CHAPTER-II
THE 74th CONSTITUTIONAL AMENDMENT ACT, FINANCE COMMISSIONS AND URBAN FINANCES IN ANDHRA PRADESH

This chapter covers the provisions of 74th Constitutional Amendment Act, 1992, functions of finances of urban government. State finance commission and its role, recommendations of the Twelfth Finance Commission for restructuring public finances and reforms suggested by Thirteenth Finance Commission for urban local bodies. Recommendations of various committees on methods of improving local finances have been discussed in this chapter. It also presents the municipal government sources of revenue, recommendations of the State Finance Commissions in Andhra Pradesh have also been discussed in this chapter.

The 74th Constitution Amendment Act, 1992 of Indian Constitution in India aims at a decentralised regime through the mechanism of devolution of functions, finances and functionaries to urban local bodies. Originally, the Constitution of India envisaged a two-tier system of federation. Until 1992, local governments had not been a Constitutional component of the Indian planning and development strategy. It took nearly four decades to accord a constitutional status to Local Self-Governments and, thereby create a three-tier system of federation. With the Constitution (73rd Amendment) Act, 1992 and the Constitution (74th Amendment) Act, 1992, local bodies became the third stratum of government. Enormous responsibilities have been identified for urban local bodies in the 74th Constitution Amendment. These include: i) preparation of plans for economic developments and social justice, and ii) implementation of such plans and schemes as may be entrusted to them, including those in relation to the matters listed in the Twelfth schedule to the Constitution (Article 243W). Besides the 18 items of responsibilities envisaged as legitimate functions of Urban Local Bodies in the Constitution of India. The Legislature of a State, by law, can assign any tasks relating to the preparation and implementation of plans for economic development and social justice (The Constitution Seventy-Fourth Amendment Act, 1992, Article-243W, http://indiacode.nic.in/coiweb/amend/amend74.htm, Retrieved on 21-02-2013).
While the 74th Amendment listed responsibilities of Urban Local Bodies, which involve expenditure it did not specify the legitimate sources of revenue for these authorities. It simply stated that the Legislature of a State may, by law, i) authorize a municipality to levy, collect and appropriate such taxes, duties, tolls and fees, ii) assign to a municipality such taxes, duties, tolls and fees levied and collected by the State Government, iii) provide for making such grants-in-aid to the municipality from the consolidated fund of the state and iv) provide for the constitution of such funds for crediting all cash received. Thus, while the municipalities have been assigned the responsibility of preparation of plans for a wide range of matters—from economic development to promotion of cultural, educational and aesthetic aspects, the power to raise resources by identifying taxes and rates to implement the plans are vested to be solely with the state legislature. This has created, what is referred to in public finance literature as vertical imbalances, i.e., constitutionally built in mismatches in the division of expenditure liabilities and revenue raising powers of the Union, States and Local Bodies. To address this problem, two significant provisions were introduced in to the Constitution of India. They are: i) the formation of State Finance Commissions (SFCs) to recommend devolution of State resources to local bodies and ii) enabling the Central Finance Commission (CFC) to recommend grants-in-aid for local bodies through augmenting the State consolidated funds. Article 243Y (The 73rd Constitutional Amendment), makes it mandatory on the part of the State Governments to constitute State Finance Commissions once in every five years to review the financial position of the Panchayats and the Municipalities. As far as the urban local bodies are concerned, it is mandatory for the State Finance Commissions to review and recommend the principles of devolution of resources from the State Government to their local bodies and suggest “measures” needed to improve their financial position. The 73rd Amendment Act stipulates that the State Governor shall cause every recommendation made by the State Finance Commission, together with an explanatory memorandum as to the action taken thereon, to be laid before the Legislature of the State. The Constitutional Amendment Acts provide for a safeguard regarding the implementation of the recommendations of State Finance Commissions. Article 280 of the Constitution under which a Central Finance Commission is appointed once every five years to assess the financial needs of the State Governments and to recommend a package of financial transfers from the Centre to States is amended. It is now mandatory on the part of the Central Finance
Commission to recommend “the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Municipalities in the State on the basis of the recommendations made by the Finance Commissions of the State”. This provision is designed to establish a proper linkage between the finances of the local bodies, State Governments and Central Government (Mohanty. P.K, Misra, B.M. Rajan Goyal, Jeromi P.D., 2007: 17-19).

