

Conclave of SFC Chairpersons & Secretaries

Prof. K N Harilal
Chairman, 7th State Finance Commission, Kerala

Vigyan Bhavan, New Delhi
14th November 2024

OPENING REMARKS

- Thank you Ministry of Panchayati Raj and other organizers for this big opportunity for interaction.
- Special thanks to the Hon'ble Chairman and respected Members of the 16th FC.
- Kerala Government is eagerly waiting to welcome the Union Finance Commission.
- The memorandum of the state will be formally presented on the occasion of the visit.
- What we present are some suggestions for discussion in the conclave.
- The SFC of Kerala will also submit a detailed note to the Commission after a full sitting of the Commission.

DECENTRALISATION; KERALA AS LEAD STATE

- Kerala is the lead state in decentralization and democratization of governance in India.
- Following the 73rd and 74th Constitutional Amendment, Kerala enacted Panchayat Raj Act and Municipality Act in 1994.
- The Peoples Plan Campaign for participatory planning from below was initiated in 1996
- The historic decision to devolve 30 - 40 percent of the state plan outlay was taken for a big bang effect
- All the LSGs in the state are making and implementing Local Development Plans every year without fail

Local Self Government profile of Kerala

| Type of LG | No, | Average Area (in Sq.km) | Average Population |
|--------------------------------|-------------|-------------------------|--------------------|
| Municipal Corporation | 6 | 113.50 | 519765 |
| Municipality | 87 | 27.54 | 51551 |
| District Panchayat | 14 | 2528.67 | 1842894 |
| Block Panchayat | 152 | 232.90 | 169740 |
| Grama Panchayat | 941 | 37.62 | 27418 |
| Total LSGs in the state | 1200 | | |

SFC devolution as a % of Net SoTR

| Share of LSG Devolution w.r.t. NET SOTR | | | |
|---|-------------------------------------|----------|----------------------------------|
| Year | Devolution to the LSGs (₹ crore) | Net SOTR | Devolution to SoTR (per cent) |
| 2019-20 | 11,867 | 48,745 | 24.3 |
| 2020-21 | 11,819 | 46,241 | 25.6 |
| 2021-22 | 12,398 | 56,108 | 22.1 |
| 2022-23 | 12,903 | 63,557 | 20.3 |
| 2023-24 (Tentative) | 14,149 | 66,452 | 21.3 |
| 2024-25 (Tentative) | 15,205 | 69,605 | 21.8 |

RECOGNITION/AWARDS

- **Leads in various indicators of decentralization**
 - Devolution of powers, Resources, Institutions, Deployment of Staff, etc.
- **Ministry of Panchayat Raj (2024) - Kerala's Panchayats Among the Best Performing States in**
 - Tax revenue, Own Source Revenue, etc.
- **Achievements recognized nationally and internationally**
 - MoPR - Child-Friendly Panchayat, Water Sufficient Panchayat, Self- Sufficient Infrastructure in Panchayat, Panchayat with Good Governance, Carbon Neutral Vishesh Panchayat Puraskar,
 - MoJS – Best Village Panchayat (2024), Swatch Sarvekshan Grameen Award (2019)
 - Deen Dayal Antyodaya Yojana-National Urban Livelihood Mission (DAY-NULM) Award (2024)
 - UN Habitat Shanghai Global Award for Sustainable Development in Cities (2024)
- **Leads in Devolution indices- TISS (2017)**

SFCs in Kerala

- Kerala constituted the First State Finance Commission on 23/04/1994.
- Kerala has been constituting State Finance Commissions on time without any break.
- Kerala is the first State to set up a SFC Cell in the Govt. Secretariat to oversee the implementation of SFC recommendations in 1997
- As a result of all the above, the Local Bodies in Kerala have transformed into the third stratum of government in letter and spirit.
- The 7th SFC constituted on 26th Sept 2024 for proposing devolution for the period from April 2026 to March 2031.

SFCs in Kerala

| SFCs | Date of Constitution | Date of Submission of the final report | Devolution period |
|-------------|-----------------------------|---|--------------------------|
| I SFC | 23/04/1994 | 29/02/1996 | April 1996 to March 2001 |
| II SFC | 23/06/1999 | 08/01/2001 | April 2001 to March 2006 |
| III SFC | 20/09/2004 | 23/11/2005 | April 2006 to March 2011 |
| IV SFC | 19/09/2009 | 22.01.2011 (part-I) 31.03.2011 (part-II) | April 2011 to March 2016 |
| V SFC | 17/12/2014 | 19.12.2015 (Part I) 11.03.2016 (Part II) | April 2016 to March 2021 |
| VI SFC | 01/11/2019 | 15.12.2020 (First Part) 22-09-2021 (Supplement) 28-12-2021 (Second Part) April 2022 (Third Part) | April 2021 to March 2026 |
| VII SFC | 26/09/2024 | | April 2026 to March 2031 |

