

## **EXECUTIVE SUMMARY**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Source: State Finance Commission Reports and Action Taken Reports.

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

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

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

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

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

## **KEY AREAS OF RECOMMENDATIONS**

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

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

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

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

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

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

Source: State Finance Commission Reports and Action Taken Reports.

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

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

Source: State Finance Commission Reports and Action Taken Reports.

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

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

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

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

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

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

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

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

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