As already mentioned until 1992 local governments were not part of the Indian federal structure. A change in the federal system of India came with the Constitution Amendment Acts of 1992 which conferred the constitutional status to local governments. These amendments took Indian democracy one step forward and added a new dimension to the federal system of government. Through this amendment the establishment of a local representative government empowered with administrative and financial abilities to deliver mandated services to its citizens came into force. It transferred responsibilities for services to elected urban local bodies and gave them the power to raise their own revenues and authority to make investment decisions. (Rondinelli & Cheema, 2002).

2.1. Functions and Finance:

The 74th Constitutional Amendment Act has specified eighteen functions which may be considered as the responsibilities of the urban local bodies. In addition state governments may assign them any tasks relating to the preparation and implementation of plans for economic development and social justice. As a result, urban local bodies are in need of substantial funds to execute their constitutionally assigned functions. The legislature of a state may, by law, authorize an urban local body to levy and collect taxes, duties, tolls and fees. Central and state governments may also provide grants-in-aid to their urban local bodies. Thus there are two main sources of revenue for urban local bodies, internal and external. Internal source revenue is commonly known as own source and it includes income generated from various taxes and non-taxes levied on the citizen. External source revenue mainly includes funds obtained from the central and state governments in the form of grants or loans. There may be other external sources of funds, for example, loans from domestic institutions or financial intermediaries. Some urban local bodies have also chosen to raise money from capital markets by issuing bonds (Aijaz, 2006:1-9).
The 74th Constitutional Amendment Act has provided new opportunities for urban governance reforms in the country. The municipal bodies have for the first time been provided the constitutional status of the third tier of government. They have been vested with increased responsibilities as a result of the devolution of 18 functions through the 12th schedule to the Constitution.

2.2. **Functions of Municipal Bodies:**
1. Urban Planning including town planning.
2. Regulation of land-use and construction of buildings.
3. Planning for economic and social development.
4. Roads and bridges.
5. Water supply for domestic, industrial and commercial purposes.
6. Public health, sanitation conservancy and solid waste management.
7. Fire services.
8. Urban forestry, protection of the environment and promotion of ecological aspects.
9. Safeguarding the interests of weaker section of society, including the handicapped and mentally retarded.
10. Slum improvement and upgradation.
11. Urban poverty alleviation.
12. Provision of urban amenities and facilities such as parks, gardens, playgrounds.
13. Promotion of cultural, educational and aesthetic aspects.
14. Burials and burial grounds, cremations, cremation grounds and electric crematoriums.
15. Cattle pounds, prevention of cruelty to animals.
16. Vital statistics including registration of births and deaths.
17. Public amenities including street lighting, parking lots, bus stops and public conveniences.
18. Regulation of slaughter houses and tanneries (Ramakrishna Nallathiga, 2008:13).

2.3. **Current Status of Finances:**

The Constitution of India specifies the taxes to be divided between the central and state governments but it does not specify the revenue base for Urban Local Bodies. Further the 74th Constitutional Amendment Act is not specific about the types of taxes Urban Local Bodies should have but on the other hand the powers for
determining the revenue base of Urban Local Bodies rests with the state governments. The resource base of Urban Local Bodies typically consists of their own resources (tax and non-tax revenues), shared revenues, state grants, and loans from state governments and market borrowings. With the abolition of Octroi by most States, Property Tax is the most important source of revenue for local governments.

