

# A REPORT CARD OF STATE FINANCE COMMISSIONS

Recommendations of State Finance Commissions of all Generations  
and their Implementation Status in India

## Part I- Main Report

*Sponsored by*



Ministry of Panchayati Raj  
Government of India

*Commissioned to*



The Indian Institute of Public Administration  
New Delhi- 110 002

July 2016

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V N Alok

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*by*

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With research support from

Ambar Zahara

Ankita Singh

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## Preface

*“I believe in cooperative federalism”*, declared Prime Minister Narendra Modi in his first session of Parliament. In his assertion, Prime Minister’s connotation of ‘cooperative federalism’ was somewhat similar to the notion advanced in other federations particularly Germany and the US where the concept was used to make local and sub-national governments work in tandem with the federal government to achieve shared national goals.

In the last two years, the story of cooperative federalism unfolded almost every day. The recommendations of the Fourteenth Finance Commission are the key elements in this process. Mechanism that determines funds flow to states has undergone sea changes enabling states to enhance their own fiscal space which was restricted due to discretionary fiscal transfers in the past from the union to states. Likewise, the Commission also recommended strengthening State Finance Commissions (SFC) to improve the state –local fiscal relations and to streamline funds flow to local governments for efficient delivery of local public goods. The recommendation reads as follows *“State Governments should strengthen SFCs. This would involve timely constitution, proper administrative support and adequate resources for smooth functioning and timely placement of the SFC report before State legislatures, with action taken notes”*

The Ministry of Panchayati Raj had taken the cognizance of the recommendation and requested the Institute on 26 August 2015 vide sanction letter number T-11013/8/2015 – AR&RS (E-office) to study the “recommendations of various State Finance Commissions (SFCs) and their implementation status across the country.

The SFC is an autonomous institution and mandated under Article 243 I of the Constitution to review the financial position of the panchayats and make recommendations to the Governor on the principles that should govern:

- i. The distribution between the State and the Panchayats of the net proceeds of the taxes, duties, tolls and fees leviable by the State, and their *inter se* distribution between the Panchayats at all levels for such proceeds;
- ii. The determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by, the Panchayats;
- iii. The grants-in-aid to Panchayats from the consolidated fund of the State;
- iv. The measures needed to improve the financial position of the Panchayats;
- v. Any other matter in the interests of sound finance of the Panchayats.

With few exceptions, the states have verbatim reproduced the constitutional provisions and placed them as the terms of reference for the SFC. However, significant variations are

noticed in the approach, methodology and recommendations of the SFCs across states and time. While a few research papers examining an SFC report of a state are available, comparative study of all the reports is not available at one place. This is primarily because all SFC reports and their Action Taken reports (ATRs) are not easily available. The present study attempts to analyse variations across states and time and present trends, in several dimensions. The report also presents the summaries of the recommendations of almost all reports and the actions taken by state governments on these recommendations.

Data for this study were collected from the available secondary sources viz., 71 SFC Reports and several Panchayati Raj Acts of various States. The Ministry, to some extent, helped in obtaining the reports and ATRs from the States. Summaries of first and second SFC have been largely prepared based on the paper published in 2004. The Reports of all the SFCs were analysed for the study barring reports which are extremely difficult to collect for unknown reasons.

An interim report containing the preliminary findings of the study was presented in the Two-day National Workshop on Fiscal Decentralization and the Role of State Finance Commissions held on 18-19 January 2016 at India Habitat Centre, New Delhi. The Ministry organized the workshop with the technical support of the Indian Institute of Public Administration and the National Institute of Rural Development and Panchayati Raj. Union Minister of Rural Development and Panchayati Raj inaugurated the workshop which was attended by several chairmen & members SFCs, national & international experts as well as senior civil servants from Union and States. Constructive comments from participants are gratefully acknowledged. Prominent among them are Roy Bahl, A K Goyal, Sudhir Krishna, Om Prakash Mathur, Tina Mathur, Sarada Muraleedharan, T R Raghurandan, Indira Rajaraman, Aruna Sharma, D K Sharma, Rashmi Shukla Sharma, K. Siva Subrahmanyam and S.M. Vijayanand. Valuable inputs came from several state finance commissions' chairmen namely B K Joshi, M L Kantha Rao, Jyoti Kiran, S Krishnan, Himmat Kothari, Anand Misra Shyam Nath and B A Prakash and members/member secretary namely C Ashokvardhan, Sushil Kumar Dwivedi, K M Naidu, M K Roy, R Sudharshan Rao, C Venkateswara Rao and Prashant M Wadnere Their contributions are gratefully acknowledged. The first draft of the final report containing summaries of all SFC reports was submitted on 12 February 2016. The Ministry sent comments on 3 March 2016. In addition, many suggestions received through frequent interactions at various levels in the Ministry.

I am grateful to the Ministry of Panchayati Raj and particularly to Secretary S M Vijayanand of for recognizing the need of this work officially and entrusting it to us. His successor Secretary J S Mathur has been equally considerate. In addition, Senior Advisor

Rugmini Parmar and her successor B D Viridi and Joint Secretary S K Patjoshi have extended full support from the Ministry.

Study of this kind is not possible without administrative support from the Institute. I am thankful to colleagues in the Administration of the Institute particularly to Registrar Amitabh Ranjan, Deputy Registrar Mithur Barua and Assistant Registrar Rameshwar Kardam for the excellent care as and when needed. Librarian Usha Mujoo Munshi and Deputy Librarian Sunita Gulati and their colleagues in IIPA Library always remained ready to help. Ambar Zahara and Ankita Singh provided excellent research support throughout the study and helped a great deal in putting things together in the preparation of the report. Mahesh Bist and Ishwar Paudiyal provided efficient typing assistance. None of them is however responsible for the remaining errors.

Lastly, I would like to record my sincere gratitude to Shri T N Chaturvedi, Chairman, IIPA for his encouragements in this study. At the same time, I am grateful to Dr Tishya Chatterjee, Director, IIPA for his guidance and encouragements.

V N Alok

## List of Abbreviations

AAY	Antyodaya Anna Yojana
ADC	Autonomous District Council
AG	Accountant General
ANM	Auxiliary Nurse Mid-wives
AP	Andhra Pradesh
APMC	Agricultural Produce Market Committee
ArP	Arunachal Pradesh
ARM	Additional Resource Mobilisation
ARV	Annual Rental Value
ARWSP	Accelerated Rural Water Supply Programme
AS	Anchal Samiti
ASHA	Accredited Social Health Activist
Assm	Assam
BDPO	Block Development & Panchayat Officer
BE	Budget Expenditure
Bih	Bihar
BP	Block Panchayat
BPL	Below Poverty Line
BRGF	Backward Regions Grant Fund
CAA	Constitutional Amendment Act
C & AG	Comptroller & Auditor General
C&P Tax	Circumstances & Property Tax
CE	Capital Expenditure
CEO	Chief Executive Officer
CFC	Central Finance Commission
CSS	Centrally Sponsored Scheme
DDO	District Development Officer
DF	Development Fund
DLFA	Director of Local Fund Audit
DP	District Panchayat
DP	Divisible Pool
DPC	District Planning Committee
DPRO	District Public Relations Office
DRD	Department of Rural Development
DRDA	District Rural Development Agency
EO	Executive Officer
ERP	Enterprise Resource Planning
ET	Entertainment Tax
FC	Finance Commission
FD	Finance Division
FFC	Fourteenth Finance Commission

FRBM	Fiscal Responsibility & Budget Management
GDP	Gross Domestic Product
GIS	Geographical Information System
GMC	Guwahati Municipal Corporation
GO	Government Order
GP	Gram Panchayat
GPF	General Purpose Fund
GSDP	Gross State Domestic Product
GST	Goods & Service Tax
Guj	Gujarat
Har	Haryana
HIPA	Haryana Institute of Public Administration
HIRD	Haryana Institute of Rural Development
HoDs	Head of Departments
HP	Himachal Pradesh
HRDD	Human Resource Development Department
HRDF	Haryana Rural Development Fund
HUDA	Haryana Urban Development Authority
HUDCO	Housing & Urban Development Corporation
ICDS	Integrated Child Development Services Scheme
IDFC	Infrastructure Development Finance Company Ltd
IGFF	Infrastructure Gap Filling Fund
IGPRS	Indira Gandhi Panchayati Raj Sansthan
ILW	Inspector of Local Works
IMFL	Indian Made Foreign Liquor
IPAI	Institute of Public Auditors of India
IRDP	Integrated Rural Development Programme
IT	Information Technology
J & K	Jammu & Kashmir
JRY	Jawahar Rozgar Yojna
Kar	Karnataka
Ker	Kerala
KP	Kshetra Panchayat
LADT	Local Area Development Tax
LBs	Local Bodies
LGs	Local Governments
LIC	Life Insurance corporation
LR	Land Revenue
LSG	Local Self Government
Mah	Maharashtra
MAHUD	Municipal Administration, Housing & Urban Development
Man	Manipur
MB	Municipal Boards

MBA	Master of Business Administration
MFP	Minor Forest Produce
MIS	Management Information System
MLA	Member of Legislative Assembly
MLALAD	Member of Legislative Assembly Local Area Development
MoPR	Ministry of Panchayati Raj
MP	Madhya Pradesh
MP	Member of Parliament
MPC	Metropolitan Planning Commission
MPLAD	Member of Parliament Local Area Development
MV Tax	Motor Vehicle Tax
NAC	Notified Area Council
NATPAC	National Transportation Planning and Research Centre
NDDP	Net District Domestic Product
NGO	Non- Governmental Organization
NRHM	National Rural Health Mission
NIC	National Informatics Centre
NIRD	National Institute of Rural Development
NIUD	National Institute of Urban Development
NLGORR	Non Loan Gross Own Revenue Receipts
NN	Nagar Nigam
NOC	No Objection Certificate
NP	Nagar Panchayats
NPP	Nagar Palika Parishads
NPRE	Non-Plan Revenue Expenditure
NRDWSP	National Rural Drinking Water Supply Programme
Odi	Odisha
O & M	Operation & Maintenance
OBC	Other Backward Caste
OMGFF	Operation and Maintenance Gap Filling Fund
OTR	Own Tax Revenue
PBR	People's Biodiversity Register
PHC	Primary Health Centre
PHEO	Public Health Engineering Organization
PHSC	Punjab Health Systems Corporation
PPP	Public Private Partnerships
PR & RD	Panchayati Raj & Rural Development
PRI	Panchayati Raj Institutions
PS	Panchayat Samiti
PU	Panchayat Union
Pun	Punjab
PWD	Public Works Department
PWSSB	Punjab Water Supply & Sewerage Board

Raj	Rajasthan
RCC	Reinforced Cement Concrete
RDA	Rural Development Agency
RE	Revenue Expenditure
RLB	Rural Local Bodies
RMC	Regulated Marketing Committees
SC	Schedule Caste
SCP	Special Component Plan
SFC	State Finance Commission
SGOTR	State's Gross Own Tax Revenue
SHG	Self Help Groups
Sik	Sikkim
SIRD	State Institute of Rural Development
SOTR	State's Own Tax Revenue
ST	Schedule Tribe
SUDA	State Urban Development Authority
SWM	Solid Waste Management
TC	Town Committee
TFC	Thirteenth Finance Commission
TN	Tamil Nadu
ToR	Terms of Reference
TP	Taluk Panchayat
Tri	Tripura
TSP	Tribal Sub Plan
TUFIDCO	Tamil Nadu Urban Finance and Infrastructure Development Corporation Limited
TUIFSL	Tamil Nadu Urban Infrastructure Financial Services Limited
UDD	Urban Development Department
UD & HD	Urban Development & Housing Department
UFC	Union Finance Commission
UK	Uttarakhand
ULB	Urban Local Body
UP	Uttar Pradesh
UPSEB	Uttar Pradesh State Electricity Board
VAT	Value Added Tax
VDO	Village Development Officer
VLT	Vacant Land Tax
VP	Village Panchayat
VRS	Voluntary Retirement Scheme
WB	West Bengal
WCP	Women Component Plan
YASHADA	Yashwantrao Chavan Academy of Development Administration
ZP	Zila Parishad

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## Chapter 1

### Introduction

#### I. Background

Under a framework of cooperative federalism, a trend has been noted in many developing countries in the last three decades towards increasing decentralization of the public sector. The period has witnessed a significant rise in local democracy with growing realization that devolution of political, administrative and fiscal authority to local units of government is one of the best ways to deepen democracy and increase efficiency. It was also felt that responsibilities for expenditure be devolved with concomitant revenue to maintain fiscal accountability (Bird, 1993). Seemingly, this shift along with privatization and deregulation has reduced the authority of national governments over economic policies.

India is also keeping pace with this trend. New systems of local and intergovernmental finance are being established as part of the evolution. The trend has been noted, particularly since early nineties with the passage of 73<sup>rd</sup> and 74<sup>th</sup> Constitutional Amendments that accelerated the process of decentralization with greater devolution and delegation of powers to local governments and the recognition of panchayats and municipalities in the book of statute as institutions of self-government

Consequently, Part IX and IXA have been inserted into the Constitution for Panchayats and Municipalities respectively and State legislature has been made responsible to transfer functions, listed in the newly created Eleventh Schedule and Twelfth Schedule. The State is also required to transfer the interrelated powers to enable them to carry out the responsibilities conferred upon them. Under the Constitution Amendment Act (CAA), the state legislature is authorized to devolve the specific responsibilities, powers and authorities to the local governments to enable them to function as institutions of self-government. The legislature of a State may both empower the rural and urban local governments to levy, collect and appropriate certain taxes, duties, tolls and fees, etc., and also assign to them the revenues of certain state level taxes subject to such conditions as are imposed by the state government. Further, grants-in-aid may also be provided to these local governments. Resulting from the CAA, the numbers of Panchayats as on March 2014 stood at 247467 of which 240542 are Gram Panchayats, 6332 are Block Panchayats and 593 are Zila Panchayats (Table 1.1). On the other hand, Municipalities by the end of December 2015 numbered 4041 in all States.

Table 1.1: Number of Panchayats in Each State/UT as on 1 March 2014

Sl. No.	State	Name of Panchayats				Rural Population per Village Panchayat
		District (a)	Block (b)	Village (c)	Total	
1	Andhra Pradesh	22	1097	21590	22709	2566
2	Arunachal Pradesh	17	177	1779	1973	489
3	Assam	21	185	2202	2408	10543
4	Bihar	38	531	8402	8971	8845
5	Chhattisgarh	18	146	9734	9898	1710
6	Goa *	2	n.a.	190	192	3564
7	Gujarat	26	223	13996	14245	2268
8	Haryana	21	119	6083	6223	2471
9	Himachal Pradesh	12	77	3243	3332	1691
10	Jammu & Kashmir	22	143	4128	4293	1848
11	Jharkhand	24	259	4423	4706	4737
12	Karnataka	30	176	5629	5835	6198
13	Kerala	14	152	978	1144	24105
14	Madhya Pradesh	50	313	23006	23369	1929
15	Maharashtra	33	351	27896	28280	1999
16	Manipur	4	n.a.	161	165	9881
17	Meghalaya (d)	3	0	0	3	0
18	Mizoram (d)	0	0	707	707	633
19	Nagaland (d)	0	0	1110	1110	1484
20	Odisha *	30	314	6232	6576	5020
21	Punjab	22	146	13041	13209	1234
22	Rajasthan	33	248	9177	9458	4718
23	Sikkim	4	n.a.	341	345	1411
24	Tamil Nadu	31	385	12,524	12940	2788
25	Tripura	4	23	511	538	5193
26	Uttarakhand	13	95	7982	8090	791
27	Uttar Pradesh *	75	821	51,914	52810	2536
28	West Bengal	18	333	3349	3700	17244
	<b>Union Territories</b>					
29	Andaman & Nicobar *	2	7	69	78	3478
30	Chandigarh	1	1	12	14	7677
31	Dadra & Nagar Haveli	1	n.a.	11	12	15457
32	Daman & Diu *	1	n.a.	14	15	7204
33	NCT of Delhi (e)	n.a.	n.a.	n.a.	0	0
34	Lakshadweep *	1	n.a.	10	11	3368
35	Puducherry *	NA	10	98	108	3324
	<b>India</b>	<b>593</b>	<b>6332</b>	<b>240542</b>	<b>247467</b>	<b>3087</b>

Source: Alok (2014).

Note: \* Figures from Report of the Eleventh Finance Commission for Traditional Village/District Councils that exist in these States, however, figure for Nagaland is from the Report of Twelfth Finance Commission  
# PRI is yet to be revived.

1. In almost all States it is known as Gram Panchayat.

2. The nomenclature of intermediate rung differs from one State to another. It is known as Mandal Parishad in AP, Anchal Samiti in ArP, Anchalic Panchayat in Assam, Janpad Panchayat in Chhattisgarh & MP, Taluka Panchayat in Gujarat, Taluk Panchayat in Karnataka, Panchayat Union in TN, Kshetra Panchayat

*in UP and Uttarakhand and Panchayat Samiti in many States, i.e Bihar, Haryana, Himachal Pradesh, Jharkhand, Maharashtra, Orissa, Punjab and Rajasthan.*

3. *It is also known as Zilla Panchayat/Parishad in many States.*

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

It is about two and a half decades since Part IX and IX A were incorporated into the Constitution. During the period, one could have found enough reasons to cheer. Conformity Acts have been enacted in all the States. Elections have been conducted in all. Women have been elected as Mayor for city government and *Sarpanch* for rural local government. All States have constituted their SFC. Most States have received their fourth-generation SFC recommendations<sup>1</sup>. Notwithstanding, local governments in almost all States continue to be starved of finances causing major impediment in their growth and effective functioning. The problem is compounded when it is seen with the expanded role and responsibilities of the local governments after CAA became effective and the 11<sup>th</sup> and 12<sup>th</sup> Schedules were inserted.

Ideally, the functional responsibilities should closely be linked with the financial powers delegated to the local government. In practice, huge mismatch between these two exists leading to a severe fiscal stress at the local level. Own revenues of local governments are generally adequate to meet only a part of their operation and maintenance (O&M) requirements. Therefore, they are dependent on the higher level of governments to finance their activities. The SFCs are responsible to examine not only the revenue-sharing arrangements between the State governments and the local governments, both rural and urban, but also the entire range of subjects concerning assignment of taxes, transfers of power and such other subjects for improving the financial health of local governments. In this case, the CAA does not draw any distinction between the plan and non-plan financial requirements of the local governments. Therefore, SFCs are not confined only to the assessment of non-plan expenditure of the local governments for recommending the devolution of funds and financial powers to the local governments at various levels.

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<sup>1</sup> 5<sup>th</sup> Finance Commission has also been constituted in a number of states.

### The Objective

Against this backdrop, the study attempts to review the working of SFCs across states and time with the following objectives:-

- a) To make a comparative analysis of the recommendations of the SFCs across States at different period of time on the following major heads which emanate from article 243 I:
  - Global Sharing
  - Assignment of Revenues
  - Horizontal Distributions
  - Grants-in-aid
  - Functions and Functionaries
  - Other Measures
- b) To highlight commonalities and variances of SFC recommendations
- c) To present the methodologies adopted by various SFCs for making recommendations to the State Governments.
- d) To analyze the implementation status of latest SFC recommendations by the State Governments through the action taken reports (ATR) passed in the State Legislatures.
- e) To bring out the constraints faced by the States in implementing the recommendations
- f) To highlight best practices
- g) To recommend roadmaps for improvements in the functioning of SFCs

The study also attempts to identify some of the emerging issues related to the efficacy of SFC in fiscal decentralization. For this, seventy one reports have been analyzed. In most cases, actions taken by the respective State Governments on the SFC recommendations have also been analyzed<sup>5</sup>

### The Method

- i. Data for this study were collected from the available secondary sources viz., 71 SFC Reports of various States and many action taken reports (ATRs). The Ministry, to some extent, helped in obtaining the reports and ATRs from the States.
- ii. The Reports of all the SFCs were examined for the study barring reports which are extremely difficult to collect for unknown reasons.

The report is in two parts. The first part of the report contains five chapters. The first chapter is introductory and presents issues related to functional and financial devolution in India across states in the wake of seventy third and seventy fourth amendments. Chapter two, as the title of the study indicates, examines the methodologies and recommendations of the SFCs under various heads. Chapter three presents impediments that the State and SFC encounter in

<sup>2</sup> Datta (2008), Mishra (2004), Mathur and Peterson, (2006); and Oommen, (2010) have also analyzed SFC reports of three to ten States and Alok (2004, 2008) and Siva Subrahmanyam (2004) presented the analysis of about forty and twenty SFC reports respectively.

the functioning of the latter. Some good practices are also presented in this chapter. Chapter IV is by way of summary, conclusion and a few suggestions to strengthen SFCs. The scope of the examination is essentially limited by the available information. The overview presented in the report is a mid-term review that can be outdated in future. The second part of the report contains summaries of the major recommendations of SFCs and the actions taken by State Governments on each recommendation.