Terms of Reference of the 7th SFC: Highlights

- Historically the ToRs of Kerala SFCs contain mandates to study and propose approaches and initiatives to strengthen the Local Self Government ecosystem in the state along with the mandatory functions of proposing fiscal devolution.
- The 7th SFC's ToR also contains many such important items. For instance:
 - Proposing innovative new own revenue sources for LGs and methods to enhance the revenue collection, incentives for increased revenue collection etc.
 - LSGs in Kerala are pioneers in implementing e-governance initiatives. The ToR mandates the commission to study and propose means to further strengthen the same.
 - Importance to spatial planning.
 - Find out opportunities for PPP, joint ventures among LSGs and government departments etc.
 - Strengthening the local governance system to effectively support the long-term vision of the state and the nation
 - To evolve a fiscal strategy for *Urban Development*

Existing devolution categories

| Devolution type | Criteria | Allocation for 2024-25 (₹ in Cr) |
|--|---|-------------------------------------|
| General Purpose Fund | 4% of State's SoTR | 2542.27 |
| Maintenance Fund | 6.5 % of State's SoTR (4 % for road assets and 2.5 % for non-road assets) | 4131.19 (2542.27+1588.92) |
| Development Fund (General Sector, Scheduled Caste Sub Plan and Tribal Sub Plan) | 27.5% of state's plan outlay for 2024-25 financial year (as per 6 th SF.C recommendation it increases 0.5% every year till it reaches 30% by starting from 26% in 2021-22) | 5714.72 (4171.87+1341.30+201.55) |

- In Kerala, SFCs devolve funds to Local Self Governments as untied funds for which LSGs can develop their own plans recognizing their functional autonomy.

Union FC devolution as a % of Net Tax Revenue

Share of Local Body Grant (all India) w.r.t. NET Own Tax Revenue (Union Government)

| Year | Grants to Local Bodies | | Total (₹ crore) | Own Tax Revenue (₹ crore) | Own tax revenue (per cent) |
|---------|------------------------|--------------|--------------------|------------------------------|-------------------------------|
| | Rural Bodies | Urban Bodies | | | |
| 2019-20 | 59,361 | 25,098 | 84459 | 13,56,902 | 6.2 |
| 2020-21 | 60,750 | 26,710 | 87460 | 14,26,287 | 6.1 |
| 2021-22 | 40,312 | 16,147 | 56459 | 18,04,793 | 3.1 |
| 2022-23 | 45,578 | 17,779 | 63357 | 20,97,786 | 3.0 |
| 2023-24 | 40,778 | 19,222 | 60000 | 23,23,918 | 2.6 |
| 2024-25 | 49,800 | 25,653 | 75453 | 25,83,499 | 2.9 |

Union FC devolution to LSGs in Kerala

Share of Local Body Grant to Kerala w.r.t. NET Own Tax Revenue (Union Government)

