on account of the larger devolution, the fact remains that LSGIs’ tax collections are way below potential. This makes them almost entirely dependent on devolution from the state government and hence extremely vulnerable to the fiscal travails afflicting the state, and hence by implication the central, government. In the absence of adequate local-level resource mobilisation the base for decentralised planning remains extremely fragile. We recognise of course that resource mobilisation is not synonymous with raising larger tax revenue: the former can take several forms, such as for instance mobilisation of voluntary labour by LSGIs, of which tax effort is only one. It has also been brought to our notice that not an inconsiderable amount of additional resource

mobilisation has occurred in LSGIs, even when conventional indices like tax revenue have shown unimpressive increases. Nonetheless, given the indubitable fact that tax collections by LSGIs have been much below potential, our Commission has felt the need to recommend the introduction of a system of reward for tax effort through an amendment in the formula for the *inter se* distribution of plan funds.

6.8 The first Finance Commission had suggested the following criteria for the *inter se* distribution of plan funds.

| | ULBs | RLBs |
|--|-------------------|-------------------|
| <i>Population in 1991 Census</i> | <i>75</i> | <i>70</i> |
| <i>SC/ST Population in 1991</i> | <i>10</i> | <i>10</i> |
| <i>Total Workers Excluding Workers in Manufacturing, Processing, Servicing, and Outside household industry</i> | <i>15</i> | <i>10</i> |
| <i>Proportion of Agricultural Workers among Workers</i> | <i>Nil</i> | <i>10</i> |
| <i>Total</i> | <i>100</i> | <i>100</i> |

6.9 The Finance Commission had not explicitly demarcated between the different tiers of the PRIs and ULBs, the presumption being that the above criteria would apply within each tier, while the division *between* tiers would continue in the same ratios as were prevailing at the time. The Cabinet Subcommittee set up to examine the First SFC report felt that, instead of the formula recommended by the Commission, plan funds may be distributed according to a simple formula giving 90 percent weight to population and 10 percent to area. The distribution of funds in

1997-8, the year when plan grant-in-aid was greatly increased, was however entirely on the basis of population alone. The Planning Board set up a Working group in October 1997 to look into the matter and evolve a fresh formula for the *inter se* distribution of plan funds. This formula, on the basis of which plan funds are distributed at present is the one set out in Chapter 3 above.

- 6.10 The total amount of transfers to local bodies is distributed between the General Sector, claiming about 75 percent, the SCP about 21 percent, and the TSP about 4 percent. The distribution of General Sector funds between the PRIs and the ULBs is in the ratio of 85 and 15, and within the former the distribution between the GPs, BPs, and DPs is in the ratio of 70, 15 and 15. SCP and TSP funds are shared between urban and rural LSGIs on the basis of the SC/ST population. The ratio of distribution between tiers however is somewhat different here compared to the General Sector funds: for SCPs it is 60, 20, 20, while for TSPs it is 40, 20, and 40. The *inter se* distribution of General Sector funds across institutions within each tier is now undertaken, as already mentioned, on the basis of the formula given in Table 3.2.9 of Chapter 3.
- 6.11 While suggesting that the tax effort, or more accurately the revenue effort, criterion should be introduced in addition to the above, we propose not to disturb the current pattern of distribution of plan funds among the various tiers. The revenue effort criterion should be introduced only at the stage of *inter se* distribution within a tier. It follows that this criterion can be introduced only in the Grama panchayats and ULBs which alone have significant revenue raising capacities. To see how we propose to introduce the revenue effort criterion into this scheme, let us

first look only at Grama Panchayats. We wish to earmark a maximum of 10 percent out of the plan funds destined for Grama panchayats for distribution on the criterion of revenue effort. This percentage, which is not a fixed one but varies from year to year, has to come out of the 65 percent currently distributed on the (Non-SC/ST) population criterion. This percentage should be arrived at as follows. In any particular year some panchayats will show an increase in their revenue (consisting of all revenue from taxes, fees and other sources¹) over the previous year, while others will show either a decline in revenue or the same level of revenue. Let the number of panchayats showing an increase in revenue be n , while the total number of panchayats is N . The percentage of plan funds distributed on the revenue effort criterion *in the following year* (by which time the relevant data regarding revenue collections by the panchayats would have become available) will then be $10.n / N$. If for instance out of 990 village panchayats in a particular year only 371 show an increase in revenue (over the previous year) then the proportion of plan funds distributed on the revenue effort criterion in the following year will be (10 multiplied by 371) / 990. We recommend that in actual calculation, 990 should be rounded off to 1000 for simplicity. Adopting this procedure, the proportion distributed on the revenue effort criterion would be 3.71 percent, and the proportion distributed on the Non-SC/ST population criterion would be 61.29 percent. Once the amount of plan funds to be distributed on the revenue effort criterion in any particular year is so determined, this amount has to be