## II. Functional and Financial Devolution<sup>2</sup>

India is a federal parliamentary democracy. The panchayats and municipalities are seen as the ‘third tier’ of government. This has also made India the most representative democracy in the World. Today, about 2.2 million representatives stand elected to the three rungs of Panchayats and three levels of Municipalities. Of these in Panchayats, more than 40 per cent are women and 27 per cent belong to marginalized sections – SCs and STs. At the village panchayat level, each elected person’s constituency comprises about 340 people or 70 families (GoI, 2006).

Article 243G of the Constitution empowers Panchayats to function as institutions of self-government for the purposes of a) preparing plans for economic development and social justice for their respective areas and b) implementing schemes for economic development and social justice in their respective areas for various subjects including those twenty-nine functions listed in the Eleventh Schedule. However, the list is merely illustrative and indicative. Unlike the division of powers and functions, as spelled out in the Union and State List in the Constitution, no such clear demarcation exists between the State and Panchayats. It is for the State Legislature to make laws regarding the devolution of powers and functions upon the Panchayats.

Though, almost all states and union territories (UTs) have claimed that they have transferred subjects in varying degrees to the Panchayats, by enacting laws in conformity with the CAA, functional domain of Panchayats pertains to only traditional civic functions in several states. Functional domain is without adequate developmental responsibilities in those states where either the intermediate Panchayats or the District Panchayats were absent for decades. States, where they existed for long, have only repeated the provisions of the old statutes in their new laws with marginal adjustments. Moreover, many State Governments have not framed the relevant rules or guidelines as a follow up measure. A few States realized that transfer of additional functions would accompany the concomitant funds and functionaries to local governments, enabling them to perform the specified responsibilities. At the same time, the local governments are also not very clear about the role they are expected to play in the new federal set up. The fact of the matter is that almost all the subjects enumerated in the Eleventh Schedule are State-concurrent, involving duplication and overlapping.

Another challenge before the State Government has been the identification of activities to the appropriate tier of the three-tier-panchayat system. Traditionally, the lowest level panchayat, *i.e.* the village panchayat (VP) has been the most active in almost all States. Generally, the VPs carry out major functions including core functions whereas intermediate and district panchayats in most States are assigned supervisory functions or act mainly as executing agents for the state government.

### **Exhibit 1.1**

#### **Classification of Functions Listed In Eleventh Schedule**

##### **Core Functions**

- Drinking Water.
- Roads, culverts, bridges, ferries, waterways and other means of communication.
- Rural electrification, including distribution of electricity.
- Health and sanitation, including hospitals, primary health centres and dispensaries.
- Maintenance of community assets.

##### **Welfare Functions**

- Rural housing.
- Non-conventional energy sources
- Poverty alleviation programme.
- Education, including primary and secondary schools.
- Technical training and vocational education.
- Adult and non-formal education.
- Libraries.
- Cultural activities.
- Family welfare.
- Women and child development.
- Social welfare, including welfare of the handicapped and mentally retarded.
- Welfare of the weaker sections, and in particular, of the Scheduled Caste and the Scheduled Tribes
- Public distribution system.

##### **Agriculture and Allied**

- Agriculture, including agricultural extension
- Land improvement, implementation of land reforms, land consolidation and soil conservation.
- Minor irrigation, water management and watershed development.
- Animal husbandry, dairying and poultry.
- Fisheries.
- Social forestry and farm forestry.
- Minor forest produce.
- Fuel and fodder.
- Markets and fairs.

##### **Industries**

- Small scale industries, including food processing industries.
- Khadi, village and cottage industries.

*Note: The Eleventh Finance Commission has given the above classifications to the functions enumerated in the 11<sup>th</sup> Schedule.*

It is a general perception that Panchayats are financially and technically under-equipped to perform even the core functions, not to speak of the welfare functions and other economic functions related to agriculture and industries (see exhibit 1.1 above). Hence, many of the core functions, which traditionally belonged to local governments like, drinking water, rural roads, street lighting, sanitation, primary health etc. have not been transferred fully in some states and are being performed by the line departments of the State Government or the parallel parastatals.

### Revenue

Powers to impose taxes by the local governments was considered imperative to be enshrined in the Constitution under Article 243H to impart certainty, continuity and strength to the Panchayats. The Union Minister of State for Rural Development, G Venkat Swamy said while moving the Constitution (73rd Amendment) Bill in Parliament, "*Constitution (Seventy-third) Amendment cast a duty on the centre as well as the states to establish and nourish the village panchayats so as to make them effective self-governing institutions....We feel that unless the panchayats are provided with adequate financial strength, it will be impossible for them to grow in stature*". Devolution of taxes to local governments can easily be linked with the activities assigned to them, which vary from State to State. From the long list of Eleventh Schedule, certain basic functions could be said to be in the exclusive domain of Panchayats. Even these essential services require huge funds.

Table 1.2 reveals that a variety of taxes have been devolved at different levels of Panchayats. The relative importance of these taxes varies from State to State. The intermediate and district panchayats are endowed with very few taxes whereas village panchayats are given substantial taxing powers. From the list, property tax, land cess, surcharge on additional stamp duty, tolls, profession tax, advertisement tax, non-motor vehicle tax, octroi, user charges, etc. contribute the maximum to the small kitty of own revenue, which contributes only six to seven percent in the total expenditure of Panchayats. In most States, property tax contributes the maximum revenue. However, this remains an inelastic tax due to inefficient administration in its collection. Its assessment is based on annual rental value of taxation with its associated evil, *i.e.* under-declaration of rentals. However, some progressive States have reformed the tax structure and use unit area method in the determination of the tax base.

After own revenue, the assigned revenue is the closest to local government finances. Such revenues are levied and collected by the State Government and are passed on to local governments for their use. Some States deduct collection charges. The practice in assigned revenue is also marked by large inter state variation. However, the typical examples of assigned revenue are: surcharge on stamp duty, cess or additional tax on land revenue, profession tax, entertainment tax, etc. In many states, these taxes form part of the own revenue of local governments.

## Borrowings

No reference is made in the CAA to loans and borrowing by panchayats. Urban local governments, with the approval of their state governments, have floated bonds in the market. In contrast to the general belief that panchayat are not empowered to raise loans (Gulati, 1994, Oommen 1995, Rajaraman 2003 and Jha 2000), Local Authorities Loans Act, 1914, a Central Act does exist enabling the grants of loans to local authorities including panchayats (Alok 2009).

## III. State Finance Commission

Generally, proceeds from own sources contributes abysmal share to the local pool. Local governments generally rely more on fiscal transfers from State government in the form of shared taxes and grants. State taxes are shared as per the recommendations of SFC. The SFC created, under articles 243-I, is viewed as the sub-national equivalent of the Union Finance Commission formed under article 280 of the Constitution. The legal provisions for the SFC are, therefore, similar to that of the Union Finance Commission except the wordings of the first paragraph of article 243-I that provides for the constitution of the SFC '*at the expiry of every fifth year,*' This is not akin to the provision exits under article 280 constituting Union finance commission '*at the expiry of every fifth year or earlier*'. The missing part '*or earlier*' disallows the constitution of a new SFC before the completion of the five-year-period. The article mandates SFC to review the financial position of the Panchayats and make recommendations to the Governor on the principles that should govern:

1. The distribution between the State and the Panchayats of the net proceeds of the taxes, duties, tolls and fees leviable by the State, and their *inter se* distribution between the Panchayats at all levels for such proceeds,
2. The determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by, the Panchayats;
3. The grants-in-aid to Panchayats from the consolidated fund of the State;
4. The measures needed to improve the financial position of the Panchayats
5. Any other matter in the interest of sound finance of the Panchayats and Municipalities

Many states have reproduced verbatim the articles 243I while framing the terms of reference (ToR) of the SFCs. Some other states deviated and added a few other terms. A detailed analysis of the ToRs of various SFCs is presented in subsequent chapters

Table 1.2: Revenue Power of Panchayats in States at Each Tier

Tax or Fee/States	Andhra Pradesh	Assam	Chhattisgarh	Goa	Haryana	Himachal Pradesh	Jharkhand	Karnataka	Kerala	Madhya Pradesh	Maharashtra	Punjab	Sikkim	Tamil Nadu	Uttarakhand	Uttar Pradesh	West Bengal	Andaman & Nicobar Island	Chandigarh
House/Property Tax	G	G	G	G	G	G		G	G	G	G		G	G	D	D	G	G	G
Surcharge on house / property tax	G	G	G	G	G			G	G	G			G					G	
Tax on agriculture land for specific purpose		G						G					G	G					
Cess on land revenue or surcharge			D										G		G				
Surcharge on additional stamp duty			D					B											
Tax on professions, trades, calling, and so forth		GB	G	G					G	GB			GD	G			G	G	
Octroi				G										G					

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Tax or Fee/States	Andhra Pradesh	Assam	Chhattisgarh	Goa	Haryana	Himachal Pradesh	Jharkhand	Karnataka	Kerala	Madhya Pradesh	Maharashtra	Punjab	Sikkim	Tamil Nadu	Uttarakhand	Uttar Pradesh	West Bengal	Andaman & Nicobar Island	Chandigarh
Entertainment tax		GB	GB	G				G	G	B			G		B			G	
Pilgrim tax or fees			GB					G		G				G			GB	G	
Tax on advertisements	G		GBD	G				G	G	G				G			G		
Education cess								G						G					
Tolls		G	GB		B			G						G			GBD		
Tax on sale of firewood and slaughter houses										G							B		
Tax on goods sold in a market, haat, fair, and so forth		G	G	G				G		GB			G	G	GD		G	G	
Tax on shops and services										GB							GB	G	
Vehicle tax		G	GBD	G				G		G				G			GB		
Animal tax	G	G	GB	G		G		G		GB				G				G	
Conservancy								G									GB		

Tax or Fee/States	Andhra Pradesh	Assam	Chhattisgarh	Goa	Haryana	Himachal Pradesh	Jharkhand	Karnataka	Kerala	Madhya Pradesh	Maharashtra	Punjab	Sikkim	Tamil Nadu	Uttarakhand	Uttar Pradesh	West Bengal	Andaman & Nicobar Island	Chandigarh
rate																			
Lighting rate	G		G			G		G		G							GBD	G	
Water rate	G		G			G		G		GD			G	G		G	GBD		
Drainage rate	G		G		G	G		G		G							G	G	
Special tax for community civic services or works				G	D	G		G		G							GBD		
Surcharge on any tax imposed by village panchayat			GB	G				G					G	G					
Shops Lease	GBD		GBD	G	GBD		D	G		GBD		GBD	G			G	GBD	G	G
Pond/Tank Lease	G				G			G		GBD		G		G		G	GBD		G
Sand Collection Charge																			
Minor Minerals Tax			GBD					G						G					
Village land lease	G		GBD		G			G				GBD	G	G					G

Tax or Fee/States	Andhra Pradesh	Assam	Chhattisgarh	Goa	Haryana	Himachal Pradesh	Jharkhand	Karnataka	Kerala	Madhya Pradesh	Maharashtra	Punjab	Sikkim	Tamil Nadu	Uttarakhand	Uttar Pradesh	West Bengal	Andaman & Nicobar Island	Chandigarh
Fees for license for hat or market																			
Fees for running trade																			
Fees for running dangerous and offensive trade																			
Fees for license for fair or mela																	B		
Issue of certificates													G						
General & Sanitation tax											G								
Irrigation cess											D								
Mobile Towers in GPs			G																
Colonizer			G																
New Ghat							G												
Community Hall Rent							GBD												

Tax or Fee/States	Andhra Pradesh	Assam	Chhattisgarh	Goa	Haryana	Himachal Pradesh	Jharkhand	Karnataka	Kerala	Madhya Pradesh	Maharashtra	Punjab	Sikkim	Tamil Nadu	Uttarakhand	Uttar Pradesh	West Bengal	Andaman & Nicobar Island	Chandigarh
Bus Stand Fee							D												
Dak Bungalow Rent							D												
Library cess														G					
Local cess														G					
Local cess surcharge														G					
D & O trade														G					
Sand collection														G					
Avenue trees rent														G					
Tract rent														G					
Ferry rentals														G					
Fisheries rental														G					
Share Social Forestry														G					
Building Plan approval fee														G					
Factory licensing fees														B					
Panchayat tax																G			

Tax or Fee/States	Andhra Pradesh	Assam	Chhattisgarh	Goa	Haryana	Himachal Pradesh	Jharkhand	Karnataka	Kerala	Madhya Pradesh	Maharashtra	Punjab	Sikkim	Tamil Nadu	Uttarakhand	Uttar Pradesh	West Bengal	Andaman & Nicobar Island	Chandigarh
Fees for running trade																	B		
Fees for running dangerous & offensive trade																	BD		

Source: Same as in Table 1

Note: G denotes Gram Panchayat; similarly B and D denote Block and District Panchayat respectively. More than one sign indicates the concurrent power of Panchayats for the respective tax.

## Chapter 2

### Recommendations and Methodologies of SFCs: A Review

#### I. Recommendations of SFCs

SFCs, in general, have framed their recommendations on the basis of a review of the existing conditions at the state and local level. A glance over seventy one SFC reports reveals that SFCs have examined some common issues including a) state finances b) state revenue c) state expenditure d) finances of Panchayats and Municipalities e) fiscal domain of local bodies f) resource requirements g) accounts and audit h) administrative structure i) procedural matters etc. Following these, SFCs have made a number of recommendations. Despite vast inter-state variations in SFC reports, the main recommendations of the SFCs can be grouped into the following six major heads:

1. Global Sharing
2. Assignment of Revenues
3. Horizontal Distribution
4. Grants-in-Aid
5. Functions and Functionaries
6. Other Measures

#### A. Global Sharing

The most critical function of the SFCs is the determination of fiscal transfers from the State to local governments in the form of revenue sharing and grants-in-aid. Since the 80th Amendment of the Constitution, following the recommendations of Tenth Finance Commission (1995-2000), a certain percentage of all Union taxes have been devolved to the States. Similarly, many SFCs have also adopted it for the following reasons: First, the system has a self-policy feature; the local governments automatically shares buoyancy of state taxes and levies. Second, there is an inbuilt transparency, objectivity and certainty in this system, as local governments can anticipate, in the beginning of each fiscal year, their share in the divisible pool. Third, this system enables local governments to understand the economy in its entirety. In other words, it induces them for own revenue generation and additional resource mobilization. Fourth, the State Government can be neutral in pursuing

tax reforms without considering whether a particular tax is sharable with local governments or not.

This leads to the issue related to the composition of divisible pool. Table 4 reveals wide variations across states in defining the divisible pool and the principle of sharing among the Panchayats and Municipalities. The first SFC of Andhra Pradesh, Assam and Goa have included the share of Union taxes in the state taxes and non-tax revenue to form the divisible pool. However, the first SFCs of Kerala, Madhya Pradesh, and Sikkim and the second SFCs of Orissa and Uttarakhand have not included the share of union taxes and included only the state tax and non-tax revenues. The first SFCs of Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal as well as the second SFC of Kerala have gone a step further and recommended that only the tax revenues of the State form the divisible pool. As an exception, the Karnataka SFCs have adopted a different mechanism by using the phrase “Non loan gross own revenue receipts” in defining the divisible pool. This table illustrates only those States where SFCs have recommended the concept of ‘global sharing’ for transfer of state revenues.

The SFCs of other States have recommended sharing of only specific taxes or awarded a fixed amount for local governments. The first SFC of Punjab, for instance, has recommended transferring 20 per cent of net proceeds of the five taxes to the local governments, i.e. stamp duty, motor vehicle tax, electricity duty, entertainment tax and entertainment tax on cinematography between the Panchayats and urban local governments. Significant inter-state variations can be noticed in the mechanism of revenue sharing as different SFCs made different set of recommendations. Following table gives the summery of the IV SFC in the selected states:

**Table 2.1: SFC Recommendations for Share in State Resources**

SFC of	%	Share of Panchayats and Municipalities	Basis of Distribution
<i>Total Revenue of State</i>			
Andhra Pradesh (I)	39.24	70% and 30%	Development criteria

Arunachal Pradesh(I)	50.00	Not Mentioned	Population, Geographical area, own income efforts, distance from highest per capita income and composite index of backwardness.
Andhra Pradesh (III)	6.7%	72.25% and 27.25%	
Assam(I)	2.0	Not Mentioned	Population.
Goa (I)	36.0	75% and 25 %	Population, Geographical area, Performance
Haryana (II)	Rs 1117.51 crores	Rs 696.22 crores and Rs 421.29 crores	
Himachal Pradesh (III)	2.75%	NA	
Himachal Pradesh (IV)	NA	Rs 559.54crores and Rs 81.96 crores	
Madhya Pradesh (I)	NA	2.91% and 8.66%	
Madhya Pradesh (III)	5%	4% and 1%	
Manipur (II)	NA	34.38% and 27.25%	
Punjab (I)	20%	NA	
<i>Own Revenue of State</i>			
Andhra Pradesh(II)*	10.39*	65% and 35%	Development Criteria
J & K (I)	13.5	67% and 33%	Not Mentioned.
Kerala (I)	1.0	Not Mentioned	Population.
Karnataka (III)	30.0	70% and 30 %	Not Mentioned
Madhya Pradesh(I)	11.57	25.13 % and 74.87%	Population, area, tax efforts.
Odisha (II)	10.0	80% and 20 %	Population, density, number of holdings, revenue efforts
Sikkim(I)	1.0	100% and 0 %	ULB does not exist in the state.
Sikkim (III)	2.0	Not Mentioned	Population, area of panchayats
Sikkim (IV)	2.5	75 and 25	Population Census2011

Uttarakhand(II)	10.0	60 % and 40 %	Population, area, deprivation index, remoteness index, tax efforts.
Uttar Pradesh (I)	10.0	30% and 70 %	Population (80%); Area (20%).
Uttar Pradesh (II)	12.5	40% and 60 %	Population and area.
Uttar Pradesh (IV)	15.0	N.A.	Population , SC/ST Population, area, Per Capita Index, Establishment comfort backwardness Index, integrated development backwardness Index,
<i>Non- Loan Gross Own Revenue</i>			
Assam (III)	25%	NA	
Karnataka (I)	36.0	85%and 15 %	For panchayats, population, area, index of decentralization and for ULBs population 67% and illiteracy rate 33%[kar II has followed it]
Karnataka (II)	40.0	80% and 20 %	
Orissa (I)	10%	60% and 40%	
State Own Taxes			
Assam(II)	3.5	Based on 1991 census	Population, area, Net District Domestic product
Assam (IV)	15.0	Based on 2001 census	Population, area, Infrastructure Index
Bihar	7.5		
Chattisgarh(I)	4.79	Not Mentioned	Population
Goa(II)	2.0	Not Mentioned	Not Mentioned
Gujarat (II)	31.15%	NA	

Haryana(III)	4.0	65% and 35%	Population , SC
Haryana (IV)	2.5	65% and 35%	Population, Population Census 2011
Kerala (II)	9.0	78.5 % and 21.5 %	Population
Kerala (III)	25.0#	Not Mentioned	Not Mentioned
Kerala (IV)	19.7	Population	Population, area, deprivation index, tax efforts
Madhya Pradesh (II)	4.0	77.33% and 26.67%	Population
Maharashtra (II)	40.0	80% and 20%	Distance from Highest Per Capita Income District, Backwardness, Population, Area, Proportion of Agricultural Income in Total Income of the District, Inverse Primary Income.
Odisha(III)	15.0	75% and 25%	Expected Population 25.8 % and 29.17 % respectively.
Odisha(IV)	3.0	75% and 25%	N.A
Punjab(II)	4.0	67.50% and 32.50%	Population, per capita, revenue, SCs
Punjab(III)	4.0	34% and 66%	Population
Rajasthan(I)	2.18	77.33 % and 22.7%	Population
Rajasthan (II)	2.25	76.6% and 23.4%	Population
Rajasthan(III)	3.5	75.7% and 24.3%	Population
Rajasthan(IV)	5	75.1 and 29.9	Population
Rajasthan(V)@	7.9	75.1 and 29.9	Population
Tamil Nadu(I)\$	8.0	60 % and 40 %	Population
Tamil Nadu (II)	10.0	58% and 42 %	Population, SCs and STs, Per capita own revenue, area, asset maintenance, resource gap.
Tamil Nadu (III)	10.0	58% and 42%	Population, resources, potential, needs
Tamil Nadu (IV)	10.0	56 % and 44%	Population SC/ST Population, Area

Tripura (I)	50.0	Not Mentioned	Population, Socio-economic backwardness
Tripura (II)	25.0	Not Mentioned	Population
Tripura (III)	20.0	Not Mentioned	Population
Uttrakhand(I)	11.0	42.23 and 57.77	Population and Distance from Rail Head
Uttarakhand (III)	10.5%	50% and 50%	
West Bengal (I)	16.0	Breakup as per population, district wise	Population and % of SC/ST, non-literates
West Bengal(II)	16.0	Breakup as per population , district wise	Population 50 % and 7% to other variables, population density, SC/ST, non-literates, IMR, rural population per capita income
West Bengal (III)	2.0	Not Mentioned	Not Mentioned
Maharashtra (III)^	7.8%	NA	

Notes: \$ In Tamil Nadu, the divisible pool called pool B consists of sales tax, motor vehicle tax, state excise revenue and other state taxes. The other pool A consists of levies, which rightly belong to local governments i.e. surcharge on stamp duties, local cess and local cess surcharge and entertainment tax. The entire proceeds of pool at taxes are recommended to be distributed to the local governments.