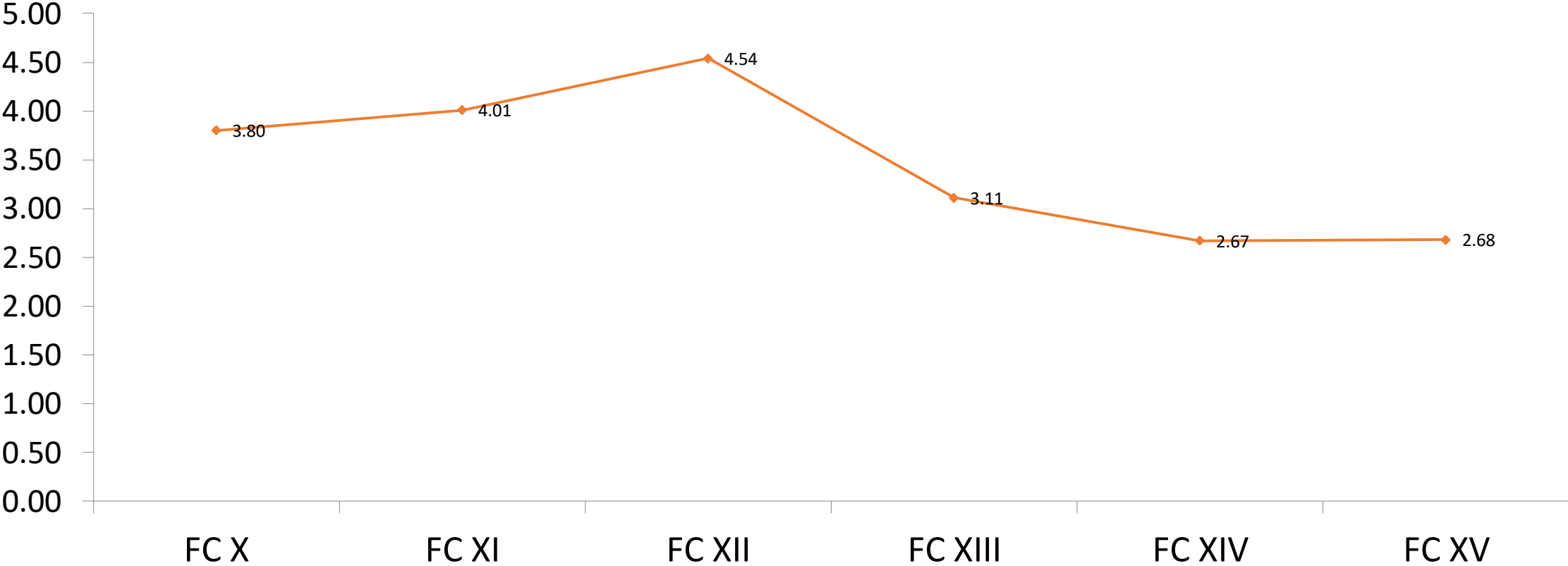
| Year | LSG Grant (₹ crore) | Own Tax Revenue of GoI (₹ crore) | Own tax revenue (per cent) |
|---------|------------------------|-------------------------------------|-------------------------------|
| 2019-20 | 2338.60 | 13,56,902 | 0.17 |
| 2020-21 | 2412.00 | 14,26,287 | 0.17 |
| 2021-22 | 2353.98 | 18,04,793 | 0.13 |
| 2022-23 | 2417.98 | 20,97,786 | 0.12 |
| 2023-24 | 2495.95 | 23,23,918 | 0.11 |
| 2024-25 | 2637.28 | 25,83,499 | 0.10 |

Grants-in-Aid to Local Governments: FC Criteria

| Criterion | FC-X | FC-XI | FC-XII | FC-XIII | | FC-XIV | FC -XV |
|--|---------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | | | | RLB | ULB | | |
| Population (Census) | 100 (1971) | 40 (1971) | 40 (2001) | 50 (2001) | 50 (2001) | 90 (2011) | 90 (2011) |
| Geographical area | | 10 | 10 | 10 | 10 | 10 | 10 |
| Distance from highest per capita income | | 20 | 20 | 10 | 20 | | |
| Index of decentralisation/ devolution | | 20 | | 15 | 15 | | |
| Index of deprivation | | | 10 | | | | |
| Revenue effort | | 10 | 20 | | | | |
| Proportion of SC/ST population | | | | 10 | 0 | | |
| FC local body grants utilisation index | | | | 5 | 5 | | |
| Total | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

Union FC devolution to Kerala decreasing trend

Figure 2: Kerala's share from the Grant awarded by Successive FCs, in per cent



Criteria for Devolution – Ideas for Discussion

- **Grants as a proportion of the divisible pool**
 - Local government grants to be expressed as a proportion of the divisible pool to benefit the LGs from the overall buoyancy of Union Tax Revenue.
 - Considering the rising requirements of LGs, the 16th UFC may recommend allocation of 9% of the divisible pool to local governments. Nine per cent is not high given the growing gap between the divisible pool and the gross tax revenue of the Union.

Criteria for Devolution – Ideas for Discussion

- **Need to revise the existing criteria for horizontal distribution**

- Use of 2011 Census adversely effected states which had implemented National Population Policy. This is one of the reasons for the fall in the share of LG grants to Kerala.
- The Criteria of ***Demographic performance*** used by the 15th FC for devolving funds to the states was not applied in the case of Local Governments. The 16th FC may bring in demographic performance into the formula for devolving funds to LGs.
- Considering population as an undifferentiated indicator is problematic. We suggest some more criteria for factoring in spatial dynamics of population/economic growth.

Criteria for Devolution – Ideas for Discussion

- The urban centers are growth centers of the nation where labour, capital, production, population concentrate. In order to factor in spatial dynamics of population/ economic growth ***urban population may be considered*** as a criteria for devolution with a weightage of 20%.
- Aging of the population is another dimension of the demographic dynamics. In view of the attendant expenditure on public services, ***aged population*** may be considered as a criteria for devolution with a weightage of 10%.
- It is also important to bring in the ***criteria of area*** considering the cost of delivery of public services. A weightage of 10% may be considered for the area criteria.
- An ***index of Devolution*** for incentivizing the states which implement the national policy of decentralization can also be considered with a weight above 20%. The problem of data availability appears to be resolved by the MoPR (2024) data.