The Government of India formulated and circulated the Guidelines for Property Tax Reforms, in 1998. Urban Local Bodies need to improve legal basis of property assessment as well as improve the tax administration. Several states have introduced unit area method of property tax assessment. User charges are most important sources of non-tax revenues for Urban Local Bodies. Urban Local Bodies opt for management innovations to improve efficiency and strengthen the municipal revenue base. These innovations include improved billing and collection, rationalization of service charges, simplification of the tax assessment system, computerization of records, improved accounting and financial management systems, intensive communication with public, project specific contribution, outsourcing, enforcement, State Government guidelines, etc. The most important lesson learned is that the municipal resource mobilization process requires the strong commitment and unwavering support of elected leaders as well as of administrators (Chetan Vaidya, 2009:18-20).

According to the Report of a Sub-Committee, there is a strong realization regarding the constraints faced by the municipal bodies in the levy and collection of own sources of revenue. Realizing these weaknesses and their potential to generate more revenue, the Municipalities have to initiate specific actions under various instruments. Individual actions which can be taken up to mobilize own sources from include (I) appropriate placement of revenue instruments and (ii) efficiency in fiscal monitoring and control. A basic minimum standard of performance for the Urban Local Bodies should be to ensure full cost recovery of O&M through user charges and at least partial recovery of capital expenditure (Report of the Sub-Committee on Financing Urban Infrastructure in the Twelfth Plan, 2012: 35).
2.4. **State Finance Commission and its Role:**

Article 243Y of the Constitution provides that a Finance Commission should be constituted, as defined by article 243 I, to review the financial position of Municipalities and Panchayats (Implications of the 74th Amendment and Integration of City Planning and Delivery Functions, 2011:6).

The State Finance Commission, for every five years, review the financial position of municipalities and make recommendation to the Governor on the following points:

1. The distribution between the state and the municipal corporations, the net proceeds of the taxes, duties, tolls and fees levied by the state.
2. The determination of the taxes, duties, tolls and fees which may be assigned to the municipal corporations.
3. The grants-in-aid to the municipal corporations from the Consolidated Fund of the State.
4. The measures needed to improve the financial position of the municipal corporations including measures for improving the management of available resources and
5. Any other matter referred to the Finance Commission by the Governor in the interests of sound finance of municipalities (Alok, V.N. 2004: 30).
6. The Commission shall also make recommendations on any other matter that may be referred to it, by the Governor, in the interest of sound finances of Municipal Bodies referred to above. In making its recommendations, the Commission shall have regard among other considerations to:
   a) The resources of the State Government and the demands particularly on account of expenditure on administration, debt servicing and other committed expenditure or liabilities;
   b) The revenue resources of the basis for the five years commencing on 1st April, 2005 on the basis of the levels of taxation possible to be reached in 2003-04 targets for additional resources mobilization and the potential for raising additional taxes;
c) The requirements of the Municipal Bodies for meeting the non-plan revenue expenditure on staff and administration etc., also keeping in view the potential for raising their resources;
d) The requirements of the bodies for capital expenditure for creating assets like, Water Supply Schemes, Roads, Bridges, Buildings, Minor Irrigation sources;
e) The maintenance and upkeep of capital assets like Buildings, Roads, Water Supply Schemes minor Irrigation sources by the Municipal Corporations and the norms on the basis on which specified amounts are recommended for the maintenance of the assets.
f) The requirement of the Municipal Bodies in up gradation of standards in non-developmental sectors and services particularly in respect of institutions which are Backward.
g) The provisions required for emoluments and terminal benefits of employees including teachers and other employees;
h) The scope for computerization of accounts; and
i) The incentives which may be provided for better realization of taxes and non-taxes.

7. The Commission shall also indicate the manner in which the receipts and expenditure of the Municipal Bodies can be monitored for better financial management.

8. The Commission may also make recommendations about the financial devolutions to the Municipal Bodies for the functions devolved on them under Articles-243-G and 243-W of the Constitution of India.