\* Second SFC of Andhra Pradesh recommended 10.39% share as additional devolution over and above the existing annual devolution.

# 25 (Twenty five) per cent of the total State Tax revenue of the year 2003-04 may be transferred to Local Self Governments (LSGs) during the year 2006-07. During each of the four subsequent years amounts derived by applying annual growth of 10 (ten) percent (which would accommodate reasonable rates of inflation and real growth) may be so transferred.

@ It has excluded Entry tax and Land revenue

^ Total Additional Transfer

## B. Assignment of Revenues

As per the practice followed in a number of developed and developing countries, the property tax has been assigned to the Municipalities and Panchayats in almost all the States and it remains the major source of own tax revenue for most local governments. Octroi was another tax that was previously assigned to the Municipalities only to abolish in later

stage in most States. However, it continues to be levied in Maharashtra<sup>3</sup> and considered to be the most buoyant source of revenue. The Profession Tax and the Entertainment Tax stand assigned to the Municipalities in Goa, Haryana, Kerala, Madhya Pradesh, Maharashtra and Uttar Pradesh. Most States have also authorized the Municipalities to collect market fee, fee for registration of cattle and vehicles. Municipalities in a number of States including Goa, Gujarat, Haryana, Himachal Pradesh, Maharashtra and Tamil Nadu also collect education cess.

Water Tax, Lighting Tax, Animal and Vehicle Tax, Trade and Callings Tax, Boat Tax, Toll Tax are the other taxes which have been assigned to the Municipalities and Panchayats in most States.

Many SFCs have tried to rationalize the local tax structure by suggesting reforms in assessment and administration of taxes besides assigning powers to local governments. SFC of Kerala, Karnataka, Tamil Nadu and Uttar Pradesh for example, have recommended reform in property taxes and have suggested the 'area based' or 'site valuation' system for assessment of property tax. SFC of Assam, Tripura and Uttar Pradesh recommended even vacant land tax.

**Table 2.2: Assignment of Revenues by various SFCs**

Assignment of Revenues	I SFC of:	II SFC of:	III SFC of:	IV SFC of:	V SFC of:
Entertainment Tax	Guj, Ker, WB, ArP	M P	MP, TN WB	---	Bih
Surcharge on various State taxes	Guj				
Advertisement Tax (Other than News paper)	Pun, ArP			Odi	Bih
Profession tax	ArP	Odi	UK, WB		
Sanitation tax	Sik		Sik	Raj	
Re-imposition of Octroi by the Municipalities.	Guj	MP			
Circumstances & Property (C&P) Tax to			UK		

<sup>3</sup> Only Municipal Corporations levy Octroi which has been changed to local body [LB] tax in Maharashtra about a year ago.

Assignment of Revenues	I SFC of:	II SFC of:	III SFC of:	IV SFC of:	V SFC of:
be replaced by profession tax.					
Vehicle Tax	Guj		AP	Raj	
Vacant Land Tax			Har	TN	Bih
Municipalities may levy property tax and service charges on the properties of the central and State government undertakings.				Asm, Odi	
Property Tax/ A surcharge of 50% on the property tax by Local Governments.				Ker, Sik, TN	Bih
Development tax				Har, Raj	
State entry tax.				Har, Odi	
Consumption based tax as Cess				HP	
Service tax.				Ker	
Irrigation tax.				Sik	
Tourist Tax				Sik	
House Tax				TN	
Congestion Tax					Bih
Betterment tax					Bih

Table 2.3: Criteria for Horizontal Distribution of Allocations to Panchayats

S. N	State	SFC	Criteria						
			Population	SC/ST Population	Other Population (AAY/BPL/Rural etc)	Area	Literacy/ Non Literacy	Backwardness	Other Measures
1	Andhra Pradesh	I	√			√			
		II							
		III	√						
2	Arunachal Pradesh	I	√					√	Own Income Effort, Distance from highest per capita income
3	Assam	I							Share of motor vehicle tax for rural areas on the basis of population of each rural local body as per latest census.
		II							
		III	√			√			Per Capita District Domestic Product, Net of mining & quarrying
		IV							
4	Bihar	IV	√		√				
		V	√			√			Under Development Index
5	Goa	I	√			√		√	Performance, Discretionary Quota
		II							
6	Gujarat	I							

		II							Income from professional tax should be shared between Municipalities and Panchayats on the basis of rural and urban population ratio i.e. 67% and 33%.
7	Haryana	I	√						Performance
		II							
		III	√		√	√	√		
		IV	√		√	√	√		Gender Sex Ratio
8	Himachal Pradesh	I							
		II							
		III							
		IV							
9	J&K	I							
10	Karnataka	I							
		II							
		III		√	√	√	√		
11	Kerala	I	√	√					Tax Effort, Financial Need
		II							
		III							
		IV	√			√			Tax Effort, Deprevalation Effect

12	Madhya Pradesh	I	√	√		√	√1	Number of agricultural labourers, Average Gross value of output of Agriculture per hectare
		II	√					
		III	√					
13	Maharashtra`	I						Per Capita Basis
		II						
		III						
14	Manipur	I	√					
		II	√			√		Distance from the State Capital
15	Odisha	I	√			√		Rural Connectivity
		II	x					
		III	x					
		IV	x					
16	Punjab	I	x					
		II	x					
		III	√					
17	Rajasthan	I	√					Incidence of Poverty <sup>2</sup>
		II	√			√	√	Poverty
		III	√	√		√	√	Poverty (No. of BPL Families)

		IV	√	√		√	√		Poverty (No. of BPL Families), Child Sex Ratio, Decline in decadal population growth 2001-11 over 1991-2001. Girl Education, Infant Mortality Rate, Own Revenue Mobilization
		V	√	√	√	√	√		Poverty (No. of BPL Families), Child Sex Ratio, Decline in decadal population growth 2001-11 over 1991-2001. Girl Education, Infant Mortality Rate, Own Revenue Mobilization
18	Sikkim	I							
		II							
		III							
		IV							
19	Tamil Nadu	I	√	√					PU(Population SC/ST Pop, Financial viability of the Panchayat Union, ((Average per capita Land Revenue)), VP (Per capita House Tax collection performance, d) Core Civic Services Infrastructure maintenance)
		II	√	√		√			Agricultural Laborers, Resource Gap on inverse per capita land revenue, Asset Maintainance

		III	√	√	√ (Women)	√			
		IV							
20	Tripura	I	√					√	
		II							
		III	√						
		I	√			√			
21	Uttar Pradesh	II	√	√		√			Composite District Level Index (population (R) 2001, SC/ST Population(R) 1991, Area (Rural), 1998, Socio-economic Backwardness, Inverse of Gross value of agricultural output per person (Rural), Average for 1997-2000, Educational Backwardness (illiterate rural population), 2001, Medical Facilities (Inverse of No. of Beds in PHCs per lakh of rural population) 1997-98, Tax Effort (share in total own revenue of all PRIs), Average for 1997-2000
		III	√	√					District Integrated Development Index, Revenue Effort
		IV	√	√		√			Integrated Development Backwardness Index
22	Uttarakhand	I							

		II	√				√	Deprivation Index, Remoteness Index, Tax Effort
		III	√				√	Remoteness, (No. of GPs Just for KP)
23	West Bengal	I	√				√	Criteria for distribution between districts covers population, level of non literacy, proportion of backward population, area of the district, proportion of rural population, and inverse ratio of per capita bank deposits and of working capital of primary agriculture cooperatives taken together
		II						
		III						

1 No. of workers in registered factories Per lakh of population, Per Capita Consumption of Power,  
Literacy rate

2 Number of poor families identified by DRDA s in their surveys of 1992

## D. Grants in Aid

Grants-in-aid are provided to fill the gap of the local governments – both panchayat and municipalities - so that they can meet the expenditure on local public goods. These can be (a) general purpose grants or block grants based on some criteria or formula meant for additional resources with no conditions attached; and (b) conditional or specific purpose grants, e.g. some schemes or projects. This can be further classified into matching or incentive grants and non-matching grants. From another perspective, grants can also be either statutory or non-statutory. Statutory grants are compulsory transfers that may be in lieu of abolition or withdrawal of certain taxes such as octroi.

Richard Bird while proposing state local fiscal transfer system in Uttar Pradesh in 1998 emphasized three major aspects that need considerations while designing grants, these are

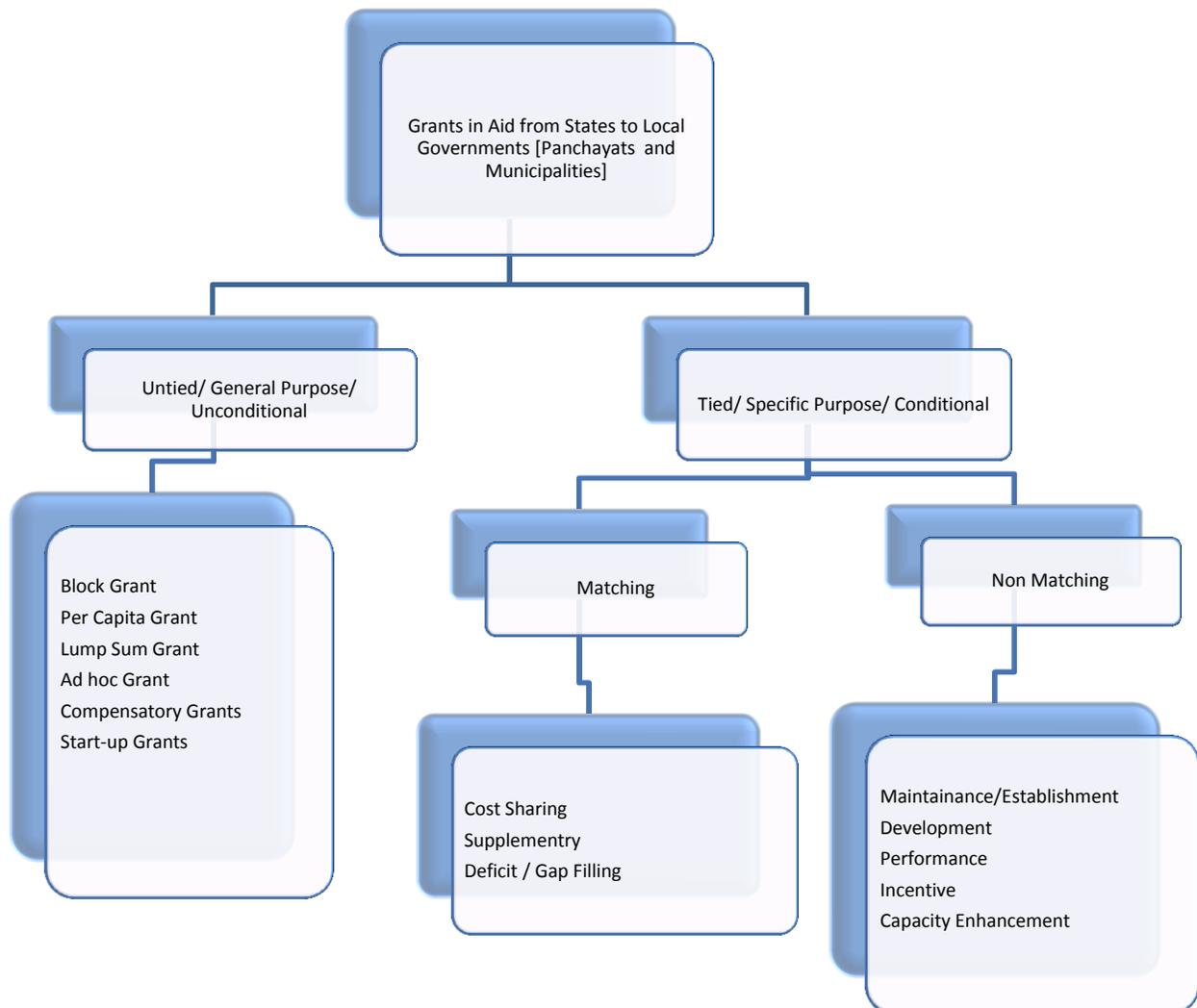
- Perspective for designing and evaluation
- The context within which the transfers would occur (the functions assigned and the revenue available)
- Appraisal of various elements that enter into the design of any grant

According to him, the purpose of grant design is not only to assist the governments financially but to make them able to provide proper basic services to the citizens. Since the financial capacity and the level of assistance vary from one jurisdiction to another it demands simplicity, objectivity, flexibility and transparency in transfer designs.

### How the SFCs designed their Grants

SFCs of all generations have recommended various types of Grants. These grants vary from state to state. Even the definitions and connotations are diverse across states over time. Broadly, we could classify the following grants recommended by various SFCs (See Fig.1).

Exhibit 2.1: Types of Grants Recommended by Various SFCs



### General Purpose /Unconditional/Untied Grants

General-purpose transfers are provided as general budget support, with no strings attached. These transfers are typically mandated by law, but occasionally they may be of an ad-hoc or discretionary nature. Such transfers are intended to preserve local autonomy and enhance inter-jurisdictional equity. First SFC of Arunachal Pradesh, Madhya Pradesh, Uttarakhand and West Bengal recommended general purpose grant. First SFC of Kerala recommended basic tax grant whereas Punjab suggested lump sum grant. It may be noted that the terminology of this grant varies from one state to another. Second SFC of Tamil Nadu

mentioned this as revenue grant whereas second SFC of Gujarat called it general purpose ad hoc grant. Nevertheless, second SFC of Madhya Pradesh, Kerala, Odisha, Tripura, Uttarakhand and West Bengal recommended the grant and called it general purpose grant only. Further, Third SFC of Madhya Pradesh, Sikkim, Tamil Nadu, Tripura, Uttarakhand and West Bengal suggested this grant. In the fourth phase, SFC of Assam, Bihar, and Rajasthan mentioned it as untied and SFC of Himachal Pradesh and Tamil Nadu referred it as general purpose grant and lump sum grant respectively.

SFCs have also specified General Purpose /Unconditional/Untied Grants in the following categories:

#### Block Grant

Block grant is given by the upper level of government for general areas of social welfare rather than a specific programme. General-purpose transfers are termed block transfers when they are used to provide broad support in a general area of the lower level of government expenditures (such as education) while allowing recipient's discretion in allocating the funds among specific uses. First SFC of Andhra Pradesh and Maharashtra, second SFC of Manipur and third SFC of Karnataka recommended block grant to address different areas of concern.

#### Compensatory Grants

Second SFC of Gujarat and Punjab, third SFC of Himachal Pradesh and Rajasthan and fourth SFC of Rajasthan recommended compensatory grant in lieu of octroi. Fourth SFC of Assam recommended this grant for payment of electricity charges of select municipalities.

#### Per Capita Grant

Shoup C. S. (1969)<sup>4</sup> distinguished two types of per capita grants for general purposes, i.e. uniform and non-uniform. Uniform per capita grant is the most generalized form of general purpose grant where the money is distributed on per capita basis. The population of the receiving government is the most implicit index of need for the grant. No index of effort is

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<sup>4</sup> Shoup C.S. (1969), Public Finance, London, Weidenfeld and Necolson.

involved here. Whereas non-uniform per capita grant gives more weight to distributive factors. It takes into consideration the ability to raise revenue. Poor jurisdictions get higher level of per capita grant in comparison to rich jurisdictions. This type of grant is differentiated according to the relative resources and relative effort (Shoup 1969). First SFC of Andhra Pradesh suggested increment in per capita grant. While the first SFC of Gujarat and Haryana and the third SFC of Andhra Pradesh recommended per capita grant, the distinction between uniform of non-uniform was ignored.

### Special Purpose Grant

This grant is also implied as conditional or tied grant. In its first phase, SFC of Andhra Pradesh, Arunachal Pradesh, Haryana, Punjab, Tamil Nadu and Uttarakhand recommended this type of grant. In the Second phase, this grant was recommended in the SFC report of Andhra Pradesh, Haryana, Madhya Pradesh Maharashtra and Tamil Nadu. Subsequently, third SFC of Andhra Pradesh, Assam, Karnataka, Rajasthan, Sikkim Tamil Nadu, Uttarakhand and Uttar Pradesh suggested it. In its fourth edition, a small number of SFCs have submitted their reports and among them SFC of Assam, Bihar, Haryana, Kerala, Odisha and Rajasthan recommended this grant. Finally, fifth SFC of Bihar and Rajasthan have recommended special purpose grant in their interim reports.

### Conditional Non-Matching:

Conditional non-matching transfers provide a given level of funds without local matching, as long the funds are spent for a particular purpose. In this category, the SFC reports include the following:

### Incentive Grants

In its first phase, SFC of Arunachal Pradesh, Rajasthan and Gujarat recommended incentive grants for functional improvement and better performance. The second generation SFC of Andhra Pradesh and Maharashtra suggested the same to establish solid waste management plants and for tax recovery respectively. SFC of Gujarat and Punjab just referred this grant

without mentioning the purpose. Second SFC of West Bengal also dealt on Incentive fund. Third SFC of Rajasthan recommended it for revenue mobilization, whereas SFC of Karnataka, Sikkim and Uttarakhand just mentioned it without assigning specified objective. Further, in the fourth and fifth generation of SFCs, Rajasthan is the only state to suggest this grant.

#### Maintenance /Establishment Grant

These grants are recommended to meet the operation and maintenance and establishment costs of panchayats and municipalities. First SFCs of Andhra Pradesh, Haryana, Kerala Rajasthan and Tamil Nadu recommended maintenance grant. Further, Second SFCs of Gujarat, Haryana and Kerala did mention it. In the third generations of SFCs, only Maharashtra suggested this type of grant. Surprisingly, fourth and fifth SFCs have not mentioned it in their reports. In its First SFC report, Manipur mentioned establishment grant. Similarly, the Second SFC of Sikkim recommended this grant to meet the establishment cost. At last, the third SFC of Madhya Pradesh suggested establishment grant.

#### Development Grant

These grants relate to specific schemes of development in respect of which the state governments are expected to bear a proportion of cost. First SFC of Manipur, second SFC of Haryana, third SFCs of Himachal Pradesh and Uttar Pradesh recommended this type of grant.

#### Capacity Building Grants

The grant intends to enhance the capacity of both panchayats and municipalities in terms of administration and organization. The objective behind capacity-enhancement grants is to strengthen the institutions so that they could be fully equipped to perform their mandated functions. Third SFC of Assam recommended capacity enhancement grant for the purpose of training and capacity building of panchayats and municipalities. Fourth SFC of Assam recommended the grant for training of auditors in the Directorate of Audit. Recently, the fifth SFC of Bihar recommended capacity enhancement grant.

#### Performance Grant

Output-based or performance grant establish a link between the funds provided through grant and the performance associated with the conditions of the grant. Third SFC of Madhya Pradesh, fourth SFC of Rajasthan and Fifth SFC of Bihar recommended performance base grants.

#### Conditional Matching Grant

Conditional matching grants, or cost-sharing programs, require the recipient or local governments to match or contribute the funds partially on explicit purposes on which the grants are approved. SFCs included the following, in this category:

#### Cost Sharing Grants

First SFC of Rajasthan and West Bengal in their reports recommended these matching grants. The former suggested the matching share for the utilization of grants recommended by the Tenth Finance Commission. Whereas, the latter recommended that the central releases for the operations of various Centrally Sponsored Schemes should be matched by proportionate state releases. First SFC of Tamil Nadu mentioned house tax matching grant. Third SFC of Himachal Pradesh recommended expenditure and infrastructure support grant. Third SFC of Haryana recommended supplementary grants. Third SFC of Maharashtra recommended cost sharing and scheme specific grants to maintain water supply schemes and to initiate a programme of low cost sewage disposal schemes in large size villages. Third SFC of Tripura suggested grants for meeting shortfall of funds in maintenance of asset and establishment expenditure. Third SFC of Uttar Pradesh recommended the grant to assist Mid-day Meal Scheme. In its preliminary report, the fifth SFC of Rajasthan proposed matching grant.

#### Supplementary Grants

Third SFC of Haryana recommended supplementary grants. Fourth SFC of Himachal Pradesh advocated supplementary grant.

#### Deficit Grant/Gap Filling

First SFC of Assam recommended debt relief against existing government loans. Similarly, Himachal Pradesh, in its First SFC, suggested grants for deficit recovery of panchayats and

municipalities. First SFC of Uttar Pradesh in its reported recommended converting loans for integrated development of small and medium towns into grants. The third SFC of Andhra Pradesh and Assam recommended the grant for payments of arrears. Further, the third SFC of Himachal Pradesh and Kerala recommended gap filling grant to wipe out deficits.

### Fiscal Equalization Transfers

In addition to the above classifications, fiscal equalization transfers that belong to regional fiscal equity concerns, also made by SFCs.. These transfers are justified on political and economic considerations. In principle, a properly designed fiscal equalization transfers program corrects distortions that may cause fiscally induced migration by equalizing net fiscal benefits across states. The second SFC of Karnataka, Maharashtra and Tamil Nadu suggested fund equalization transfers.