¹ *There have been instances, where due to some government or Court order, revenue has not been collected for some time under some particular head, and the lifting of the ban causes a sudden jump in revenue under that head. Since jumps of this sort would cause a distortion in the application of our proposed criterion, we suggest that in all such cases the increase in revenue under this head in the year of the jump should be ignored. This head should begin to count only from the next year onwards.*

distributed among the panchayats which did raise their revenue, i.e. the 371 panchayats in the above example. For this we recommend the following procedure. For each of the 371 panchayats there is a certain *percentage* increase in revenue in the year just completed over the preceding year. This percentage for any panchayat multiplied by its population gives a number for that panchayat. The share of that panchayat (in the total amount available for distribution on the revenue effort criterion) is this number divided by the sum of such numbers for all the 371 panchayats. If the share for panchayat i is denoted by θ_i , the percentage increase in its revenue is given by r_i , and its population by P_i then

$$\theta_i = r_i \cdot P_i / \sum r_i \cdot P_i$$

- 6.12 A simple example will clarify the proposed procedure. To do so however let us take a smaller number of panchayats showing a revenue increase. Let the number be 10. Then 10 times 10 divided by 1000, i.e. only 0.1 percent of plan funds will be distributed on the revenue effort criterion and 64.9 percent on the non-SC/ST population criterion. Suppose the plan grant-in-aid earmarked for Grama panchayats is Rs.1000 crores; then Rs.1 crore will be distributed on the revenue effort criterion. How will it be distributed? Suppose the percentage increases in the revenue of the 10 panchayats are respectively, 1, 2, 3, 4, 5, 6, 7, 8, 9, and 10. And suppose their populations are respectively 100, 200, 300, 400, 500, 600, 700, 800, 900, and 1000. Then the share of the first panchayat will be (1 times 100) / (1 times 100 + 2 times 200 + 3 times 300 + 4 times 400 +.....). The respective shares of the ten panchayats in the pool of Rs.1 crore work out in this fashion to: 1/385, 4/385, 9/385, 16/385, 25/385, 36/385, 49/385, 64/385, 81/385, and 100/385. These shares add up to 1.

- 6.13 In the actual application of the formula however we suggest a modification. Since we are taking percentage increases, a Panchayat with a low base can show a phenomenal increase in a particular year and hence get unduly rewarded by our formula. Likewise a Panchayat which shows a negative increase in one year and a large increase in the following year would stand to gain by our formula (since we are not directly penalising negative increases). To avoid such quirky results, *we propose to count all percentage increases of 30 or above as 30*. The reason for taking 30 as the ceiling is the following. From simulations carried out on data for 1998-9 and given in an Annexure, it turns out that the difference made to the big losers from alternative ceilings is negligible. This being the case, since the incentive effect for the others would get blunted if we take a very low ceiling, say 10 or 20 percent, we have decided to take 30 percent as the ceiling.
- 6.14 We recommend an exactly analogous procedure for incorporating revenue effort into the criteria for the distribution of plan funds among the ULBs. Here too a maximum of 10 percent of the plan funds earmarked for ULBs can be set aside for distribution on the revenue effort criterion. The actual percentage would be given by this maximum multiplied by the proportion of ULBs showing revenue increases, and this percentage would come out from the 75 percent currently earmarked for distribution on the population criterion. Likewise the *inter se* distribution of this amount among the ULBs would be on the basis of the following formula: the share of any ULB = percentage increase (subject to a maximum of 30 percent) in its revenue during the previous year times its population / the sum of the percentage increase in revenue times population of all such ULBs (which show revenue increases). *Revenue in this entire discussion, we wish to emphasise, includes only taxes, fees and license fees, and other incomes, which are the result of the LSGIs' own effort. It excludes what they get from shared and assigned taxes, the other non-plan grants, and of course the plan grants, from the state government.* In short,

the term “revenue” used in this context is synonymous with “own collected revenue”.