9. The Commission shall indicate the basis on which it has arrived at its findings.

10. In making its recommendations on the various matters aforesaid, the Commission shall adopt the population figures of 2001 in all cases where population is regarded as a factor for determination of devolution of taxes and duties and grants-in-aid and

The Eleventh Finance Commission, while dealing with the issue of local finances recommended a number of measures which could be adopted by the state governments and the local bodies for augmenting the consolidated funds of the states to supplement the resources of panchayats and municipalities. These include assignment of land tax, profession tax and surcharge/cess on state taxes for improving the basic civic services and taking up schemes of social and economic development. Reforms had been recommended in respect of property tax/house tax, octroi/entry tax and user charges. The Eleventh Finance Commission recommended an ad hoc annual grant of Rs.1600 crore for panchayats and Rs.400 crore for municipalities and mandated certain activities such as maintenance of accounts, development of data base and audit to be the first charge on this grant. Amount remaining thereafter was to be utilized by the local bodies for maintenance of core civic services (Report of the Twelfth Finance Commission, 2005:137).

The Ministry of Urban Development and Poverty Alleviation (MUD&PA) has estimated a resource gap of Rs.76896 crore for all the states during the period 2005-10 in the matter of operation and maintenance of various civic services in urban areas. It has suggested that this gap should be bridged through a grant-in-aid by Twelfth Finance Commission (TFC).

2.5. Ministry of Urban Development and Poverty Alleviation has suggested the following to improve the functioning of the urban local bodies:—

i. It should be made obligatory for the state governments to take a final decision on the recommendations of the finance commission within a specified period preferably within 6 months;

ii. Urban local bodies should be assigned a separate list of taxes and any exemption from levy of property tax should be avoided. They should be adequately compensated if any exemption is given by the state government;

iii. Unproductive and non-viable taxes should be abolished and new sources of revenue should be explored;

iv. Urban local bodies should explore the possibility of issue of municipal bonds;

v. The accounting procedure should be modernized and use of computer should be facilitated;
vi. Performance budgeting and social auditing should be introduced;
vii. The cost of public utility services should be recovered by charging appropriate fees from the user of the services;
viii. Municipalities must progressively recover full costs covering operation and maintenance, billing and collection and capital;
ix. Inter-governmental transfers including share in state taxes and grants-in-aid should be formula based and not amenable to negotiation;
x. Borrowings can be one of the primary sources of capital funding for municipalities; and
xi. Grants given for development of infrastructure should be utilized to leverage additional financial resources (Report of the Twelfth Finance Commission, 2005:140-141).

2.6. Appointment of 12th Finance Commission:

The 12th Finance Commission under the chairmanship of Dr. C. Rangrajan was appointed on November 1, 2002, to make recommendations regarding the distribution between the Union and the States of net proceeds of shareable taxes, the principles which should govern the grants-in-aid of the revenues of States from the Consolidated Fund of India, and the measures needed to augment the Consolidated Fund of a State to supplement the resources of local bodies in the State on the basis of the recommendations made by the Finance Commission of the State.


2.7. Recommendations of the Twelfth Finance Commission Restructuring Public Finances:

i. Centre and States shall be improve the combined tax- Gross Domestic Product (GDP) ratio to 17.6 per cent by 2009-10.
ii. Combined debt- Gross Domestic Product (GDP) ratio, with external debt measured at historical exchange rates, shall be brought down to 75 per cent by 2009-10.
iii. Fiscal deficit to Gross Domestic Product (GDP) targets for the Centre and States shall be fixed at 3 per cent.

iv. Revenue deficit of the Centre and States to be brought down to zero by 2008-09.

v. Interest payments relative to revenue receipts shall be brought down to 28 per cent and 15 per cent in the case of the Centre and States, respectively.

vi. States shall be follow a recruitment policy in a manner so that the total salary bill, relative to revenue expenditure, net of interest payments, does not exceed 35 per cent.

vii. Each State shall be enact a fiscal responsibility legislation providing for elimination of revenue deficit by 2008-09, and reducing fiscal deficit to 3 per cent of State Domestic Product.

viii. The system of on-lending shall be brought to an end over time. The long-term goal should be to bring down debt- Gross Domestic Product (GDP) ratio to 28 per cent, each for the Centre and the States (Report of the Twelfth Finance Commission of India, 2005 and Smriti Chand, 2013:1-2).