**Table 2.4: Types of Grants Recommended by SFCs**

First Generation SFCs

SFC of:	Types of Grants
Andhra Pradesh	<p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ Water supply schemes in municipal areas</li> <li>▪ A special grant to newly formed GPs for purchasing of furniture, forms and registers.</li> <li>▪ Newly formed Gram Panchayat converted into Municipality.</li> </ul> <p>Maintenance</p> <ul style="list-style-type: none"> <li>▪ Maintenance of rural roads</li> <li>▪ Maintenance of minor irrigation sources</li> <li>▪ Maintenance of family planning staff quarters.</li> <li>▪ Maintenance of school buildings.</li> </ul> <p>Block</p> <ul style="list-style-type: none"> <li>▪ To each Municipal Corporation.( Hyderabad, Vishakhpatnam and Vijayawada )</li> <li>▪ To each of the remaining Municipal Corporations as block grants to be utilized for felt needs.</li> <li>▪ Increment in Per capita grant</li> </ul>
Arunachal Pradesh	<p>Special Purpose (Plan grants to the Panchayats )</p> <ul style="list-style-type: none"> <li>▪ 40% should be spent on the “productive sector”,</li> </ul>

	<ul style="list-style-type: none"> <li>▪ 30% on “infrastructure building” and</li> <li>▪ 10% on “gender-sensitive schemes and subsidies”</li> <li>▪ 20% may be “open” at the discretion of the Panchayats.</li> </ul> <p>General purpose Incentive Grant (to GPs)</p> <ul style="list-style-type: none"> <li>▪ For raising their own revenue.</li> </ul>
Assam	<p>Fund Equalization</p> <ul style="list-style-type: none"> <li>▪ debt relief against existing government loans</li> </ul>
Gujarat	<p>Per Capita Basic Grant Incentive Grant to municipalities</p> <ul style="list-style-type: none"> <li>▪ For revenue mobilization</li> </ul>
Haryana	<p>Maintenance</p> <ul style="list-style-type: none"> <li>▪ for maintenance of community assets at Block level</li> <li>▪ for maintenance of Panchayat buildings</li> <li>▪ for the repair of Zilla Parishads for the Panchayat Samities buildings in the entire State</li> </ul> <p>Special purpose</p> <ul style="list-style-type: none"> <li>▪ for sanitation and environmental improvement</li> </ul> <p>Per capita grant</p>
Himachal Pradesh	<p>Deficit</p> <ul style="list-style-type: none"> <li>▪ For Deficit recovery of Panchayats and Municipalities</li> </ul>
Kerala	<p>General Purpose (Basic tax grants)</p> <ul style="list-style-type: none"> <li>▪ The total amount may be credited to a state pool.</li> </ul> <p>Maintenance</p>
Madhya Pradesh	<p>General purpose grant</p>
Maharashtra	<p>General Purpose</p> <ul style="list-style-type: none"> <li>▪ The irrigation cess grant equal to 66.67% of the demand should be given to the Zila Parishads as advance grant.</li> </ul> <p>Block Grant</p> <ul style="list-style-type: none"> <li>▪ The primary education grant</li> </ul>
Manipur	<p>Establishment Grant Development Grant</p>
Punjab	<p>General Purpose Grant(Lump Sum ) Special Purpose grant Incentive grant</p>

Rajasthan	<p>Maintenance</p> <ul style="list-style-type: none"> <li>▪ For rural roads and buildings @ Rs. 5000/- per panchayat and @ Rs. 10,000/- per Panchayat Samities to maintain office buildings and staff quarters. In case of Zilla Parishads, the amount is Rs. 20,000 per Zilla Parishad per annum.</li> </ul> <p>General; Purpose (Start-Up) Grant</p> <ul style="list-style-type: none"> <li>▪ To each of 1856 newly created Gram Panchayats due to delimitation exercise carried out before the constitution of the Commission.</li> </ul> <p>Incentive</p> <ul style="list-style-type: none"> <li>▪ to each level of PRIs for functional improvement, and better performance</li> </ul> <p>Matching Grant</p> <ul style="list-style-type: none"> <li>▪ Matching share for the utilization of grants recommended by the Tenth Finance Commission.</li> </ul>
Tamil Nadu	<p>Specific Purpose</p> <ul style="list-style-type: none"> <li>▪ lighting grants, water-supply grant, drainage grants,</li> </ul> <p>Maintenance</p> <ul style="list-style-type: none"> <li>▪ Road maintenance grant,</li> <li>▪ Maintenance of maternity centers and dispensaries</li> </ul> <p>General Purpose (Revenue)</p> <p>matching grants (House Tax)</p>
Uttar Pradesh	<p>Fund Equalization</p> <ul style="list-style-type: none"> <li>▪ Loans for integrated development and of small and medium towns, as on 31st March 1994 with interest thereon are to be converted into grant.</li> </ul>
Uttaranchal (Uttrakhand)	<p>General Purpose</p> <p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ Computerization</li> <li>▪ Environmentally sensitive pilgrim places</li> <li>▪ Slum Improvement</li> </ul> <p>Deficit</p>
West Bengal	<p>General Purpose</p> <p>Matching</p> <ul style="list-style-type: none"> <li>▪ A large number of Centrally Sponsored Programmes such as JRY, IRDP, ARWSP etc. are now in operation in which the Central releases have to be matched by proportionate State releases.</li> <li>▪ Covering of non-Plan expenditures will also be grants.</li> <li>▪ D.A. liabilities of approved staff should be available as</li> </ul>

	grants.
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## Second Generation SFCs

SFC of:	Types of Grants
Andhra Pradesh	Special Purpose <ul style="list-style-type: none"> <li>▪ To meet the demand of the salaries bill of teaching employees.</li> <li>▪ To provide drinking water in schools.</li> <li>▪ For construction of Panchayat building</li> </ul> Incentive <ul style="list-style-type: none"> <li>▪ To establish Solid Waste Management Plants</li> </ul>
Assam	General Purpose
Goa	General Purpose
Gujarat	Incentive Compensatory (in lieu of Octroi) Maintenance General purpose (Ad hoc)
Haryana	Maintenance <ul style="list-style-type: none"> <li>▪ for maintenance of Panchayat buildings</li> <li>▪ for the repair of Zilla Parishads for the Panchayat Samities buildings in the entire State</li> </ul> Special purpose <ul style="list-style-type: none"> <li>▪ for sanitation and environmental improvement</li> </ul> Development
Himachal Pradesh	Deficit <ul style="list-style-type: none"> <li>▪ For Deficit recovery of Panchayats and Municipalities</li> </ul>
Kerala	Maintenance General purpose
Madhya Pradesh	General purpose Special Purpose <ul style="list-style-type: none"> <li>▪ (Establishment grant ) for the payment of honorarium and other payments to the staff working in the 3- tier Panchayats,</li> <li>▪ For organizing training programmes at the district level for the elected representatives Panchayats in their</li> </ul>

	respective jurisdictions.
Maharashtra	<p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ For VPs to eliminate backlog in the districts of Marathwada, Vidarbha, Konkan and the rest of Maharashtra where backlog regarding development exists</li> </ul> <p>Incentive (Tax Recovery)</p> <ul style="list-style-type: none"> <li>▪ All VPs shall be given Tax Recovery Incentive Grant on the basis of recovery of all the previous financial year</li> </ul>
Manipur	<p>Block Grant</p> <ul style="list-style-type: none"> <li>▪ For purchase of essentials like chalk, registers and stationery etc.</li> <li>▪ For carrying out essential repairs of school furniture, fixtures and fittings.</li> <li>▪ For purchase of class rooms furniture.</li> <li>▪ For purchase of games and sports material.</li> </ul>
Odisha	General Purpose
Punjab	Compensatory (in lieu of Octroi) Incentive
Rajasthan	Incentive
Sikkim	<p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ grants to meet establishment cost</li> </ul>
Tamil Nadu	<p>Specific Purpose</p> <ul style="list-style-type: none"> <li>▪ Reserve fund</li> <li>▪ Equalization Fund</li> <li>▪ Incentive Fund</li> </ul>
Tripura	General Purpose
Uttar Pradesh	<p>Block Grant (A one-time non-recurring grant)</p> <ul style="list-style-type: none"> <li>▪ For IT equipment and MIS needs of the Directorate of Local Bodies and the Task Forces to be set up in all districts.</li> </ul>
Uttarakhand	General Purpose
West Bengal	General Purpose Incentive Fund

Third Generation SFCs

SFC of:	Types of Grants
Andhra Pradesh	<p>Per Capita Special</p> <ul style="list-style-type: none"> <li>▪ For construction of GP office building</li> <li>▪ For providing basic civic amenities</li> <li>▪ For the Rural Water Supply Schemes</li> <li>▪ For Rural Sanitation.</li> <li>▪ For the construction of Rural Roads and released to Panchayats</li> <li>▪ For providing drinking water facilities in the schools for the Panchayats</li> <li>▪ For maintenance of Mandal Office Buildings.</li> <li>▪ for maintenance of Municipal Buildings</li> <li>▪ Towards payments of arrears. (Deficit Grant)</li> <li>▪ Towards increase of half yearly D.A. and revision of pay scale of Municipal Staff.</li> </ul>
Assam	<p>Deficit Grant</p> <ul style="list-style-type: none"> <li>▪ For the purpose of clearing the arrear dues of Panchayat Secretaries.</li> </ul> <p>Capacity Building</p> <ul style="list-style-type: none"> <li>▪ for capacity building of GMC and other Municipalities</li> <li>▪ For the purpose of training and capacity building in Panchayats.</li> </ul> <p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ To Municipalities including GMC for construction of cremation and burial grounds.</li> <li>▪ To Municipalities including GMC for the construction of public convenience.</li> <li>▪ To the ZPs for repair and maintenance of roads and buildings within their respective jurisdiction</li> </ul>
Haryana	Supplementary
Himachal Pradesh	<p>Matching Conditional Grants (expenditure and infrastructural support grants)</p> <ul style="list-style-type: none"> <li>▪ For augmentation of accommodation of Panchayat ghars and office infrastructure.</li> </ul> <p>Development Supplementary Compensatory (in lieu of Octroi)</p>

	Deficit Grant (Gap Filling)
Karnataka	<p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ to organize programmes at village level covering sanitation, health checkup, cultural and folk sports</li> <li>▪ construction of youth association buildings</li> <li>▪ For conducting folk arts training programmes.</li> <li>▪ To take up youth development programmes at village, hobli, taluk and district levels.</li> </ul> <p>Statutory Development Fund Equalization (Additional Grant) Incentive Block Untied Grant</p>
Kerala	The difference between funds available with LSGs and that share of outlay should be given to LSGs.
Madhya Pradesh	<p>Performance Based</p> <ul style="list-style-type: none"> <li>▪ To those Gram Panchayats which levy and collect the taxes on time.</li> </ul> <p>General Purpose Establishment Maintenance Compensatory Conditional Matching Grant</p>
Maharashtra	<p>Matching (Scheme Specific, Cost Sharing)</p> <ul style="list-style-type: none"> <li>▪ For maintaining water supply schemes</li> <li>▪ To initiate a programme of low cost sewage disposal scheme in large size villages.</li> </ul> <p>Maintenance</p> <ul style="list-style-type: none"> <li>▪ for repair and maintenance of School rooms</li> <li>▪ for repair and maintenance of health service to ZPs.</li> </ul> <p>Fund Equalization (One Time Grant)</p> <ul style="list-style-type: none"> <li>▪ To meet 50% of the remaining outstanding amount of arrears of Maharashtra Jeevan Pradhikaran by GPs.</li> </ul>
Punjab	Downward percolation of grants at district level as per the recommendation of District Planning Committee
Rajasthan	<p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ To panchayats as per the district -wise requirement of the tanks transferred to them.</li> </ul>

	<p>Compensatory (in lieu of Octroi) Incentive</p> <ul style="list-style-type: none"> <li>▪ For raising revenues from untapped sources by the Panchayats.</li> </ul>
Sikkim	<p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ under 15 sectors (agriculture, horticulture, animal husbandry, HRDD, health, forest, commerce and industry, disaster management, irrigation, culture, rural management and development department, co-operative, social welfare, tourism &amp; power) excluding teacher's salary</li> </ul> <p>General purpose Incentive</p>
Tamil Nadu	<p>Special Purpose General Purpose</p>
Tripura	<p>Matching</p> <ul style="list-style-type: none"> <li>▪ Matching amount of additional grant equal to the amount of revenue collected by the Panchayats to be provided from the state govt. as an incentive.</li> </ul> <p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ For setting up of three more training institutes in the state</li> </ul> <p>Matching Conditional</p> <ul style="list-style-type: none"> <li>▪ Grants for meeting shortfall of fund in maintenance of assets and for establishment expenditure</li> </ul>
Uttar Pradesh	<p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ To fulfill the basic infrastructural needs.</li> <li>▪ for the needs based on social justice</li> </ul> <p>Conditional</p> <ul style="list-style-type: none"> <li>▪ One time grant and annual recurring grant for the construction of libraries and information centers.</li> </ul> <p>Matching (Scheme Specific)</p> <ul style="list-style-type: none"> <li>▪ To assist Mid Day Meal Scheme.</li> </ul>
Uttarakhand	<p>Incentive Special Purpose</p> <ul style="list-style-type: none"> <li>▪ For construction of ZP building in Champawat.</li> <li>▪ For institutional arrangement of solid waste in</li> </ul>

	<p>Kausani.</p> <ul style="list-style-type: none"> <li>▪ For repairs, renovation and modernization of Durga Sah Memorial Library in the year 2012-13.</li> <li>▪ For capacity building/research work relating to urban issues has been recommended.</li> </ul> <p>General Purpose</p>
West Bengal	<p>Deficit Grant (Pension Grant)</p> <ul style="list-style-type: none"> <li>▪ A special fund named as a 'Pension Fund' to be granted to the Municipalities constituting of the amount received on account of arrear Property Tax and the Service Charges.</li> </ul> <p>General Purpose</p>

## Fourth Generation SFCs

SFC of:	Types of Grants
Assam	<p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ For construction of functional and residential buildings for Panchayats at all levels.</li> <li>▪ For construction/improvement of markets, cremation and burial grounds at all level of Panchayats and cold storage for selected GP.</li> <li>▪ For construction of Town Halls.</li> <li>▪ installation of water supply plants in Municipal Boards and Town Committees</li> <li>▪ For purchase of equipments for solid waste management and creation of toilets.</li> <li>▪ For extending pensionary benefits to the employees of GMC.</li> <li>▪ For construction of Zonal offices of GMC and for other purposes.</li> <li>▪ For training of Auditors in the Directorate of Audit.</li> <li>▪</li> </ul> <p>Untied Compensatory</p> <ul style="list-style-type: none"> <li>▪ For payment of electricity charges for four municipalities. viz. Jorhat, Golaghat, Sonari and</li> </ul>

	<p>Titabor.</p> <p>Deficit</p> <ul style="list-style-type: none"> <li>▪ For liquidating deferred liabilities of 21 Municipalities.</li> </ul>
Bihar	<p>General Purpose (Untied)</p> <p>Special Purpose</p> <ul style="list-style-type: none"> <li>▪ Retirement Benefits of the Municipal Employees:</li> </ul>
Haryana	<p>Special Purpose (one time)</p> <ul style="list-style-type: none"> <li>▪ Maintenance of municipal road and SWM</li> <li>▪ Up gradation of fire services</li> <li>▪ Capacity building</li> <li>▪ Strengthening the rate base of Panchayats &amp; Municipalities</li> <li>▪ Maintain some of accounts &amp; audit of local bodies</li> <li>▪ Setting up of calls for research &amp; analyzing of public finance policy</li> </ul>
Himachal Pradesh	<p>General Purpose</p> <p>Supplementary</p>
Kerala	<p>General Purpose</p> <ul style="list-style-type: none"> <li>▪ A special grant of Rs. 25 lakh to each one of the 16 GPs (Names of the 16 GPs are given in Appendix 8A of the Report).</li> <li>▪ A grant of Rs. 15 lakh to each of 58 GPs (Names of the 58 GPs are given in Appendix 8B of the Report).</li> </ul>
Odisha	<p>Special Purpose</p> <p>Odisha Kendu Leaves Grants should be either shared with the pluckers instead of Panchayats or it should be withdrawn completely.</p> <p>The Commission does not consider the continuance of Sirat Grants and MFP worthwhile and recommends that it should be stopped.</p>
Rajasthan	<p>Special Purpose (Functional)</p> <p>Performance</p> <p>General Purpose (Untied)</p> <p>Incentive</p> <p>Compensatory (in lieu of Octroi)</p>
Tamil Nadu	<p>General Purpose (Lump Sum)</p>

Uttar Pradesh	No. Recommendation
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#### Fifth Generation SFCs

SFC of	Types of Grants
Bihar	Capacity Building Performance
Rajasthan	Special Purpose Incentive Matching

#### E. Functions and Functionaries

Article 243 G stipulates every State to provide the panchayats with powers and authority to enable them to function as institutions of self-government. For the purpose, States are required to enact laws which contain provisions for the devolution of powers and responsibilities upon panchayats with respect to a) the preparation of plans for economic development and social justice; and b) the implementation of schemes for economic development and social justice including those in relation to the twenty-nine matters listed in the Eleventh Schedule. However, the list is merely illustrative and indicative. Unlike the division of powers and functions, as spelled out in the Union and State List in the Constitution, no such clear demarcation exists between the State and Panchayats. It is for the State Legislature to make laws regarding the devolution of powers and functions upon the Panchayats.

Though, almost all states and union territories (UTs) have claimed that they have transferred subjects in varying degrees to the Panchayats, by enacting laws in conformity with the CAA, functional domain of Panchayats pertains to only traditional civic functions in several states. Functional domain is without adequate developmental responsibilities in those states where either the intermediate Panchayats or the District Panchayats were absent for decades. States, where they existed for long, have only repeated the provisions of the old statutes in their new laws with marginal adjustments. Moreover, many State Governments have not framed the relevant rules or guidelines as a follow up measure. A few States realized that transfer of

additional functions would accompany the concomitant funds and functionaries to local governments, enabling them to perform the specified responsibilities. At the same time, the local governments are also not very clear about the role they are expected to play in the new federal set up. The fact of the matter is that almost all the subjects enumerated in the Eleventh Schedule are State-concurrent, involving duplication and overlapping.

Another challenge before the State Government has been the identification of activities to the appropriate tier of the three-tier-panchayat system. Traditionally, the lowest level panchayat, i.e. the village panchayat (VP) has been the most active in almost all States. Generally, the VPs carry out major functions including core functions whereas intermediate and district panchayats in most States are assigned supervisory functions or act mainly as executing agents for the state government.

It is a general perception that Panchayats are financially and technically under-equipped to perform even the core functions, not to speak of the welfare functions and other economic functions related to agriculture and industries (see exhibit 1.1). Hence, many of the core functions, which traditionally belonged to local governments like, drinking water, rural roads, street lighting, sanitation, primary health etc. have not been transferred fully in some states and are being performed by the line departments of the State Government or the parallel parastatals.

It is therefore the mandate of each SFC to make recommendations for the devolution of certain functions, finances and functionaries to panchayats. While recommendations of SFCs with respect to finances are analyzed in other parts of the report, the following table contains recommendations of all five generations SFCs with respect to the devolution of functions and functionaries to panchayats.