Criteria for Devolution – Tentative Ideas for Discussion

| No's | Criteria | Tentative Weight |
|------|-------------------------|------------------|
| 1. | Population | 30 |
| 2. | Urban Population | 20 |
| 3. | Aged Population | 10 |
| 4. | Demographic Performance | 10 |
| 5. | Area | 10 |
| 6. | Index of Devolution | 20 |

Inter-se distribution of grants among RLBs and ULBs within states

- For the distribution among RLBs and ULBs, the 15th FC used a set of common ratios for the nation as a whole.
- Instead, rural-urban distribution should be based on the rural-urban population ratio in each state details of which may be left to the SFC or the State Government.

Suggestions for improving own sources of revenue

- We observed a disconnect between the growth of the local economy and the ability to mobilise resources by the Local governments.
- Local governments do not have tax handles to tap local economic growth. This is true for state governments as well. States and local governments cannot tax individual or corporate income or other taxes payable by those who avail public services or generate more than proportionate pollutants.
- The first thing to overcome this gap is to bring in constitutional amendments to facilitate increase in the upper ceiling of profession tax.
- We suggest the introduction of a pollution tax or user fee to make the polluter pay. All the major and medium enterprises will be required to submit their annual statement on the production of pollutants and the mode of treatment adopted. The collection of the pollution tax will not be highly promising in the beginning, but will emerge as a stable and dynamic source of revenue. We urge the FC to take the lead to design a national approach on this. Otherwise competition among states will spoil the effort to tax the polluters.

Conditions on devolution of grants to LSGs

- FC suggestions to improve efficiency of LSGs are welcome. But, the conditions so set should be facilitating rather than denying them the grant or the autonomy of decision making.
- Entry conditions set by the 15th FC is illustrative. The condition of submission of audited accounts online presupposes capacity building that reach every nook and corner of the country. In the absence of infrastructure and capacity building, the exercise would lose value and become a namesake exercise.
- Experience of Kerala is important to be cited here. In spite of a sizable audit team with long years of service and experience, the state found it difficult to meet the milestones set from above. One major difficulty our audit team faced was the large volume of development activities of LSGs caused by the success of decentralization in Kerala. The LSGs in Kerala handle much larger amount of resources compared to what is devolved through LSG grants from the Centre.

Conditions on devolution of grants to LSGs

- Another entry condition is the collection of property tax.
- Property tax collection is required to keep pace with GSDP growth. But every region will not be growing at the same pace. There will be laggards on account of unexpected economic or climate change events. In many such cases, the entry condition will lead to unjustifiable denial of funds to the most deserving LSGs.
- National priorities such as sanitation, waste disposal and drinking water need not be the priority in every locale. Drinking water may not be scarce everywhere. Even in a region with water scarcity, the LSG grants need not be used for water projects if there are such projects run with other sources of funds. In Kerala for example, there are several sources of funds which address the issues of sanitation, waste disposal and drinking water.
- Local governments should be able to spend the grant within their functional domain according to local needs, as they are constitutionally mandated local governance institutions.
- All grants may be given as 'Basic Grants' to enhance the functional autonomy of LSGs.

Conditions on devolution of grants to LSGs

- As has been the experience of health grants, the Special grants are likely to be designed as Centrally Sponsored Programs (CSS). It is against the spirit of decentralization.
- Therefore, the 16th FC may dispense the system of devolving special grants, such as the Health Grant, and revert it to the format of Basic Grant.
- Here it is advisable to refer back to the terms of reference of the 16th FC.

“The measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State.”

Need for agile models to set priorities

- There is consistent demand from the LSGs for an agile model for setting priorities by recognizing field level realities and honouring functional autonomy.
- In the case of tied grants of Union Finance Commission that come with preset priorities, confusions in the field level has now become a common thing.
- For instance, in the case of LSGs, which have been investing funds in implementing drinking water schemes as part of SFC grants or own revenue for long and the need is in a saturated status, the tied grants of the Union Finance Commission that comes with the same as a top priority in a later stage may result in confusion and wasteful expenditure.

Expectations from this conclave

- Sharing of best practices and out of box thoughts for strengthening of the local governance ecosystem in the country.
- Ideas on new sources and innovative practices to enhance the own revenue collection by the LSGs.
- The ever deteriorating health of the environment and proportionately aggravating effects of climate change have become a reality now. Productive discussions on how to capacitate LSGs to tackle these issues.
- Early childhood care and education as well as support for active aging are vital to shape healthy, creative, development oriented societies. How SFCs can guide the Governments and LSGs in this direction.

Thank you