2.8. Thirteenth Finance Commission Reforms:

2.8.a). Introduction:

The recommendations of the Thirteenth Finance Commission (13th FC) are of far reaching significance for strengthening local governance in India. The Commission initiated a process to reform and vitalizes the self-governing institutions to enable them to play the role the Constitution has envisaged through the Seventy Third and Seventy Fourth Constitution Amendment Acts.

The 13th Finance Commission made several recommendations to strengthen the urban governance. These recommendations mostly relate to augmentation of Urban Local Bodies finances. They include:

1. The Urban Local Bodies should exploit the scope that exists in property tax and profession tax;

2. The Urban Local Bodies should recover at least the operation and maintenance costs of the services they render. This is one of the mandatory
reforms under Jawaharlal Nehru National Urban Renewal Mission. But unfortunately, the states have not done enough to ensure that this mandatory requirement is complied with even in the Mission cities;

3. Levy of user charges on roads shall be imposed if construction of any road in the city leads to tangible commercial benefit;

4. Urban Local Bodies should access market based financing of infrastructure and desired that Pooled Financing Model should be fully exploited;

5. Urban Development Authorities should share a percentage of their income including income from sale or lease of land with Urban Local Bodies;

6. The Urban Local Bodies should be enabled to levy and collect user charges from the central properties.

7. State governments should share a portion of mining royalties with Urban Local Bodies;

8. Grants recommended by the Commission shall be released in two installments in January and July subject to submission of utilization certificates without any other documentation;

9. Speedy implementation of Jawaharlal Nehru National Urban Renewal Mission reform relating to assigning or associating Urban Local Bodies in planning and delivery functions;

10. The city development plans must incorporate civilian portions of the Cantonments to facilitate integration in service delivery like water supply and other schemes and the civil community should benefit from the schemes being implemented under Jawaharlal Nehru National Urban Renewal Mission or other projects;

11. A portion of 13th Finance Commission grants to Urban Local Bodies may be spent on revamping fire services and the Urban Local Bodies may also extend financial support to the Fire Services Department;

12. Developing and using comparable and audited data in all the Urban Local Bodies; and

13. Strengthening of Local Fund Audit Department through capacity building and personnel augmentation, etc shall be done (Operationalising the 13th Finance Commission Recommendations- Urban Local Bodies, 2010:3-8).
The Thirteenth Finance Commission (13th FC) recommendations relating to urban local bodies aim at strengthening municipal finances and urban governance in India. The 13th FC, making a departure from the previous Finance Commissions, divided the grants to be distributed to the states for local bodies into two parts - general basic grant and general performance grant. The performance grant can be accessed only if the state complies with nine conditions, which in other words can be called reforms. They are:

1. The State Government must put in place a supplement to the budget documents for local bodies.
2. The State Government must put in place Audit System.
3. The State Government must put in place a system of independent local body Ombudsmen.
4. The State Government put in place a system to electronically transfer local body grants provided by the Commission.
5. The State Government must prescribe through an Act the qualifications of persons eligible for appointment as a member of the State Finance Commissions.
6. All local bodies should be fully enabled to Levy Property Tax without hindrance.
7. The State Government must put in place a State Property Tax Board.
8. The State government must gradually put in place standards for delivery of essential services and
9. All municipal corporations with a population of more than one million (2001 census) must put in place a Fire -hazard Response and Mitigation plan for their respective jurisdictions.

States are given one year i.e., 2010-2011 to comply with these conditions before they can access the performance grant from 2011-2012. Complying with these conditions within the stipulated timeframe, require comprehensive understanding and capacity at the State and Urban Local Bodies level (Report of the Thirteenth Finance Commission, 2011:1).

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2.9. **Improving the Data Base for Urban Local Bodies:**

The Thirteen Finance Commission, in its report submitted in 2009, had noted that notwithstanding the fact that the Eleventh and Twelfth Finance Commissions underlined the need for maintaining a data base as well as up-to-date accounts of the local bodies and made a provision for supporting State governments in addressing these shortcomings, no credible data on the financial performance of the local bodies could be obtained. In view of this, the Thirteen Finance Commission reiterated that the States should implement in all Urban Local Bodies an accounting framework consistent with the accounting format and codification pattern suggested in the National Municipal Accounts Manual (NMAM) of the Ministry of Urban Development (MUD). There is, thus, a need to devise and implement a uniform pattern of budgetary and accounting practices to enable improved compilation/reporting/dissemination of financial data relating to Urban Local Bodies (Harun R Khan, 2013, Financing Strategies for Urban Infrastructure: Trends and Challenges, para.42, http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=824, Retrieved on 26-01-2014).