**Table 2.5: Devolution of Functions & Functionaries by SFCs to Panchayats**

S.N.	SFCs → Parameters ↓	I SFC of:	II SFC of:	III SFC of	IV SFC of:	V SFCs
I.	Subjects/Functions Transferred					

1	Agriculture, including agricultural extension	AP, Ar.P, Tri, UP	Odi	Mah, Har, Pun, Raj	-	-
2	Land improvement, implementation of land reforms, land consolidation and soil conservation	AP, Tri, UP	Odi	-	-	-
3	Minor irrigation, water management and watershed development	AP, Ar.P, Tri, UP	Odi	Mah, Pun, Raj	-	-
4	Animal husbandry, dairying and poultry	AP, Ar.P, Man, Tri, UP	Odi	HP, Mah, Pun, Raj	HP	-
5	Fisheries	AP, Tri, UP	Asm, Guj, Odi	Har, Tri	-	-
6	Social forestry and farm forestry	AP, Man, Tri, UP	Odi	AP, Har, Pun, Raj	-	-
7	Minor forest produce	AP, Tri, UP	Odi	Pun, Raj	-	-
8	Small scale industries, including food processing industries	AP, Tri, UP	AP, Odi	-	-	-
9	Khadi, village and cottage industries	AP, Tri, UP	Odi	-	-	-
10	Rural housing	AP, Tri, UP	Odi	-	-	-
11	Drinking water	AP, Kar, Man, Odi, Tri, UP	Guj, Odi	HP, Kar	Bih	-
12	Fuel and fodder	AP, Tri, UP	Odi	-	-	-
13	Roads, culverts, bridges, ferries, waterways and other means of communication	AP, Ar.P, Kar, Man, Odi, Tri, UP	Asm, Guj, Odi, Pun	Kar, Mah	-	-
14	Rural electrification, including distribution of electricity	AP, Tri, UP	Odi	-	Bih	-
15	Non-conventional energy sources	AP, Tri, UP	Odi	-	-	-
16	Poverty alleviation	AP, Tri,	Odi	-	Bih	-

	programme	UP				
17	Education, including primary and secondary schools	AP, Ar.P, Tri, UP	MP, Odi, Pun	HP, Mah, Pun, Raj	Bih, HP	-
18	Technical training and vocational education	AP, Tri, UP	Odi	-	-	-
19	Adult and non-formal education	AP, Man, Tri, UP	Odi	-	-	-
20	Libraries	AP, Tri, UP	Odi	-	-	-
21	Cultural activities	AP, Tri, UP	Odi	-	-	-
22	Markets and fairs	AP, Man, Tri, UP	Asm, Odi	Tri	-	-
23	Health and sanitation, including hospitals, primary health centres and dispensaries	AP, Ar.P, Odi, Tri, UP	Odi	HP, Mah, Raj, Pun	Bih, HP	-
24	Family welfare	AP, Ar.P, Tri, UP	Odi	-	-	-
25	Women and child development	AP, Tri, UP	Odi	HP, Mah	-	-
26	Social welfare, including welfare of the handicapped and mentally retarded	AP, Ar.P, Man, Tri, UP	Odi	-	Bih	-
27	Welfare of the weaker sections, and in particular, of the Scheduled Castes and the Scheduled Tribes	AP, Tri, UP	Odi	-	-	-
28	Public distribution system	AP, Tri, UP	Odi	-	-	-
29	Maintenance of community assets	AP, Kar, Ker, Man, Tri, UP	Odi	-	-	-
30	Registration/Issuance of Certificate of birth & death	Asm	Asm, Odi	HP, TN	Asm, Sik	-
II.	Administration					
1	Regular Inspection by Senior Officials	AP, Ar.P	-	Asm, Mah	Odi, TN	-

2	Assessment of Resources	-	Asm	Ker	-	-
3	Transfer of Staffs	-	-	MP	Raj	-
4	Preparation of Annual Plans	Ar.P, MP, Pun	AP, Ker	-	Sik	-
5	Maintenance of Statistics	Man	Asm	MP	HP, Ker	
6	Maintenance of Infrastructures	Man	UP	Har	-	-
7	Execution & Implementation of Projects/Schemes	Ar.P, Pun	-	-	-	-
8	Human Resource Management Policy	-	Kar	-	Ker	-
9	Creation of Ombudsman Institution	Goa	-	Kar, TN	-	-
10	Handling Disciplinary Matters	-	-	-	Sik	-
III.	Tax Administration					
1	Property Tax	Guj	Kar	Har	TN	-
2	Water Tax	Guj, TN	-	-	-	-
3	Advertisement Tax	Guj, TN	Har, Ker	Har	-	-
4	House Tax	-	Har	AP, Pun	-	-
5	Service Tax	-	-	Har	-	-
6	Marriage Registration/Birth & Death Fee	-	-	HP	-	-
7	Collection of Tolls	-	-	Tri	-	-
8	Collection of Cess	Guj	Guj	-	-	-
9	Collection of Revenues from different Sources	-	Tri	-	-	-
10	Collection of Arrears	Man	-	-	-	-
11	Collection of User Charge	TN	Kar	Har	-	-
12	Assessment of Taxes	Asm	Har	-	-	-
13	Determination of Rate of Structure of Taxes & Fees	Har, Krn	Asm, Har, Pun, WB	Sik	-	-
14	Collection of Taxes should be Outsourced	-	-	Har	-	-

IV.	Financial Administration					
1	Contributory Pension Scheme	-	TN	-	-	-
2	Enhancement in Rates of Honorarium	-	Sik, Tri	-	-	-
3	Salary/Allowances of the Employees	-	Guj	-	-	-
4	Exercise of Financial Powers	Pun, WB	-	-	-	-
5	Prediction of Fund Flow	-	-	-	TN	-
V.	Audit & Accounts					
1	C & AG Prescribed Accounts Format	-	Asm	-	Asm, Raj	-
2	Single Account System	-	Ker	-	Ker	-
3	Primary Auditor	-	-	-	Asm	-
4	Audit by Deputy BDO	-	TN	-	-	-
5	Separate Wing for Audit			Asm, Kar		
6	Finance & Account Wing			Ker		
7	Accounts Cadre		MP		Ker	
8	Accrual Based Accounting System		TN		Odi	
VI.	Staffing & Recruitment					
1	Officer on Special Duty	AP	AP			
2	Recruitment for Database & Accounts	AP	TN	Kar	Bih	
3	Secretary as Permanent Staff		HP, Raj, UK		Sik	
4	Executive Officer		Odi			
5	Panchayati Raj Cadre		MP, Sik			
6	Recruitment of Qualified, Skilled & Adequate Candidates	AP, WB			Bih, Raj, UP	
7	Regularised System of Recruitment		Asm, Goa, Kar	UK	Har, Raj	
8	Special Appointment for SFC functioning	AP	AP	AP	HP	

9	Creation of Separate Service Cadres		Ker, MP	Odi		
10	Authority to Abolish Vacant Posts/Create New Posts		UK			
VII.	Training & Capacity Building					
1	Regularized System of Training		Guj, Odi	Asm, Sik, UK, WB		
2	Training for Candidates Newly Inducted	AP	UK	Raj		
3	Refreshers Training for Service Candidates	AP				
4	Training for Officials	Har, Kar	Guj	AP		
5	Training for Elected Representatives	Kar	Guj, Raj, UK	Pun		
6	Strengthening/ Establishment of Institutes for Training Purpose		Har	WB	Raj	
7	Training by State Specific Institutes			Har		
8	Training of Accounting Officials		TN		Sik	
9	Action Plan on Capacity Building prepared by State Institute				Asm	
10	Capacity Build of Accounting Staff				Sik	
VIII.	Committees/Expert Groups					
1	To fix Staffing Pattern	AP	Ker	Odi		
2	Auditing Committee			MP		
3	Human Resource Commission				Ker	
4	District Level Committee	Har				
5	Standing Committee				Raj	
6	High Level/High Level Monitoring Committee			MP	Odi	
7	Expert Group	Ker			Ker	

8	Public Accounts Committee	Har				
IX.	Others					
1	Outsourcing of Waste Disposal/Civic Facilities to Private Agencies	MP	Raj	Raj, UK	TN	
2	Public Private Partnership			Har, UK	Ker	
3	Collection of Taxes should be Outsourced			Har		
4	Medical Assistance to Elected Members		Sik			
5	Parastatals to be accountable to Local Governments				Asm	

## F. Other Measures

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

**Table 2.6: Other Policy and Administrative Measures**

Other Measures	I SFCs	II SFCs	III SFCs	IV SFCs	V SFCs
One common legislation for all local bodies to avoid confusion regarding the regulations and bye-laws	Kar, Ker, Mah, Pun, UP				
Tax Valuation Committee to listen to the objections of the tax-payer regarding Property Tax assessment-Punjab(I)	Pun				
Finance Commission Cell should function in the Finance Department	Kar, Ker, TN			Asm	

of the State government even after the expiry of the SFC's term to review the implementation of the recommendations of the SFC					
Public Accounts Committee for municipal finance -	Har, Pun				
Local Body should be allowed to levy taxes and service charges on all government properties (including the properties of public sector undertakings of the Union and State Governments, Boards, Corporations). The Constitution should be amended for this purpose.	Mah, Raj, TN, UP		WB		
Fund for data base, computerization, software etc	Mah, Pun, Kar,			Har, Raj	
A permanent secretariat for SFC with adequate staff./SFC Cell/Other related Issues	-	AP, Asm, Guj,	AP, M P, Sik	Asm, HP	Bih
Audit of Municipal Corporation accounts by Accountant General of the State	UP			Asm	
Review of implementation of recommendations of the State Finance Commissions may be entrusted to a statutory authority	AP				
An independent service selection commission to				Raj	

select officers and subordinate officials of municipal services.					
A state level Property Tax Board should be set up.				Bih	
Synchronization of the period of SFC with the period of Union Finance Commission	-	Odi	Sik	HP, Asm	-
Introduction of GIS/ Extension of GIS	-	UP	Pun, WB		-
Creation of Property Tax Board	-	-	Kerala	Ker, Bih	-
DRDA should be dissolved and its office should be merged in ZP	-	UP	-	Odi	-
The immediate introduction of e-governance or related issues	-	-	-	Raj, Asm, Har, UP	Bih
Constitute a strong cadre of officers	-	Odi, Sik	MP	Odi	-
A separate wing for auditing the accounts of local bodies. / audit Committee	-	-	, AP. Kar, MP	-	-
Ombudsman system to be introduced having jurisdiction over Panchayats and Municipalities	-	-	Kar, TN	TN	-
Set up Municipal Development Fund	-	Sik	Mah, Pun	-	-
Training programs for the elected representatives and staff of Panchayats and Municipalities	AP, Har, Kar, Pun, Mah, TN, Ker	AP, Guj, UK, UP	Pun, Raj, UK, WB	Asm, Raj	Bih
For proper accountability of the LSGs, double entry system of book keeping	-	-	WB	-	-

and accounting in order to speed up the system					
A monitoring and evaluation/ Monitoring Committee	-	Sikkim	-	Asm, Odi	Bih
Introduction of accrual based double entry system in all the Municipalities	-	-	-	Har, Odi	-
Privatization of desired services	Mah,UP, TN, Ker, Pun	UP	-	Har, Ker	-
Appointment of Tariff Commission	Asm, Guj				
The powers, functions and responsibilities of the State Governments and the local bodies may be bifurcated similar to the division of subjects that exists between the Union and the States in the form of the Union and the State Lists. A third list for District Governments may be inserted in the Constitution.	Raj			Raj	
Women Component Plan (WCP) may be strengthened and gender budgeting be given statutory status.				Ker	
Establishment of Biodiversity Management Committee				Ker	
The Central Government should set up a unit at the National Institute as a repository of State finance Commissions				HP	

Documents.					
LSGs should prepare their annual budget and maintain monthly accounts.				Asm,Bih	
Apart from house tax and tax on trades, all other sources of revenue allocated to the GPs are in the nature of fees, fines, tolls, cess etc. Hence these can be categorized as non-tax revenue.				Asm	

## II. Methodologies of SFCs

In order to address the common terms of reference, various SFCs have adopted different methodologies. Many of them attempted to estimate, in their own fashion, the resource gap. The definition of resource gap also varies from one report to another even in the same state. In some cases, unique method is employed to quantify the resource gap. After all these, lump-sum ad hoc grants are recommended. Successive Union Finance Commissions have pointed out that states' resource requirements for local governments cannot be compared and aggregated at national level due to inconsistent and unique methodologies each SFC uses to estimate resource gap.

Some SFCs have attempted to estimate the gap on a normative basis- though unsuccessfully in the absence of any systematic work in the recent past, at national level to develop expenditure norms of core services at different geographical terrains viz. hilly, coastal, desert and plain areas since the Zakaria Committee Report (1963). In many reports, methodology is not presented as could be seen from the following table:

**Table 2.7: Methodologies Adopted by SFCs**

S. N	States	Methodology Adopted by SFCs				
		I SFC	II SFC	III SFC	IV SFC	V SFC
1	Andhra Pradesh	Public Meetings, discussions with elected representatives, press conferences. Questionnaires issues for public response. Questionnaires issues for officials of concerned local bodies. National seminars were	Questionnaires issued were issued to GPs seeking information about income, expenditure and to indicate their views on tax collection, resource mobilization etc. Field visits were conducted in 10 districts and meetings were carried out with the senior officials.	Questionnaires issued were issued seeking information on receipts & expenditure of the local bodies. Field visits were conducted and regional conferences were organized at Tirupati, Guntur and Warangal.	-	-

		organized on Local Body Finances.				
2	Arunachal Pradesh	Not mentioned in the Report	-	-	-	-
3	Assam	Not mentioned in the Report	Views, suggestions and opinions on the terms of reference of the Commission were invited from individuals, institutions, political parties and other academic organizations. Separate questionnaires were prepared and sent to both urban and rural local bodies. Relevant data/ information were collected from the State and Central Government agencies and autonomous bodies. Discussions were held with departmental officers of the State Government. A member of the Commission was deputed to participate in the National Workshop on Panchayati Raj Finances organized by NIRD at Hyderabad.	Data on income, expenditure, area, population etc. were collected from concerned department of each local body. Questionnaire method was widely used alongwith regular interaction with elected representatives and officials of Panchayats & Municipalities. Frequent field visits were carried out. Workshops were conducted at different district headquarters. Tasks Force were constituted to assess infrastructural gaps in local administration.	A set of general questionnaires covering the whole gamut of physical and fiscal administration of Panchayats and Municipalities were formulated & circulated to all concerned departments. Field visit were carried out in various phases, covering almost all the districts of the state. Inter-active sessions were held with the elected representatives and officials of Panchayats and Municipalities.	-

4	Bihar	-	-	-	Questionnaires were circulated to all the Panchayats and Municipalities. Views of the Director Panchayati Raj, non departmental representatives, Panchayati Raj Department, Urban Development department were collected. The Commission made a visit to Nalanda district.
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5	Goa	<p>Questionnaires were prepared and circulated to the concerned departments. A considerable amount of data was thus collected and analyzed for preparation and presentation of key documents. Meetings were held with the representatives of the Panchayat bodies and municipal councils with Commission. The population figures of 1991 were adopted in all cases where population is regarded as a factor for determinations of devolution of taxes and duties and grants-in-aid.</p>	<p>On the basis of meetings &amp; detailed discussions carried out with Secretaries &amp; HoDs &amp; representatives of other important organizations of Central &amp; State government. A considerable amount of data was also collected and analyzed. The interactions with the Public and with elected representatives of VP, North and South Goa ZPs, Municipalities and consultations with departments on policy issues were limited because of the Code of Conduct that operated in the months of April, May and June 2007 for elections of Panchayats and of the Assembly. The Code of Conduct also operated in the months of September- October 2007 for the Parliamentary bye-elections.</p>	-	-	-
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6	Gujarat	<p>Considering the scope of the work entrusted to the commission, the statistical data and other information were obtained in different forms from the following sources: Concerned Departments, Director of Municipalities, Gujarat Municipal Finance Board, All the Municipal Corporations/Municipalities, District Collector, Gujarat Water Supply and Sewerage Board</p>	<p>The Commission interacted with other SFCs &amp; views were exchanged on the functioning of the local bodies in the states. Reports of SFCs from UP, AP, Bihar, Punjab, TN &amp; Kerala were useful in understanding other state governments' views on the finances &amp; procedures between governments &amp; the LBs. Video conferencing with the concerned officers were also held. Detailed statistical information and inputs with regard to financial positions of Municipalities and Panchayats were collected through specially designed schedules, annual reports and budgets of Panchayats and Municipalities. The Commission also contacted NGOs to solicit their suggestions with regard to the local self governance system.</p>	-	-	-
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7	Haryana	<p>Data on LB's finances was collected through director of Panchayats and from Municipalities. Information on revenue receipts, grants-in-aid, sharing pattern &amp; implementation of CSSs &amp; expenditure and assets owned by LBs were collected on a detailed proforma received from GoI. A study of the finances &amp; tax administration of the Faridabad Municipal Corporation was conducted by NIUD. Similar other studies were conducted for municipalities and Panchayats. Secondary data from various departments was also collected. Discussions were held with officers of</p>	<p>An exhaustive questionnaire was designed to collect information on finances of all tiers of Panchayats and all levels of Municipalities. Suggestions were invited from all stake-holders and held meetings with the persons of eminence in the field of local governance. The Commission also studied the latest Panchayati Raj Act and Municipal Act. The Commission analysed the annual Administrative Reports of Panchayati Raj, Urban Local Bodies, Rural Development Department, Local Fund and Audit, as also the reports and papers published by National Institute of Urban Affairs, New Delhi, National Institute of Rural Development, Hyderabad and National Institute of Public Finance and Policy, New Delhi.</p>	<p>Comprehensive questionnaires were designed and circulated to the state ministers, elected representatives of LBs, universities, colleges, district bar associations, reputed institutions, eminent experts and professionals and stakeholders inviting their views and suggestions on functional, financial and institutional empowerment of LBs. An analytical study on state finances was sponsored &amp; a Study Group was also constituted to make suggestion on the empowerment of Municipalities. Group discussions/open house seminars were</p>	<p>Site visits were organized which helped the Commission in getting first-hand knowledge of the ground level working of LBs. States of HP, Karnataka and Gujarat were visited to know the working &amp; status of their LBs as also the approach &amp; methodology adopted by their SFCs. The Commission also used data from state budget documents, State Statistical Abstract, State Economic Survey, plan documents, accounts related documents, Annual Administrative Reports of various departments. The overall approach of the Commission was</p>	
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		different departments, district level officers and newly elected Panchayat members.		also organized.	to foster inclusive growth promoting fiscal federalism.	
8	Himachal Pradesh	The existing revenue receipts and revenue expenditure of the LBs were estimated. Large number of units were accessed for collection of basic data. The Commission had to collect data separately for the three tiers of the Panchayats. The Commission also resorted to the methodology of mailed questionnaires for collection of basic information. Views of the general public on the terms of reference of the Commission	Information was collected from the Municipalities on the following items: 1991 population, area, statutory functions, delegated functions, existing establishment expenditure, details of assets to be maintained. For the collection of data on receipts & expenditure of Municipalities, department of LBs was approached.	Mailed questionnaires were used for collection of basic information and proformae were also circulated time to time to the Municipalities to gather requisite data. Information collected for the assessment of expenditure & receipts of Municipalities has been based on the 2001 population census, area, statutory functions, delegated functions, existing establishment expenditure, details	The Commission collected data separately from the three tiers of Panchayats and Municipalities. Separate questionnaire were designed for each tier of Panchayats & Municipalities. The task of data collection was assigned to the Department of Information technology to conduct the survey with the help of Lok Mitra Kendras. Regular meeting	

		was invited by sending advertisements in the selected newspapers. Commission also held meetings with the elected representatives of Panchayats as well as with the concerned Heads of Departments.		of assets to be maintained and, other committed expenditure of Municipalities.	were conducted to review the status of survey work. More emphasis was given to participatory approach. The Commission invited views and suggestions by publishing advertisements in selected national and regional newspapers.	
9	Karnataka	Requisite data were formulated and collected through questionnaires. Interactive sessions were planned with different rungs of Panchayats and all the Municipalities which were arranged at the district level. Meetings were held with concerned representatives and officials.	Not mentioned in the Report	District level interactive meetings were held in all districts except Haveri. Consultations were carried out with experts, academicians, former chairpersons of SFCs. State visit was conducted to Kerala, New Delhi & views were exchanged with delegates and heads & faculty members of academic institutes. Various reports, papers and	-	

				documents were studied for gaining inputs for the formulation of recommendations.		
10	Kerala	Not mentioned in the Report	The Commission directly studied the functioning of each of the five types of local government with special reference to financial matters viz. VP, BP, DP, Municipality and Corporation by visiting one representative of each type. The Commission held consultations with representatives of LB associations which, brought forward issues relating to finances of the LBs. Detailed discussions were held with the Secretaries & Head of Department involved in decentralization. Special meeting were held with Finance Minister & Finance	The financial data was collected in three parts reflecting three major stages of transformation: LSGs before 73rd & 74th CAAs, LSGs during & after substantial shift of services & institutions that took place in accordance with Article 243 (G) and 243 (W) and LSGs as instruments of economic development resulting from Kerala's widely acclaimed experiment of decentralized	The Commission visited selected LBs to have a firsthand experience of important developmental issues & good practices. Various meetings, workshops as well as seminars were conducted from time to time. The Commission launched an ambitious project to collect online data from the LBs, using the software developed by KELTRON for	