- 6.15 Let us now turn to the rationale of the above formula. Ideally, revenue effort should be evaluated by looking at the actual revenue collections in comparison to some notion of potential revenue generating capacity. Unfortunately we simply do not have the data to calculate this potential capacity for each and every LSGI. Looking at *increases* in revenue as an indicator of effort is only a convenient proxy. Here, introducing *explicit* penalties for LSGIs showing reductions in revenue would be unfair, and would inevitably result in appeals to discretion on pleas of special circumstances, which would have the effect of undermining the entire system. We have therefore introduced penalties indirectly, not merely through an exclusion from reward for revenue increases, but through consignment to a group that only shares a reduced amount available for distribution on the population criterion. The precise formula of course has been dictated by the need to have “well-behaved” properties (which also constitute a reason for the exclusion of “negative” transfers, i.e. of explicit penalties for reduced revenue collection), and the need to avoid absurd results. For instance, a variable proportion of plan funds is supposed to be distributed on this criterion, as opposed to a fixed proportion on other criteria, because of the need to avoid absurd results. If in a particular year, say, only 10 panchayats happen to show an increase in revenue, then, with a fixed 10 percent distribution on revenue effort basis, they would walk off, in the above example, with nearly Rs.100 crores between them, which would be extremely unreasonable (especially since we are using ordinal terms like “increase” and “decrease”). As for the actual formula for the *inter se* distribution from the pool earmarked for rewarding revenue effort, it satisfies the property that if all panchayats showing revenue increases showed the same percentage revenue increases, then the pool would be shared among them exactly in the same ratio as their non-SC/ST

population, which is perfectly reasonable. On the other hand the above formula also says that if all panchayats showed a reduction or constancy in revenue collections, then again the size of the pool would be zero, so that the entire 65 percent of plan funds would be shared among grama panchayats (75 percent for ULBs) on the non-SC/ST population criterion, the same as is the practice now. In such a case in other words, all being delinquent, none would be singled out for punishment, which too is reasonable.

- 6.16 The real limitation of the above formula arises from the fact that we are taking percentage increases. This gives rise to two different kinds of problems: the first is the “low base” effect. For example, if a panchayat had zero (or very low) revenue in one year and some increase in the next year, then its rate of growth would be infinitely large, giving it an enormous, illegitimate advantage. One way of avoiding this problem is to divide the absolute increase in revenue by the total income of the inhabitants of a panchayat (or some similar variable). But we do not have data on the total income of the inhabitants of a panchayat. Taking the expenditure by panchayats as the denominator, while it would get rid of the low base problem, would work against the poorer panchayats. All things considered, therefore, there is no easy alternative to taking percentage increases in revenue as the proxy for revenue effort. And it may not be a bad proxy in practice. Nonetheless, to guard against anomalies, we are suggesting a maximum figure of 30 for the percentage increase in revenue. The second problem with taking percentage increases is the fact that the revenue raising capacity of panchayats and ULBs is subject to a limit that does not move up much from one year to the next. It does not even go up in tandem with price increases or real income increases of residents within their jurisdiction, since a good part of this revenue is supposed to come from property taxation, and the revenue to be raised from a particular property can be adjusted only at discrete intervals. As a result,

even with the best of intentions some local bodies will find it difficult to raise their revenue beyond a point. Any criterion that looks only at percentage increases in revenue therefore is potentially discriminatory against them. This no doubt is an important consideration, but its practical relevance over the next five years may not be all that much. The current level of revenue mobilisation relative to potential is too low in the case of all Panchayats and ULBs for us to worry about the implicit discrimination against those that have hit or are close to their revenue-raising capacity. What is true however is the fact that this formula, though adequate for the coming five years, should not be continued *ad infinitum*. True, the low base effect would disappear over time, but the other factor mentioned above would introduce serious biases as some local bodies approach their revenue-raising ceiling.

- 6.17 Let us now turn to the practical problems of using the above formula. While the mechanics of making the necessary computations are quite simple and non-time consuming once the data on tax and non-tax revenue collections by the local bodies are available, the real problem lies in obtaining reliable revenue collection data. To overcome this, our recommendation is that it should be made mandatory for all local bodies to have a separate account with the treasury where collections from all items constituting their own income, and only such collections, are deposited. Then these data would be easily available to the state government from the treasury, and would be useful for a number of purposes quite apart from the employment of the revenue effort criterion for determining the *inter se* distribution of plan funds. Of course even if this statutory provision is introduced, local bodies would not necessarily comply with it immediately. To goad them into doing so before more drastic action is taken against the deviants, a particular date should be fixed from which the revenue effort criterion should be introduced into the distribution of plan funds; and all local bodies for whom there

is no treasury-authenticated information on revenue collection, should *ipso facto* be treated as if they have not had any revenue increases and thereby excluded from any distribution under this head. Announcing such a date in advance would also be useful for another reason, namely, any sudden drops in plan funds for particular LSGIs can be avoided if they intensify revenue collection effort owing to prior warning. (And if they do not, then they can scarcely claim injured innocence). For an early introduction of the revenue effort criterion, it is essential that the government should bring in this statutory provision as soon as possible. Since the criterion is based on increases, time-lags are intrinsic to it.

- 6.18. A simulation exercise on the basis of the data given to us on PRI and ULB revenues has been carried out to determine what would have been the distribution of plan funds in 1998-9 if the revenue effort criterion had been applied in that year. Some results from a comparison of this distribution with the actual distribution is given in an Annexure 6.1.