2.10. **Recommendations of Various (Committees) to Improve the Finances of the Urban Local Governments:**

A number of committees appointed by Government of India made important recommendations to improve the finances of urban local bodies. Some important recommendations are given below:

2.10.a). **The Local Finance Enquiry Committee (1951):** This committee recommended a list of thirteen taxes for the exclusive utilization by or for local government. Out of these thirteen taxes one at present figures in the union list and the remaining twelve figures in the state list of subjects. The thirteen taxes recommended by the Committee were as under:

1. Terminal tax on goods or passengers carried by railway, sea or air.
2. Tax on lands and buildings.
3. Tax on mineral rights subject to any limitations, imposed by parliament by law relating to mineral development.
4. Tax on the entry of goods into a local area for consumption, use or sale therein.
5. Tax on consumption or sale of electricity.
6. Tax on advertisements other than advertisements published in the newspapers.
7. Tax on good and passengers carried by road or on inland waterways.
8. Tax on vehicles other than those mechanically propelled
9. Tax on animals and boats.
10. Tolls.
11. Tax on professions, trades, callings and employment.
12. Capitation tax, and
13. Tax on entertainment including amusements.

2.10.b). **The Taxation Enquiry Commission (1953-54):** This committee had recommended a list of ten taxes to be reserved for a local government, adding, however, that “the recommendations should not be construed as precluding transfer of other taxes to any local body, wherever appropriate, if the state governments consider such a source desirable” (Report of the Taxation Enquiry Commission, 1953-54:363). The recommended taxes were;

1. Tax on lands and buildings.
2. Tax on the entry of goods into the area of local authority for consumption, use or sale therein, popularly known as octroi.
3. Tax on Vehicles other than those mechanically propelled.
4. Tax on animals and boats.
5. Tax on professions, trades, callings and employment.
6. Theatre or show tax.
7. Tax on advertisements other than advertisements published in newspapers.
8. Duty on transfer of property.
10. Tax on goods and passengers carried by road or inland water ways.
2.10.c). Report of the Rural-Urban Relationship Committee (1966): This committee made the following recommendations: -

1. Municipal Taxes should be classified into compulsory and optional.

2. Taxes on land and buildings, vehicles other than those covered by the motor vehicles Act and on professions, trades and callings should be compulsory.

3. The law should prescribe minimum rates for compulsory taxes.

4. Municipal councils should have the power to alter rates of compulsory taxes (subject to the minimum prescribed) and optional taxes (subject to such limits as may be laid down) but in case of reduction in the current rate of any tax, the prior approval of the state government should be necessary and

5. The state government should have the power to direct a municipal council to impose on optional tax at such rate as it may prescribe and such direction shall have the same force as a resolution passed by the municipal council (Report of the Rural-Urban Relationship Committee, 1966:98-99).


This committee felt that the main reason for the inadequacy of local resources is the reluctance of local bodies to step up taxation even in those fields earmarked as “Local Taxes”. To quoted the committee, “its fatal weakness lies in its unwillingness and incapability to tax itself and to collect its taxes” (The Committee on Augmentation of Financial Resources of Urban Local Bodies, 1963: 20). The committee recommended that a statutory urban development board shall be established in each and every state. The committee felt: “A specialized institution like the urban development board will have the following advantages.

1. It will be in a better position to make use of all possibilities offered by the capital market than would be the local bodies individually.
2. It will have better opportunity to influence the conditions prevailing in the capital market in favor of wishes and requirements of the local bodies than they could do separately.