			Secretary. And there were exchange of views with the SPB with particular focus on decentralized plan preparation and implementation. A detailed analysis of the report of the First Finance Commission was conducted.	planning. Five proformae were prepared help the LSGs make self-assessment of their services, wherein only two types of entries were to be made- receipts and expenditure.	online collection of data relating to receipts and expenditure of LBs based on accounting system. In addition to this a number of studies were also sponsored by the Commission.	
11	Madhya Pradesh		For making a macro review of the finances of LBs, the commission used the data furnished by the XI FC. Personal visits were made to a number of district/block headquarters, to interact with the elected representatives of LBs. Since, number of rural local bodies in the state is high, Commission decided to take a sample of Gram Panchayats in the state & blow up the data for the whole state, on the basis of sampled data. While making projections of revenue & expenditure, the commission followed the methodology evolved by the XI FC, with certain		-	-

			modifications. In regard to projection of own tax revenue, representative tax approach has been adopted.			
12	Maharashtra	<p>Financial &amp; other data were obtained directly from the local bodies. Budgetary data and projections were obtained from Finance Department. Study groups were constituted by different departments of local bodies and intensive interactions were carried out with concerned officials. Seminars and workshops were conducted and were participated in by the senior members of the Commission.</p>	Not mentioned in the Report.	<p>Statistical information was collected from the Finance Department, UDD, DRD, etc. and data relating to income &amp; expenditure was collected from the LBs. Training camps were organized for the officers of LBs. Discussions were held with the officers of 1st &amp; 2nd SFC &amp; also with other stakeholders. Seminar/workshop were organized to exchange ideas &amp; suggestions with regard to the finances of LBs. Study groups were appointed to study some specific topics pertaining to</p>	-	-

				the Municipalities/Corpo rations in the State.		
13	Manipur	Questionnaires were prepared and circulated to the concerned departments. But there were many gaps in the information supplied. A series of meetings were thereafter arranged, individually & jointly with all the officials	Not mentioned in the Report.	-	-	-

		of concerned departments.				
14	Odisha	Not mentioned in the Report	Questionnaires related to various schemes being operated at LB's level were circulated and statistical data were collected. Visits were carried out in different districts to acquire first hand information. Visits were also made to the states of WB, Karnataka & Kerala in order to acquaint the Commission with the functioning of LBs in other States. Several meetings were held with the relevant officials in line.	Visits were carried out to Panchayats and Municipalities in the states of Karnataka, Kerala and West Bengal to gain first hand information about their organization, functioning, resource mobilization efforts and their patterns of expenditure vis-à-vis the activities assigned to them. Meetings were held with different stake holders, from time-to-time, to analyse the problems of the Panchayats and	Commission had apprised the public of constitution of the 4th SFC & its mandates & their valuable views/advices were sought to strengthen the local self-governments of the State. The Commission visited some of the districts, & the Chairman & Members visited a few other districts individually or in smaller groups for direct interaction with the local body representatives, local	-

				Municipalities and, to work out appropriate policies that would strengthen their finance and rightly impact their working.	public and officials working at the grassroots level.	
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15	Punjab	<p>The task of primary collection of data from Panchayats &amp; Municipalities was undertaken for which detailed questionnaires were issued to different rungs/level of Panchayats/ Municipalities. The data was collected in relation to income &amp; pattern of expenditure, deficit &amp; future requirements and plan &amp; non-plan expenditure. Sources of revenue for the activities listed in 11th &amp; 12th schedules was also reviewed. Interactions were carried out with the officials of State departments, members of other SFCs from Mah, Kar, &amp; Guj.</p>	<p>The Commission devised detailed and exhaustive Information Proformae about functions, income and expenditure, grants received from various sources, and under various schemes, indebtedness, level of Civic Services, future requirement of funds etc. and sent these to all the LBs. The received data from the local bodies was then scrutinized, tabulated and analyzed. The Commission also tried to collect information from other States about the finances of the state governments and the local bodies. Interaction with the Senior Officers of the state governments and experts provided valuable information and ideas. District level meetings were held with Divisional Commissioners, Deputy Commissioners, Regional and District level Officers of local government.</p>	<p>The basic services essential for civilized living, have been identified and cost of providing these services has been researched for a duration of over 10 years. Also, the cost of running local bodies at present level of services has been worked out. Questionnaires were circulated to all the Panchayats and Municipalities. Views of different officials were taken into account. Seminars were conducted and several meetings were organized. The data were collated and analysed for report writing.</p>	-	-
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16	Rajasthan	<p>The Commission visited AP to have first hand information on the functions &amp; finances of Panchayats &amp; Municipalities in the State. The Commission also visited national level institutions to interact with the experts familiar with the subject. Seminars were attended by the Commission officials to enhance their understanding on the subject.</p>	<p>The methodology adopted by the commission included collection of information and materials and analysis thereof. Various meetings as well as field visits were conducted to enhance the feasibility of the report. Suggestions were invited through public notices. The Commission participated in a number of Workshops and Conferences organized at National and State levels. The Commission also visited some major States and closely studied the working patterns of local governments and the concerning State Finance Commissions.</p>	<p>Questionnaires were circulated to all the Panchayats and Municipalities. The Commission visited a few LBs to have a first hand experience of important developmental issues &amp; good practices. Various meetings, workshops as well as seminars were conducted from time to time. The distribution of divisible share in net tax revenue (excluding entertainment tax), between the LBs, has been based on the population figures for the year 2004-05. Census figures of rural- urban break up have been used for the distribution of net share. Inter-se distribution among</p>	<p>For collecting information and relevant data from each tier of Panchayats and Municipalities, a well designed questionnaire and some formats were sent to all the Panchayats and Municipalities. The Commission participated in a number of Workshops and Conferences organized at National and State levels. The Commission also visited some major States and closely studied the working patterns of local governments and the concerning State Finance Commissions.</p>	<p>A comprehensive analysis has been taken up of the data &amp; other information gathered through questionnaires, detailed studies of previous reports, interaction with stakeholders, expert advices, seminars, workshops and field visits to the state and other states also to study their best practices. Public suggestions were also invited through news</p>
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				ULBs has been based on municipality wise population figures of census 2001.		paper and commission's website. An attempt is made to develop a Rational Devolution Index. Its also attempted to upgrade and refine the devolution criteria suggested by the 4th Commission by redesigning some weights and reshaping some parameters by utilizing Socio Economic and Caste Census (July 2015)
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17	Sikkim	Not mentioned in the Report	Not mentioned in the Report	<p>The internal allocation of revenue between ZPs and GPs shall be based on population figures of 2001. The horizontal distribution among 4 ZPs will be on the basis of population figure and the Panchayat Area. Questionnaires were circulated to all the Panchayats and Municipalities. The Commission also used data from state budget documents, State Statistical Abstract, State Economic Survey, plan documents, accounts related documents, Annual Administrative Reports of various departments. To firm up the data received from various sources several rounds of</p>	<p>Data was collected through various consultations, meetings, questionnaires, formats, secondary information resources &amp; other correspondences. Both qualitative &amp; quantitative information were collected from the desired destinations. Besides issuing ToRs as public notice in the regional newspapers the Commission also tried to reach experts &amp; retired public servants in Sikkim to get their views. The Commission also tried to invite suggestions / comments / views of netizens on the ToRs by advertising the IV SFC Facebook page</p>	
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				meeting were conducted.	link through public notices in the local newspapers. Various workshops were also organized at state/district level.	
18	Tamil Nadu	Not Available	The data have been obtained both in manuscript & through computer floppies & were fed into computer by obtaining the services of Data Centre, Chennai. Interactions were carried out at every stage with elected representatives & other officials. The Commission undertook field visits to various districts also other states viz. Guj, Mah, Kar, AP. State level seminars/regional seminars were conducted and also, various committees were constituted at the Tamil Nadu Institute of Urban Studies, Coimbatore and PRIs Training Institutes.	In order to assess the income, expenditure, service level, debt and human resources, a detailed questionnaire was prepared and sent to Panchayats & Municipalities. Tours to various Districts were undertaken to take up discussions with District Collectors, District officials and elected chairpersons of LBs at District Collectorates. Visits were carried out to other states to study the functioning of LBs. Sub-committees were constituted on entrustment of functions and	The Commission formed an In house Committee to design an elaborative questionnaires to assess the income, expenditure, service level, capital needs etc. The Commission installed its own server system to collect online data. External agencies were also engaged to study the data collected from local bodies and to furnish an analytical report to the Commission. The commission also visited to various districts on the states as well as of other states to collect	

				delegation of powers to the LBs. A website was hosted in September, 2005, containing the details of all the SFCs constituted so far in the state of Tamil Nadu.	relevant information through face to face interviews and discussions with the concerned people. A questionnaire was sent to all the recognized National and State Political Parties.	
19	Tripura	The Commission invited views, suggestions and opinions from individuals, recognized institutions, political parties and organizations. Relevant data/information were collected from the State Government and other semi-government bodies and autonomous bodies. Discussions were carried out with departmental officers of the State	The Commission held discussions with all the secretaries of all Panchayats, who were requested to indicate their views as to what is expected of the 2nd SFC, what is the financial viability of the Panchayats, what could be the areas of improvement etc. A number of suggestions were brought out & formed the consideration of the Commission. Visits were carried out to different Panchayat institutions.	Approach is guided by the mandate of the constitutional provisions & the terms of reference contained in the order constituting the commission. Actual revenue expenditure is to be assessed & realistic estimates of expenses are to be projected over a period of next 5 years in order to ascertain the revenue gap of all Panchayats in totality. Differentiation has been made for hilly	-	-

		Government and elected representatives of the three-tiers of Panchayats.		& plain areas. Projection is computed keeping in view forecast of the State Government on SOTR submitted to the 13th Finance Commission. Pre-devolution gap has been computed by assessing requirement of establishment expenditure, maintenance expenditure & development expenditure of the Panchayats.		
20	Uttar Pradesh	Questionnaires were prepared and sent to concerned departments. Team of officers from the Commission was sent to various districts to create awareness for the importance of filling the questionnaires and to have an intimate	The Commission developed detailed questionnaires to elicit information on the financial and other aspects of LBs which were issued to Panchayats & Municipalities. The Commission undertook visits to other States to familiarize itself with the working of LBs as also the approach of other SFCs. The Commission collaborated with SHERPA, a		The commission constructed various kinds of questionnaires to gather relevant information from various sources. The collected information/responses were analyzed to determine the resource requirement	-

	<p>knowledge of the working of rural &amp; urban LBs. Also, visits were carried out to different States (Karnataka, Kerala, Assam, Tamil Nadu, Andhra Pradesh, Haryana &amp; Bihar) with a view to familiarize with the approaches adopted by the other SFCs. Discussion were taken up with the elected representatives of the Panchayats &amp; Municipalities. Seminar at Hyderabad, Mussoorie, New Delhi &amp; Madras were attended to have a better understanding of the need for devolution of funds to LBs and making them self-sufficient for raising their own resources.</p>	<p>NGO, in carrying out a field survey on the functioning of Panchayats in the State.</p>		<p>of various rungs of Panchayats and levels of Municipalities. Field visits were also conducted within the state as well as various other states to enrich the information gained. Time to time meetings with various stake holders workshops as well as seminars were also part of exercise.</p>	
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21	Uttarakhand	<p>The review of the institutions is made in the context of the specific historical, demographic, physical and socio-economic realities of Uttaranchal. An effort has been made to bring in the citizens' point of view. The Report of the first UPSFC for the period 1996 to 2001 has been taken as a starting point. The observations of the 11th FC have been taken note of. Several instruments were used for carrying out the review: Desk studies, Questionnaires, Study of memorandums received, District level hearings, Formal/Informal meetings &amp; consultations,</p>	Not mentioned in the Report.	<p>The assessment of the finances of Municipalities &amp; Panchayats includes their resources base, capacity to raise resources, and expenditure requirements in terms of the functions assigned to them. Separate financial assessments have been made for the State, the Municipalities and the Panchayats at various levels. Assessments of the finances of the local bodies have been based on the responses to the detailed questionnaires sent out by the Commission.</p>	-	-
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		Consultants' reports and other inputs.				
22	West Bengal	Data were collected from all departments of the State to find out the proportion of plan expenditure spent for districts. However, the information provided was incomplete and entirely unsatisfactory.	The initial task undertaken by the Commission was to review the actions taken so far by the government on the recommendations of the First SFC and its impact on the LSGs' functioning in general and their financial state in particular. Meetings were held with representatives of Panchayats and Municipalities, government officers and leaders of political parties of all districts in the State. Discussions were carried out with academicians, senior government officials and ministers.	Questionnaires were circulated to all the Panchayats and Municipalities. Views of the Director Panchayati Raj, non departmental representatives, Panchayati Raj Department, Urban Development department were collected. Visits were made to several districts, blocks and GPs and discussions were carried out with the representatives of Panchayats, Municipalities and Corporations.	-	-

## Chapter 3

### Impediments in the Functioning of SFCs and Good Practices

*“... As far as funds are concerned, the awards of State Finance Commissions should be fully honored. There are reports that State Finance Commissions are not constituted, of them not giving awards in time, and of these awards not honored when given, all of which erode Panchayati Raj.”* - An extract from the speech of Prime Minister on 29<sup>th</sup> May, 2004

#### Local fiscal data deficiencies

SFC gets frustrated due to non-availability of reliable fiscal data on most aspects of state-local finances on which to base the analyses and inferences. These include internal revenue and expenditure data of Panchayats, the funds transferred to them from upper levels of governments in the form of devolution and grants, data related to assignments of functions and taxes from the state government. Since an SFC ceases to exist after the submission of its report, many SFCs could not have access to the data generated and scrutinized by the previous SFCs. Most SFCs have indicated these limitations in their reports. In fact, neither the local government; nor the State Directorate on Panchayats; nor local fund audit; nor Accountant General of the State; nor Reserve Bank of India; nor Central Statistical Organization; nor Ministry of Panchayati Raj; and nor the NITI Aayog (erstwhile Planning Commission) have consistent fiscal data on local governments. Many SFCs, have attempted to collect data from the thousands of Panchayats but could not analyzed and maintained it systematically.

Almost all the SFCs, in all generations so far, have complaint about the lack of data availability which burdens them with the extra task of collecting the requisite data from the local bodies. This delays the report submission by a considerable amount of time. A separate and permanent SFC cell, as recommended by various SFCs, could help a great deal in curbing the issue. But, State governments have not shown serious inclination towards this issue.

### **Inconsistent Methodologies of various SFCs**

In order to address the common terms of reference, various SFCs have adopted different methodologies. Many of them attempted to estimate, in their own fashion, the resource gap. The definition of resource gap also varies from one report to another even in the same state. In some cases, unique method is employed to quantify the resource gap. After all these, lump-sum ad hoc grants were recommended. Some SFCs have attempted to estimate the gap on a normative basis- though unsuccessfully in the absence of any systematic work in the recent past, at national level to develop expenditure norms of core services at different geographical terrains viz. hilly, coastal, dessert and plain areas since the Zakaria Committee Report (1963).

### **Poor Response by the State Governments on SFC Reports**

Article 243 I (4) stipulates state government to present before the Legislature of the State every recommendation made by the respective SFC together with an explanatory memorandum as to the action taken thereon. The provision is akin to article 281 related to the action taken by the Union government on the recommendations of Union finance commission. However, the respective government treats this Institution and its recommendation very differently. It can be easily observed that key recommendations of the Union finance commission are implemented within a timeframe without modification and other general recommendations are respected and considered at various policy-making exercises. However, at the state level, little attention is paid even to the principal recommendations of the SFC. In several cases, the recommendations are rejected. In many cases, they are accepted through the action taken report, but not implemented by not issuing government orders. In some cases, despite issuance of government orders money is not released. In three cases, - second SFC reports of Karnataka & Maharashtra and third SFC of Gujarat -the reports have been neither considered nor placed in the State Legislature. The report of second SFC of Kerala was submitted to the legislature without any action taken report three years after it was submitted.

### **Non-synchronization with Union Finance Commission**

The CAA provides that the Union finance commission should suggest measures to augment consolidated funds of states based on the recommendations of SFCs. However, all Union finance commissions, *i.e.* 11<sup>th</sup>, 12<sup>th</sup>, 13<sup>th</sup> and 14<sup>th</sup> were handicapped due to the non-availability and non-synchronization of the SFC reports for the relevant period. The 11<sup>th</sup> Finance Commission even recommended to delete the words ‘on the basis of the recommendations made by the Finance Commission of the State’ from sub-clauses (bb) and (c) of article 280 (3) of the Constitution. According to the Twelfth Finance Commission (TFC), SFC reports should be available to UFC at the time of UFC’s constitution to make it easier for the UFC to assess the SFC on the basis of uniform principles. TFC suggested that as the time of the constitution of UFC is predictable, the States should constitute their SFCs accordingly. In a similar vein Thirteenth Finance Commission also recommended about timely constitution of SFCs. Similarly, the Fourteenth Finance Commission suggested timely constitution of SFC, proper administrative support and adequate resources for smooth functioning and timely placement of the SFC report before the State legislature with action taken reports.

### **Indefinite Tenure of SFCs’**

In many States, SFCs are constituted for a period of six to eighteen months. But, due to frequent transfers and consequent compositions of SFCs the tenure keeps on being extended for indefinite period. At times, the report is submitted for the award period of previous years. Moreover, as mentioned earlier, State government takes its own time to consider or not to consider the report and places before the legislature. A few instances are as follows:

The ToR of the Fifth **Assam** State Finance Commission, constituted under the section 2 (I) of the Assam Finance Commission Act, 1995, dated 5<sup>th</sup> March 2013, mandated the Commission to submit its report by 30<sup>th</sup> April 2014, covering a period of five years commencing on 1<sup>st</sup> April 2015. However, the report of the commission has not yet been placed before the Legislature.

As per the ToR of the Second SFC of the State of **Manipur**, appointed under the section 3 of the Manipur State Finance Commission Act, 1996 vide Finance Department's order No. 6/2/2000-FC (i) dated 3<sup>rd</sup> January 2003, the Commission was asked to make recommendations in respect of Panchayats including District Councils and Municipalities at all levels; within three months from the date the Chairman & other members preside over the office. The Commission was constituted in 2003 to make recommendations on the concerned matters covering a period of five financial years beginning from April 2001, i.e. 2001-02 to 2005-06. Later the award period of the Commission was extended till March 2010.

Under the **Odisha** Finance Commission Act, 1996, the Fourth SFC of the State was appointed vide notification dated 13<sup>th</sup> October 2013, initially for a term of six months, i.e. upto 30<sup>th</sup> April 2014. However, its tenure was subsequently extended upto 30<sup>th</sup> September 2014.

As per the ToR of the Fourth **Kerala** SFC, constituted under the section 186 of the Kerala Panchayat Raj Act, 1994 and section 205 of the Kerala Municipality Act, 1994 vide notification dated 19<sup>th</sup> September 2009, the Commission was required to submit its report within one year from the date of notification of its constitution but, the term was extended by six months i.e. till 31<sup>st</sup> March 2011. The ToR of the Commission assigned it the task of re-visiting the recommendations of the previous three SFCs of the state and make suggestions on those of recommendations which have been accepted by the Government but have not been operationalized. The Commission did so by pointing out 18 such recommendations from the previous three SFCs which, as per the Commission, were supposed to be re-accepted and implemented without delay, but the suggestion was not considered in the action taken report.

In pursuance of the section 213 of the **Haryana** Panchayati Raj Act 1994 and Rule 3 of the Haryana Finance Commission Rules, 1994, the Governor of Haryana constituted the Fourth SFC of the State vide notification dated 16<sup>th</sup> April 2010. According to the ToR of the Commission was required to submit its report by 31<sup>st</sup>

March 2011. However, due to lack of infrastructural facilities and other impediments, the Commission's term was extended several times and lastly upto 30<sup>th</sup> June 2014. Hence, it took the Commission four years to finally submit their report.

In few States the Terms of Reference of the Commission have been issued separately after the SFC has been constituted. A ToR acts as a guiding light for the team to act towards achieving the goals with which the Commission has been established. Since, the ToR contains the order of appointment of the Chairman and other members, establishment of Commission before the release of ToR, makes the Commission almost meaningless. It has also been observed that, a SFC is reconstituted several times, due to some reason or other, which hampers their efficiency to deliver. Also the frequent transfer of members/member secretary/ Chairman of SFCs and the re-composition of the team thereafter, affect the smooth functioning and results in unnecessary delays in report submission.

### **Qualifications of SFC Members\***

The State is required to make law with respect to the composition of SFC and the qualifications of their members under Article 243 I (2) of the Constitution which reads "*the Legislature of a State may, by law, provide for the composition of the Commission, the qualifications which shall be requisite for appointment as member thereof, and the manner in which they shall be selected.*" Similar rules are prescribed for the composition of the Union Finance Commission. Even though a majority of States has espoused the Rules of Union Finance Commission, no State so far has appointed a member who has been, or is qualified to be appointed as a judge of High Court. Some State Legislatures, as per the analysis of K Siva Subrahmanyam, have enacted laws providing for the following:

- a) ....the chairman and the members of the Finance Commission shall possess such qualifications and shall be appointed in such manner as may be prescribed. [Bihar Panchayat Raj Act, 2006, Section 168]
- b) ...the Chairman and members of Finance Commission shall possess such qualification and shall be appointed in such manner as may be prescribed. [Goa Panchayat Raj Act, 1994, Section 199 (3)]

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\*This section is drawn heavily from Siva Subrahmanyam's contribution in the Workshop on Fiscal Decentralization & SFCs held on 18- 19 January 2016 at New Delhi.

- c) ...the two members of Finance Commission shall be selected from among the officers of the State Government not below the rank of Secretary of the Government or Head of the Department. [Himachal Pradesh Panchayati Raj Act, 1994, Section 98 (3-A)]
- d) ...the Chairman and members of Finance Commission shall possess such qualification and shall be appointed in such manner as may be prescribed. [Section 267 of the Karnataka Panchayat Raj Act, 1993]
- e) The chairperson of the Commission shall be “an eminent serving or retired civil servant well-versed in administration and finance or a person with experience in public affairs. [Maharashtra Finance Commission (Miscellaneous Provisions) Act, 1994, Section 4]
- f) ...the Commission shall have A Chairperson from amongst persons who have had experience in public affairs; and such number of other members not exceeding four as the State Government may determine from time to time....[Rajasthan Panchayati Raj Act, 1994, Section 118 (1)]
- g) ...the Chairman or members of Finance Commission shall possess such qualification and shall be appointed in such manner as may be prescribed. [The Tripura Panchayats Act, 1993, Section 214 (3)]

Notwithstanding, some State have enacted good provisions in their Panchayat Acts which could be comparable to the similar Act meant for Union Finance Commission. A few of them are mentioned below:

*Part VI, Section 236 of the Andhra Pradesh Panchayati Raj Act 1994*, talks about the Qualifications for appointment as, and the manner of selection of, members of the Commission; which elaborates that ‘the Commission shall be selected from among persons who have had experience in public affairs and the other members shall be selected from among persons who-

- a) have special knowledge of the finances and accounts of Government; or
- b) have had wide experience in financial matters and in administration; or
- c) have special knowledge of economics.

As per the *Assam Finance Commission (Miscellaneous Provision) Act, 1995*, ‘the Chairman of the Commission shall be selected from among persons, who have wide experience in public affairs, with special reference to economic & financial matters and four other members including the Member-Secretary shall be selected from among persons who-

- a) are or have been or are qualified to be appointed as Judges of a High Court; or
- b) have special knowledge of the finance and accounts of a Government; or

- c) have had wide experience in financial matters and in administration; or
- d) have special knowledge of economics; or
- e) have had long experience as an administrator at senior levels with particular reference to financial and economic matters.’

The *Himachal Pradesh Panchayati Raj Act, 1994, Section 98 (3)*, provides that ‘the Chairman of the Finance Commission shall be selected from amongst the persons who have experience in public affairs and who have-

- a) special knowledge & experience in economic and financial matters relating to Panchayats; or
- b) special knowledge & experience in economic and financial matters relating to Municipalities; or
- c) wide experience in administration and financial matters; or
- d) special knowledge of economics.

As per the *Kerala Panchayat Raj Act 1994, Section 186*, ‘persons who are to be appointed as member of the Commission shall be-

- a) One shall be a person having special knowledge and experience in financial matters and economics; and
- b) The other two shall be persons having experience in public administration or local administration or having special knowledge in financial matters and accounts of the Government and local bodies.

*Section 4 of the Maharashtra Finance Commission (Miscellaneous Provisions) Act, 1994* provides that ‘the Chairman of the Commission shall be an eminent serving or retired civil servant well versed in Administration and Finance or a person with experience in public affairs and the four other members shall be selected from amongst persons who-

- a) have special knowledge of the finances and accounts of Government; or
- b) have had wide experience in financial matters and in administration; or
- c) have special knowledge and experience about the local self Government in urban areas
- d) have special knowledge and experience about the local-self Government in rural area:

Provided that one of the members shall be a person who is holding or has held the post not lower in rank than that of [an officer in Junior Administrative Grade in Indian Administrative Service or an Officer in equivalent Grade] and he shall be the Member-Secretary of the Commission.

*Manipur Panchayat Raj Act 1994, under Section 97 (2)*, describes that ‘the member of Finance Commission shall be appointed in such a manner as may be prescribed from among persons who-

- a) have experience in public affairs; or
- b) are or have been, or are qualified to be appointed as a Judge of a High Court; or
- c) have special knowledge of finances & accounts of Governments; or
- d) have had wide experience in financial matters and in administration; and
- e) have special knowledge of economics.

*Under Section 198 of the Tamil Nadu Panchayat Act, 1994* the Chairman shall be a person who-

- a) is a serving or a retired judge of the High Court; or
- b) is a serving or retired government servant who has served in senior capacities for a period of not less than ten years; or
- c) a person of eminence with substantial experience in public life as a Member of Parliament, State Legislature or in local government bodies; or
- d) is an eminent academician in economics or public finance or political science or a related area of studies.

In this connection, Siva Subrahmanyam (2016) made the following observations:

“As for the composition of the SFC, the strength and mode of selection of the members of the SFC widely varies across the States. While in Andhra Pradesh, all members, including the chairperson, are drawn from retired academics or non-governmental sector, in Tamil Nadu, Kerala, Bihar, Odisha, Maharashtra, Gujarat, Tripura, Assam, Karnataka, Punjab, West Bengal, Arunachal Pradesh, Haryana, Manipur, and Rajasthan, some of the chairmen and / or members appointed as ex officio members are senior serving or retired IAS officers some of whom directly concerned with local government institutions. The members appointed to the SFCs consist of full-time members, part-time members, ex-officio members, expert members, and consultant members (Manipur). The available information indicates that the total strength of the Chairman and members of a SFC varied between two (Chhattisgarh and Manipur) and five (A.P, Punjab, West Bengal, Gujarat, Odisha, Rajasthan, and Tamil Nadu) or six (Haryana, Tamil Nadu (4th SFC) and Odisha (4th SFC).

While most of the States applied the eligibility criteria for the selection of members of the Central Finance Commission to their respective SFC chairman and members, in Tamil Nadu, the Rules framed under Section 198 of the Tamil Nadu Panchayat Act, 1994,

provides that “the Commission shall consist of: (a) a Chairman; (b) Member –Secretary; (c) Director of Rural Development; and (d) Director of Municipal Administration as ex-officio members; and (e) one non-official member. In Uttar Pradesh, the rules framed for the SFC provide that “a person shall not be qualified for appointment to the post of the chairman or member unless he possesses experience of dealing with public affairs, public policies, public finances and district administration and experience of financial matters relating to PRIs or of local bodies”. In the case of 4th SFC of Odisha, the chairman and members were appointed on part-time basis, and the Member-Secretary on a full-time basis as per its ToR dated October 31, 2013.”

Both the Eleventh and Twelfth Finance Commissions suggested that States should by legislation; ensure that chairpersons and members of the SFCs may be drawn from the experts in specific disciplines such as economics, law, public administration and public finance. TFC also mentioned that States should follow the central legislations and rules which prescribe qualifications of chairpersons and members and should enclose similar rules. TFC also advised that the persons with expertise in the rural and urban affairs should also be taken into consideration while selecting SFC members. the selection should be for fulltime and the seats should not exceed more than five members including the chair person and excluding a serving officer who could act as secretary.

### **Composition of the SFCs**

In most of the States, the relevant Panchayat Acts prescribe the total size of their respective SFC and the qualifications requisite of its members, including the chairman. Nevertheless, there are instances where the actual number of members (full-time / part-time / *ex-officio*/expert / consultant) appointed to the SFC exceeded / fell short of the statutorily- fixed number. For instance, in Tamil Nadu, and Odisha, though the statute permitted one chairman and four members, their 4<sup>th</sup> SFC had altogether six members, including the chairman. Similarly, in the case of the 4<sup>th</sup> SFC of Rajasthan, the total number of members statutorily fixed is one chairman and not more than four members, while its 3<sup>rd</sup> SFC had one chairman and only three members. Likewise, in *Haryana*, the actual number of members including the chairman appointed was five for the 1<sup>st</sup> SFC and six for its 4<sup>th</sup> SFC since the statute does not fix the absolute number of its members. In

Chhattisgarh, though one chairman and two members can be appointed as per the relevant statute, the 1<sup>st</sup> and 2<sup>nd</sup> SFCs of the State had only two members including the chairman. In West Bengal, the statute prescribes a maximum number of five, including the chairman but the 4<sup>th</sup> SFC of the State initially appointed only the chairman and one member.

The *Eleventh Finance Commission* recommended that “States should, by legislation, ensure that the chairpersons and members of the SFCs may bedrawn from amongst experts in specific disciplines such as economics, law, public administration and public finances”. Similarly, the *Twelfth Finance Commission* recommends that “SFCs must be constituted with people of eminence, and competence with qualification and experience in the relevant fields”. Moreover the Commission observed that “it is important that experts are drawn from specific disciplines such as economics, public finance, public administration and law. In order that the concerns of both rural and urban local bodies are adequately addressed, it is suggested that at least one member with specialization and / or experience in matters relating to the PRIs and another similarly well-versed in municipal affairs must be appointed in the SFC. Twelfth Finance Commission recommended that the number of members including the chairperson may not exceed five excluding a serving officer who may act as the Secretary. The *Thirteenth Finance Commission* recommends that the State governments should be empowered to constitute and direct their SFCs to produce report well before the UFC finalizes its recommendations. The Commission also prescribed a model template for the SFC reports for uniformity in presentation, which most SFCs, later on, followed. The *Fourteenth Finance Commission* recommended that “the State government should strengthen SFCs. This would involve timely constitution, proper administrative support and adequate resources for smooth functioning and timely placement of the SFC report before State legislature with action taken notes”. It is therefore necessary for the States to arrive at a consensus as regards the size of SFC members.

### Procrastinated Constitution of SFC

Article 243 I of the Constitution granted one year time to the Governor to constitute the first SFC in the State from the date of commencement of the 73<sup>rd</sup> Constitution Amendment Act, 1992. Accordingly, States to which this Act applies were required to

constitute their first finance commission before 24 April 1994. However, compliance by the States with this mandatory duty was partial. It may be observed from Table-3.2 that around 50 per cent of the States had constituted their 1<sup>st</sup> SFC only after cut-off dates of 24 April 1994.

- Article 243 I also stipulates that succeeding SFC needs to be constituted “at the expiration of every fifth year”. As pointed out earlier, this provision leading to the timely constitution of SFC is flawed. Many state governments aggravate it by not constituting it even at the expiry of every fifth year. In some cases, only the chairman and secretary are appointed initially, other members and even terms of reference for the SFC come much later. On the other hand, there are States which constituted their SFC even *before* the expiry of fifth year from the date of appointment of their previous SFC. It may be seen from the Table 3.2 that there are a few States which appointed their next SFC about two years *before* the expiry of the appointment of their preceding SFC. Examples can be found in Bihar, Assam, Punjab, H.P, Rajasthan, Sikkim and U.P. In this connection, it needs to be noted that States, by and large, are also gradually trying to synchronize the award period of their SFC recommendations with the corresponding award period of the ensuing UFC. It is unfortunate that several States have indulged in abnormal delay in constituting their SFCs. The delay ranged from 5 months to more than 5 years. Instances of this type of default can be seen in the States of A.P, Arunachal Pradesh, Karnataka, M.P, Maharashtra, Manipur, Rajasthan, Tripura, U.P and West Bengal. In this connection, the Eleventh Finance Commission suggested that Art. 243 I should be amended to enable a state to set up the SFC at expiry of every five year or earlier, in place of the expiration of the SFC at the expiry of every fifth year.

The following table gives a broad picture of the constitution of SFCs as on January 01, 2016. So far, as may be seen from the said table, only *six* States have constituted their 5<sup>th</sup> generation SFCs, *seventeen* States constituted their 4<sup>th</sup> generation SFCs, while *twenty-one* States constituted their 3<sup>rd</sup> generation SFCs. The table indicates only States which

constituted their latest SFCs but it does not show the submission or otherwise of their reports nor does it indicate that the recommendations of their respective SFCs are in operation.

**Table 3.1: Constitution of State Finance Commissions by States: How Regular?**

Rank	State	Last SFC Constituted
I	Asm, Bih, H.P, Ker, T.N. and Rajasthan	5 <sup>th</sup> generation
II	A.P., Asm, Bih, Har, H.P.,Ker, Odi,M.P., Mah,Pun, Raj, Sik, T.N,Tri,U.P., U.K. and W.B.	4 <sup>th</sup> generation
III	A.P.,Asm, Bih, Guj, Har, H.P., J.K.. Kar, Ker, M.P., Mah, Man, Odi, Pun, Raj, Sik, T.N., Tri, U.P.,U.K., and WB	3 <sup>rd</sup> generation

*Note: This table does not cover the states of Jammu & Kashmir, Nagaland, Mizoram and Meghalaya and the U.Ts for want of information*

As pointed out earlier, the constitutional provision leading to the timely constitution of SFC is seemingly flawed. The postponement in the constitution of SFC, partial constitution, and delay in submission of report obstructs the cycle and its connection with the Union finance commission.

### **Extraneous Contents and unordered Presentation of SFC Reports**

In the past, Datta (2008) and Mishra (2004) made comments on several SFC reports submitted at that time. We endorse their views as a glance at the content and presentation of various SFC reports, even of the recent times, reveal the following:

- The Second SFCs of all States, except Andhra Pradesh, Kerala, and Uttar Pradesh, did not review the First SFC reports.
- The data base on which the SFCs had based their reports, was absent in West Bengal and inappropriately tabulated in most states except Kerala.
- None of the Second SFCs attempted to assess local taxable capacities in terms of measurable indicators but in the Third and Fourth generations of SFCs of various

States like Himachal Pradesh, Kerala, Rajasthan, Tamil Nadu have attempted to estimate it.

- The SFCs generally recommended Global Sharing with wide variations ranging from 1% in Sikkim to 40 % in Karnataka.
- Most SFCs adopted supply driven approach to calculate the need of the local governments.
- The SFCs waste much of their time in collecting financial data from local governments.
- SFCs have paid little attention towards improving fiscal structure of local governments.
- SFC reports are generally unsatisfactory in comparison to Union Finance Commission Reports.
- So far as the presentation is concerned, Second SFC report of Uttarakhand and Third and Fourth SFC report of Sikkim, Fourth SFC report of Rajasthan, Odisha and Tamil Nadu stand out as neat and well drafted, other reports are not presented properly. The report of Fourth SFC of Kerala is in Two Parts with separate ATRs. Both of the parts were submitted separately and the dates of ATR submission also vary. This confuses the fiscal arrangements.
- The report Third SFC of Uttarakhand is not based on processed data and meaning full budget classification of the local governments. The report of Fourth SFC of Himachal Pradesh covers relevant issues and also provides revenue projections for the local governments for the award period.
- While the First SFC report of West Bengal contained 11 pages and the second report had 31 pages, Tamil Nadu second SFC report was presented in five volumes, covering a lot of irrelevant issues. With the passage of time the trend shifted in the same State, as the Third SFC report of West Bengal was presented in 360 pages while the Third and Fourth SFC Reports of Tamil Nadu contained 260 pages each.
- Third and Fourth SFCs of Uttar Pradesh, First and Third SFCs of Madhya Pradesh and Rajasthan have published their Report and ATR only in Hindi. It limits the number of the readers and perceptions of various terms explained.
- Further SFCs of Madhya Pradesh, Tripura had always presented the report in two parts- one for Panchayats and other for Municipalities. In such a situation it

becomes difficult to generate a combined picture in mind to understand overall situation.

- ATR of the Third SFC of UP consists of 134 pages while the ATR of Fourth SFC of Himachal Pradesh comprises only three pages.
- Though almost all the SFCs of Kerala, Odisha, Rajasthan, Sikkim and Tamil Nadu have mentioned TORs in the introductory chapter, there are reports of states like Bihar, Uttar Pradesh etc. where TOR is in the annexure.
- In most of the SFC reports Summary of Recommendations comes as the concluding Chapter except the Fourth SFC Report of Tamil Nadu where the report starts with the summary of recommendations.
- Fourth SFC of Assam has also added suggestions along with recommendations. It creates confusion in assessing the report as they have not distinguished between the two terms.
- Third SFC of Bihar and Fourth SFC of Himachal Pradesh have incorporated their interim reports in the final report.
- Second SFCs have not followed the guidelines of the Eleventh Finance Commissions. But most of the third and fourth generation SFCs have followed the model template for the report as prescribed by the 13th Finance Commission
- In most of the States, SFCs make recommendations in respect of non-plan revenue requirements, but in some states like Kerala, West Bengal; the SFCs make recommendations for both plan and non-plan allocations.
- First and Second SFCs of Bihar did not submit the report due to some reason whereas Third, Fourth and Fifth SFCs have been constituted later on. These SFCs did not take cognizance of previous practices.
- Assam, Bihar, Himachal Pradesh, Kerala, Rajasthan and Tamil Nadu have constituted Fifth SFCs. Among them, Assam's constitution is rejected by the cabinet. Rajasthan has submitted interim report and Kerala and Bihar have submitted final report. The report is available on SFC website but does not seem to have been presented in the State Assembly as no ATR is available. The report presents the holistic picture of the economy of Bihar.

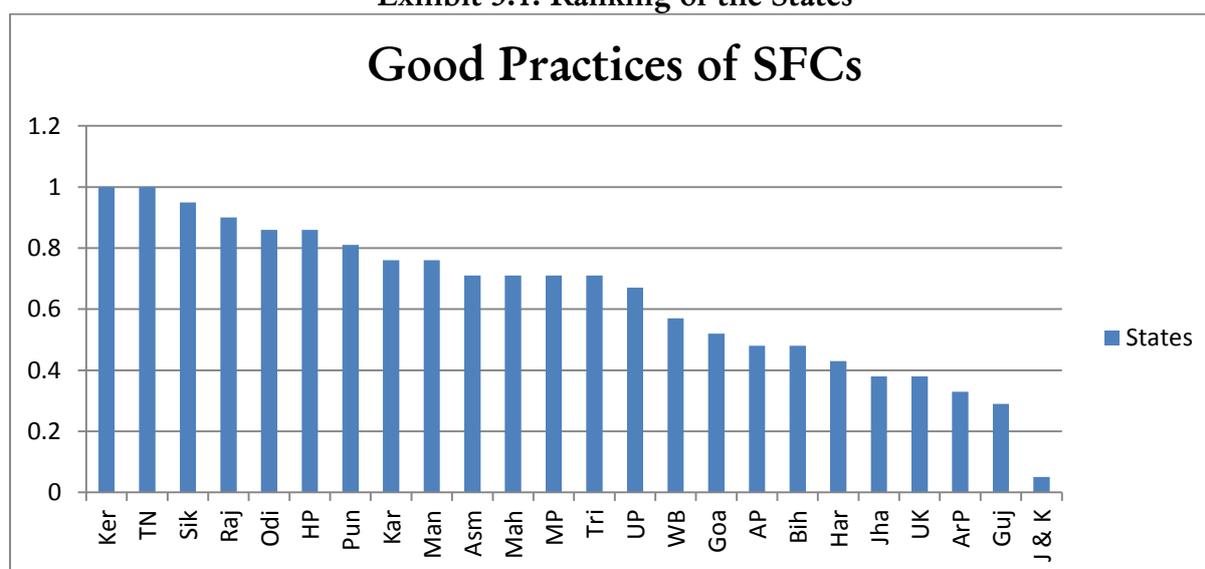
### Good Practices of SFCs

With an objective to assess the good practices adopted by various States in the working of SFCs, five variables were taken into consideration that covers the major aspects of SFCs these are

- V1 Qualification of SFC Members in the State Acts/ Rules
- V2 Constitution of SFCs
- V3 Gap in the constitution of last two SFCs
- V4 Submission of report by the SFCs from the date of constitution
- V5 ATR laid before the Legislature from the date of submission of report by SFC

Each variable has been assigned weight to assess the practice from the given data. Based on the scores secured by each State, ranks have been assigned. Result of the analysis is presented below:

**Exhibit 3.1: Ranking of the States**



Based on the parameters used, states have been ranked according to the score they secured in aggregate. From the table given below, it is clear that Kerala and Tamil Nadu are ranked at the top, in the context of the five variables assessed. Over all indicator analysis reflects that these states have performed well in almost all the parameters considered in the analysis of good practices so far as the working of various SFCs across states are concerned. These states have constituted fifth SFC, gaps between the two SFCs is not more than 5 years. They have submitted reports in the minimum time from the date of constitution and laid ATRs before the legislature in less than a year. Among the north eastern states

SFC of Sikkim has performed very well as it is ranked third among the top four States. Though Rajasthan has also acted its best but it falls at fourth rank just because of the zero score in the context of V1. On the contrary States like Arunachal Pradesh, Gujarat and Jammu Kashmir are among the lowest rank holder SFCs.

If we consider each variable separately we find that in case of Variable 1 only 11 States among 24 states qualify. In the context of constitution of SFCs only seven states have constituted fifth SFC. In case of Jharkhand its third SFC is considered as Fourth SFC and for Uttarakhand its fourth SFC is considered as Fifth SFC. For this particular Variable Bihar, Himachal Pradesh, Uttarakhand and Rajasthan will be ranked top as they also have constituted its Fifth SFC along with Kerala and Tamil Nadu.

In assessing the gaps in the constitution of two SFCs we found that SFCs of Andhra Pradesh, Gujarat and Manipur were performing badly as the gaps in the last two SFCs in these states were more than eight years on the other hand in almost 14 states the gaps were less than equal to five years.

In case of the gap in the submission of the report, submission of last SFC is considered. In case of states who have constituted fifth SFC submission of the report of Fourth SFC is taken into consideration. This parameter puts Haryana and Tripura at the bottom as these two states took more than four years in the submission of the report from the date of constitution, whereas SFCs of Assam, Kerala, Maharashtra, Manipur, Odisha, Rajasthan, Sikkim, Tamil Nadu and West Bengal performed well.

Regarding ATR submission, Government of Andhra Pradesh and Maharashtra took more than six years to put the ATR on desk. On the other side the Government of Himachal Pradesh, Kerala, Madhya Pradesh, Odisha, Rajasthan, Punjab, Tamil Nadu, Tripura and Uttar Pradesh laid ATR before the Legislature in less than one year from the date of submission of report.

### Other Areas of Concern

- As per the practice of the Eleventh Finance Commission (EFC), one more chapter should be added in the SFC report, which could focus on specific measures that

need to be taken to improve the financial provision of local governments to transform them into Self-Government Institutions.

- EFC report pointed out that there is no time prescribed either in Article 243 I (4) or in the State legislation for submission of ATRs. The commission opined that the State governments should place the ATR on the floor of the State legislature within six months from the date of the submission of the report by the SFC.
- The Twelfth Finance Commission argued that the States should follow the recommendations of SFC without much modification as per the practice at the Union. However, States do not follow the practice even though the recommendations are accepted in the Assembly. Such kind of practice makes the institution of SFCs meaningless
- TFC suggested that SFCs should follow the procedure adopted by UFC regarding transfers of resources from Union to States. Further, it advised SFCs to assess the resource gaps by following normative approach for the resource requirements of the local governments instead of forecasts based upon historical trends.
- Thirteenth Finance Commission highlighted the issues of the quality of SFC reports and recommended a template which was prepared after comprehensive consultation process.
- The Fourteenth Finance Commission is of the view that there is an urgent need of reliable data of local government finances. Further the Commission suggested that local governments should be encouraged to generate own resources and to improve the quality of basic services and local governments should spend the grants only on the basic services within the functions assigned to them.

Table 3.2- Constitution and Submission of SFC Reports and Action Taken thereon

S.N.	State	Date of Constitution of SFC	Date of Submission of SFC Report	Date of Submission of ATR	Period Covered by SFC
<b>First State Finance Commissions</b>					
1	Andhra Pradesh	Jun-94	May-97	Nov-97	1997-98 to 1999-2000
2	Arunachal Pradesh	Sep-05	Apr-08	-	-
3	Assam	Jun-95	Feb-96	Mar-96	1996-97 to 2000-01
4	Bihar	Apr-94	-	-	-
5	Chhattisgarh	Aug-03	May-07	Jul-09	2005-06 to 2009-10
6	*NCT of Delhi	Apr-95	-	-	1996-97 to 2000-01
			ULBs- Dec 1997		
7	Goa	Apr-99	Jun-99	Nov-01	2000-01 to 2004-05
8	Gujarat	Sep-94	RLBs- July 1998 ULBs- Oct 1998	Aug-01	1996-97 to 2000-01
9	Haryana	May-94	Mar-97	Sep-00	1997-98 to 2000-01
10	Himachal Pradesh	Apr-94	Nov-96	Apr-97	1996-97 to 2000-01
11	Jammu & Kashmir	Jan-08	Not Submitted		
12	Jharkhand	Jan-04	-	-	-
13	Karnataka	Jun-94	RLBs- July 1996	Mar-97	1996-97 to 2000-01

ULBs- Jan 1996					
14	Kerala	Apr-94	Feb-96	Feb-97	1996-97 to 2000-01
15	Madhya Pradesh	Feb-95	Jul-96	Jul-96	1996-97 to 2000-01
16	Maharashtra	Apr-94	Jan-97	Mar-99	1994-95 to 1996-97#
17	Manipur	Apr-94	Dec-96	Jul-97	1996-97 to 2000-01
18	Meghalaya	Meghalaya SFC Act 2012			
19	Mizoram	Mizoram SFC Act 2010			
20	Nagaland	Exempted under Article 243 M			
21	Odisha	Nov 1996/Aug 1998*	Dec-98	Jul-99	1997-98 to 2004-05
22	Punjab	Apr-94	Dec-95	Sep-96	1996-97 to 2000-01
23	Rajasthan	Apr-94	Dec-95	Mar-96	1995-96 to 1999-00
24	Sikkim	Jul-98	Aug-99	Jun-00	2000-01 to 2004-05
25	Tamil Nadu	Apr-94	Nov-96	Apr-97	1997-98 to 2001-02
26	Tripura	RLBs- Apr 1994	Jan-96	Feb-97	1996-97 to 2000-01
		ULBs- Aug 1996	Sep-99	Nov-00	1999-00 to 2003-04
27	Uttar Pradesh	Oct-94	Dec-96	Jan-98	1997-98 to 2000-01
28	Uttarakhand	Mar-01	Jun-02	Jul-04	2001-02 to 2005-06

29	West Bengal	May-94	Nov-95	Jul-96	1996-97 to 2000-01
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### Second State Finance Commissions

1	Andhra Pradesh	Dec-98	Aug-02	Mar-03	2000-01 to 2004-05
2	Arunachal Pradesh	Aug-12	Jun-14	-	-
3	Assam	Apr-01	Aug-03	Feb-06	2001-02 to 2005-06
4	Bihar	Jun-99	-	-	1998-99 to 2002-03
5	Chhattisgarh	Sep-11	Mar-13	-	2011-12 to 2016-17
6	*NCT of Delhi	Oct-04	-	-	2006-07 to 2010-11
7	Goa	Aug-05	Dec-07	-	2007-08 to 2011-12
8	Gujarat	Nov-03	Jun-06	-	2005-06 to 2009-10
9	Haryana	Sep-00	Sep-04	Dec-05	2001-02 to 2005-06
10	Himachal Pradesh	May-99	Oct-02	Jun-03	2001-02 to 2006-07
11	Jammu & Kashmir	Not Constituted			
12	Jharkhand	Jan-09	-	-	2009-10 to 2013-14
13	Karnataka	Oct-00	Dec-02	Jun-06	2005-06 to 2010-11
14	Kerala	Jun-99	Jan-01	Jan-04	2001-02 to 2005-06

15	Madhya Pradesh	Jun-99	Jul-03 (1st Report)	Mar-05	2001-02 to 2005-06
			Aug-03 (2nd Report)		
			Dec-03 (3rd Report)		
16	Maharashtra	Jun-99	Mar-02	Mar-06	1999-00 to 2001-02
17	Manipur	Jan-03	Nov-04	Dec-05	2001-02 to 2005-06 (award period extended to 1.3.10)
18	Meghalaya	Exempted under Article 243 M			
19	Mizoram	Exempted under Article 243 M			
20	Nagaland	Exempted under Article 243 M			
21	Odisha	Jun-03	Sep-04	Aug-06	2005-06 to 2009-10
22	Punjab	Sep-00	Feb-02	Jun-02	2001-02 to 2005-06
23	Rajasthan	May-99	Aug-01	Mar-02	2001-01 to 2004-05
24	Sikkim	Jul-03	Sep-04	Feb-06	2005-06 to 2009-10
25	Tamil Nadu	Dec-99	May-01	May-02	2002-03 to 2006-07
26	Tripura	Oct-99	Apr-03	Jun-08	2003-04 to 2007-08
27	Uttar Pradesh	Feb-00	Jun-02	Mar-04	2001-02 to 2005-06
28	Uttarakhand	Apr-05	Jun-06	Mar-11	2006-07 to 2010-11

29	West Bengal	Jul-00	Feb-02	Jul-05	2001-02 to 2005-06
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### Third State Finance Commission

1	Andhra Pradesh	Dec-04	Jan-08	Jan-14	2005-06 to 2009-10
2	Arunachal Pradesh	Not Constituted			
3	Assam	Feb-06	Mar-08	Sep-09	2006-07 to 2010-11
4	Bihar	Jul-04	Nov-07	Mar-07	2003-04 to 2007-08
5	Chhattisgarh	Not Constituted			
6	*NCT of Delhi	Jan-01	-	-	2001-02 to 2005-06
7	Goa	Not Constituted			
8	Gujarat	Feb-11	Feb-14	-	2010-11 to 2013-14
9	Haryana	Dec-05	Dec-08	Aug-08	2006-2011
10	Himachal Pradesh	May-05	Nov-07	Apr-08	2007-08 to 2011-12
11	Jammu & Kashmir	No data available			
12	Jharkhand	Apr-15	-	-	-
13	Karnataka	Aug-06	Dec-08	Oct-11	2011-12 to 2015-16
14	Kerala	Sep-04	Nov-05	Feb-06	2006-07 to 2010-11
15	Madhya Pradesh	Jul-05	Oct-08	2009	2006-07 to 2010-11

16	Maharashtra	Jan-05	Jun-06	Dec-13	2006-07 to 2010-11
17	Manipur	May-13	-	-	-
18	Meghalaya	Exempted under Article 243 M			
19	Mizoram	Exempted under Article 243 M			
20	Nagaland	Exempted under Article 243 M			
21	Odisha	Sep-08	Jan-10	-	2010-11 to 2014-15
22	Punjab	Sep-04	Dec-06	Jun-07	2006-07 to 2010-11
23	Rajasthan	Sep-05	Feb-08	Mar-08	2005-06 to 2009-10
24	Sikkim	Mar-09	Nov-09	Mar-10	2010-11 to 2014-15
25	Tamil Nadu	Dec-04	Sep-06	May-07	2007-08 to 2011-12
26	Tripura	Mar-08	-	Mar-10	2005-06 to 2009-10
27	Uttar Pradesh	Dec-04	Aug-08	Feb-10	2006-07 to 2010-11
28	Uttarakhand	Dec-09	-	-	-
29	West Bengal	Feb-06	Oct-08	Jul-09	2008-09 to 2012-13

#### Fourth State Finance Commission

1	Andhra Pradesh	Constituted (No data available)			-
2	Arunachal Pradesh	Not Constituted			

3	Assam	Apr-10	Feb-12	-	2011-2016
4	Bihar	Jun-07	Jun-10	2010	2010-11 to 2014-15
5	Chhattisgarh	Not Constituted			
6	*NCT of Delhi	Constituted	-	-	-
7	Goa	Not Constituted			
8	Gujarat	Not Constituted			
9	Haryana	Apr-10	Jun-14	No Data	2011-12 to 2015-16
10	Himachal Pradesh	May-11	Jan-14	Feb-14	2012-13 to 2016-17
11	Jammu & Kashmir	Not Constituted			
12	Jharkhand	Not Constituted			
13	Karnataka	Not Constituted			
14	Kerala	Sep-09	Jan-11(Part 1) Mar-11 (Part 2)	Feb-11 -	2010-11 to 2015-16
15	Madhya Pradesh	Jan-12	-	-	2010-11 to 2015-16
16	Maharashtra	Feb-11	-	-	2010-11 to 2015-16
17	Manipur	Not Constituted			
18	Meghalaya	Exempted under Article 243 M			
19	Mizoram	Exempted under Article 243 M			
20	Nagaland	Exempted under			

Article 243 M					
21	Odisha	Oct-13	Sep-14	Feb-15	2015-2020
22	Punjab	Nov-08	May-11	-	2011-12 to 2015-16
23	Rajasthan	Apr-11	Jul-11	Aug-11	2009-10 to 2014-15
24	Sikkim	Jul-12	-	-	2014-15 to 2019-20
25	Tamil Nadu	Dec-09	Sep-11	May-13	2011-12 to 2016-17
26	Tripura	Constituted March 2013/ No data available			
27	Uttar Pradesh	Dec-11	Dec-14	Mar-15	2011-12 to 2015-16
28	Uttarakhand	Constituted/ No data available			
29	West Bengal	Apr-13	Apr-14	-	2013-14 to 2017-18

#### Fifth State Finance Commission

1	Assam	Mar-13	Cabinet rejected the Commission		2015-16 to 2019-20
2	Bihar	Jan-14	Jan-16	-	2015-16 to 2019-20
3	Himachal Pradesh	Nov-14	-	-	2017-18 to 2021-22
4	Kerala	Dec-14	Mar-16		
5	Rajasthan	Jun-15	Sep-15(Interim)	Sep-15	2015-16 to 2019-20
6	Tamil Nadu	Dec.14	May-16 (Tent.)	-	2017-18 to 2021-22

## Chapter 4

### Conclusions and Suggestions

The SFCs have a major role to ensure that the democratic decentralization envisaged under the CAA becomes operational and effective. The State Governments have the responsibility to enhance the credibility and acceptability of the SFCs. It is the State Government that has to enact a conformity act prescribing the number and qualification of members of the Commission. It is unfortunate that most States have considered the appointment of SFC as one of the instruments through which they can please or appease the group of favourites whether from bureaucracy or from outside. It is interesting to note that the composition of the SFCs, including the chairperson, varied between two to five persons that too varied from full time to part time or the mix of both. The qualification, status and background of the members range from anybody to former Chief Minister (Rajasthan) and former Union Minister of State (Andhra Pradesh and Madhya Pradesh). In many States, SFC report is submitted to the State Government and not to the Governor. In addition, the institution of SFC is further weakened in the absence of firm database on local governments and norms for service delivery. Diverse views, channels and methods of State-local fiscal transfers make their task even more challenging.

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

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

Given the heavy non-plan developmental tasks the local governments have to perform, the assigned taxes and non-tax revenue sources are unlikely to be adequate. Moreover, the revenue generating capacities of local governments, whatever is their level; differ from State to State and even within the State. Some have high revenue potential and some have low. Similarly, cost factor in providing services also differs for various reasons including cost disability factor, e.g. area under forest or desert. One cannot deny the fact that vast differences are also found within the State. A classic example is the case of Uttarakhand, a newly carved out State from Uttar Pradesh, which has been declared a special category state (now Himalayan State) due to its special features e.g. hilly and difficult terrain and considerable international border. Prior to that, the State was a part of Uttar Pradesh, a non-special category state. No inter-governmental transfer mechanism had ever realized that part of Uttar Pradesh had characteristics akin to a special category state. Intra-state variations postulate the need for an equalization transfer mechanism through SFCs that assess the needs of the local governments as well as their efforts to tap their own revenue potential. This kind of normative assessment by the SFCs should have been to ensure the fulfillment of every citizen's entitlement of basic minimum service or a set of local public goods. Unfortunately, such an issue has either not addressed or attempted amateurishly in most SFC reports.

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

Most SFCs have recommended a medley of taxes, cesses, or even surcharge on State taxes. Given the fact that collection of taxes at the local level is difficult, such type of efforts lead only to the escalation of administrative cost as each tax requires tax collection machinery. At times, cost of collection exceeds the actual collection of a particular tax. In order to strengthen the revenue base of the local governments, SFCs could have recommended measures to tighten tax administration for better compliance of existing taxes, rationalization of taxes and recovery of cost through appropriate user charges.

After the CAA, most States made not much change in their existing laws related to Panchayats. Panchayat laws are fragmented in some States. .

Like Union Finance Commission, SFC's recommendations are recommendatory not mandatory in nature, but unlike Union Finance Commission, SFC's recommendations are occasionally honored. In fact, many states are making a mockery of the constitutional provision. On the one hand, they constitute a body with people of little knowledge on public finance; on the other hand, they do not even consider the report. If the report is considered, very few recommendations are accepted. In the process, the crucial ones are rejected without assigning reasons. In the action taken report in some States, only numbers are mentioned. In this number game, sometime the most crucial recommendations are found rejected surreptitiously. At the top of it, many times, the accepted recommendations are not implemented. Sometime, money is not released even though actions on these recommendations are notified. The story becomes more interesting given the fact that a state Government took three years to only consider the report of the SFC.

Since State Governments do not consider the recommendations of the SFC in time, the major problem regarding the synchronization of the periods of SFC with that of the Union Finance Commission (UFC) arise. All UFCs – from the Tenth to Fourteenth - felt the absence of SFC reports as a handicap. All UFCs, though, had the reports of SFC's of most States but these were of different period of time period covered by the concerned UFC. For this very reason the Eleventh Finance Commission even went to the extent and recommended to delete the words "*on the basis of the recommendations made by the Finance Commission of the State*" appearing in sub-clauses (bb) and (c) of Article 280 (3) of the Constitution. Subsequent Finance Commissions, including the 14<sup>th</sup> Finance Commission, endorsed views of previous commissions on this issue.

### Suggestions

The institution of SFC is evolving over a period of time as evident from a few good SFC reports and their treatments by respective state governments in recent time. The working of SFCs could be improved further through a concerted efforts of Union and State governments as well the SFCs themselves. Suggestions in that direction are outlined below:

### Role of Union Government

- To introduce a bill to amend Articles 243 I, 243 Y and 280 (3) (bb) & (c) mooted by various SFCs to provide teeth to SFCs;
- To oversee the fulfillment of constitutional provisions in states particularly the mandatory provisions of Article 243 I and 243 Y related to SFC. Report of the Commission on Centre-State Relations recommended *inter-alia* in para 8.6.01, “A Commission be constituted in every five years to report on the Status of Local Government Devolution of Powers. For this requisite provision be made in Parts IX and IX-A on the same lines as Articles 339 and 340;
- To set up an SFC cell in a National Institute for MoPR, MoUD and MoF, each non-overlapping and synergetic;
- To disseminate best practices of SFCs;
- To monitor national grants both from UFCs and Ministries to local governments through periodic evaluations of *inter se* distributions to local governments by SFCs and states;
- Encourage non-Part IX states, especially in North- East, to set up SFCs;
- To hand hold states for capacity equalization of local governments;
- To set national minimum goal for equalization of basic services;
- To create vertical schemes so that the above objectives could be achieved;
- To help states in all matters as and when needed;
- To conduct international experience sharing through workshops and conferences;
- To conduct national & international programs for capacity enhancement;
- To disseminate best practices of SFCs.

### Role of State Governments

- To constitute the SFCs for a life span of 18 months and a time limit of six months to act on SFCs’ recommendations;
- To issue GOs on the accepted recommendations and release funds timely to the banks of Panchayats;
- To appoint Chairman and members of eminence with requisite qualifications in public affairs and public finance on the lines of UFC;

- To desist from making frequent changes in the composition of SFCs;
- To establish a permanent SFC Cell in Finance Department;
- To provide core staffs to SFCs;
- To institutionalize the arrangements for annual data collection, preferably work-flow based;
- To notify and implement activity maps for all schemes & services for local governments;
- To adopt standard accounting systems as prescribed by the National agencies, including PRIA Soft;
- To indicate entitlements of Panchayats in the State annual budgets;
- To prescribe a common set of accounting practices which ensure that the accounts of the parallel structures which remain or are created because of functional efficiency are captured in the accounts of the local governments concerned (as suggested by the Commission on Centre-State Relations in para 8.7.08);
- To standardize and notify:
  - Procedures for levy of property and other local taxes
  - Norms for basic services at local level
  - Norms for staffing & salaries for local governments
- To incentivize performance through:
  - Levy and collection of taxes and user charges
  - Economy in expenditure
  - People's participation
  - Database on local finances
- To periodically review the basis for assignment of assets, staff and budget allocations to local governments;
- To maintain a local government profiler, directory, assets register, PRIA Soft etc;
- To issue GOs to delineate changing role for the local governments and others.

### **Role of SFC**

- To review the finances of the State and local governments of the last at least five years. The State finance review includes structure of the State economy, trends in growth and development and fiscal transfers from the Union. The local government finances includes own tax revenues, own non-tax revenues, fiscal transfers, borrowings and expenditure (both on revenue and capital account);

- To review the status of decentralized governance and devolution this includes functional devolution, activity mapping, financial devolution and, administrative devolution;
- To review the debt positions and fiscal management of the State and local government;
- To make *inter se* distributions of the grants recommended by the 14<sup>th</sup> Finance Commission;
- To recommend more specific schema for giving effect to the other recommendations of 14th UFC;
- To present clear-cut methodologies and approaches- whether positive or normative, in the report, this may also include approaches adopted by the State for district plans;
- To present issues for the considerations of the Union government;
- To assess & review the cost of basic civic services in different geographical provisions of the States, so that the revenue expenditure requirements of the local governments could be recommended;
- To assess expenditure requirement of the local government to maintain common property resources;
- To analyze expenditure on schemes assigned by the Union and State governments;
- To explore possibilities of borrowings by the local governments;
- To set up and maintain a dynamic SFC website in more than one language to make it user friendly. Through the web suggestions from general public on the issues contained in its ToR could be sought. Studies commissioned by SFC, basic data of the State, Panchayats & Municipalities may be placed for informed public debate;

Through such concerted efforts there would be some uniformity in a) SFC reports, b) local budgetary classifications, c) definitions of local taxes & expenditures, d) fiscal transfer mechanism to local procedures for data collection etc.

### At Last

Considering the feeble own revenue base of the local governments so far, and its high dependency on higher level of governments, the recommendations of State Finance Commission have to be of utmost importance to the local governments. Since all available SFC reports are different to each other with reference to their approaches and methodologies and even the time period covered by them, it is extremely difficult, to standardize these recommendations. Moreover, some SFCs have access to data, some have not and reliable data on panchayat and municipal finance are still not available from any source. In such circumstances, it is a challenge to the best brain to analyze the impact of SFC recommendations on the finances of local governments. It is clear, from the progress report of the last two and half decades that though the stipulation of SFC is an innovative and significant feature of the CAA, it lacks teeth and substance.

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