3. It can raise long-term loans more easily than can individual local bodies as possible lenders can make available substantial amounts to the board whose credit worthiness can be assessed without applying the standards applicable for assessing the separate credit worthiness of individual local bodies.

4. It will be in a position to prove certain services to local bodies on consolidated basis at least in regard to projects for which loans are sought. It can also advise on the technical and economic feasibilities of schemes, on debt-redemption policies, accounting and legal matters, etc. and

5. The board will also be in a better position to attract capital from abroad and can also make better provisions against risks of fluctuations in foreign exchange, than can individual local bodies”.


1. Increasing the standard rent by 50 per cent of the percentage increase in the consumer price index between the year of fixation of rent and the present time and then onwards to revise it every 3 to 5 years.

2. Creation of a central valuation board which would primarily lay down norms, impart training, and take-up sample checks, to determine the rent of small properties.

3. Moderate tax component (not the service charges) for the owner-occupied properties.

4. Surcharge on sales tax, confining octroi only to the metropolitan cities and abolishing it from other towns and cities by imposing a state-wide surcharge on the sales tax, and its substitution by a state-wide entry tax on the lines of the MP entry tax.

5. Discriminating policy for water for different types of consumers, namely, industrial, commercial, domestic, and institutional. Among the domestic
consumers, the pricing policy has to be based on the concept of cross-subsidy. Such a discriminating price policy, besides helping in recovering the costs and probably generating some marginal surplus for future expansion, would also help in conserving the water resources of the country.

6. Levying a sewerage surcharge on the water rate for certain ranges of properties.

7. Imposition of a solid waste charge on each property, allowing 5 persons per property. The charge has to be imposed on the basis of solid waste generation. For industries and commercial enterprises also a charge has to be imposed for collection, renewal and disposal of solid wastes.

8. Treating area development, shelter and urban renewal, as a composite system the Task Force suggested cost recovery based on the cross-subsidy from income group to income group, from land use to land use, and also from urban renewal to urban renewal and

9. Suggested a permanent system for devolution of funds from the higher levels of government. The Task Force suggested setting up a Municipal Finance Board as a standing institution to constantly review the local finance, maintain the municipal data and provide secretarial support to the Municipal Finance Commission to be constituted every five years (Gangadhar Jha, 1983: 31-35).

2.11. Municipal Government Sources of Revenue:

In India, finance is the basic problem of urban governments. Adequate finances constitute the life-blood of the whole system of local government. Without sufficient finances, urban governments become mere subordinate units of state government and fail to cater to the civic needs of the community. Their income is derived from local taxation, enterprises, or the wealth of the citizens, located within the limits of municipal body. Direct taxation is common in municipal fiscal administration. In addition, they impose special levies, commonly termed as “betterment levies” charged for improvements on property made by them. Besides, they receive assistance from state and central governments for discharging their obligatory duties. International agencies through state governments also provide financial assistance for projects of urban development, such as, water supply, housing, roads etc.

2.12. Sources of Income of Urban Governments may be grouped under:

1) Tax-revenue
2) Non-tax revenue
3) Grants-in-Aid, and
4) Loans.

2.13. These sources are briefly discussed as below:

2.13.a). Tax-revenue:

The major proportion of income of urban governments flows from taxes. It ranges between two-fifths and three-fourths of total income. The main taxes are:

1) Octroi or terminal tax
2) House tax
3) Tax on trades, professions
4) Tax on dogs
5) Tax on advertisements other than those published in the newspaper
6) Bazaar tax
7) Tax on vehicles
8) Tax on theatres
9) Toll tax.

2.13.b). Non-tax revenue:

It includes receipts from rents of municipal property, interest on investments, profit from public utility undertakings like water supply, passenger transport, electricity supply, fee for issuing licenses or permits, fines realized for offences against municipal bye-laws, rules, regulations etc. The national average of the proceeds from this source is a little above 30 per cent.

2.13.c). Grants-in-Aid:

It is another important source of income of urban governments in India. Grants represent subsidies given by the state government in aid of certain services rendered by urban governments. Grants can broadly be divided into two categories, namely, recurring and non-recurring. The former are provided by the state government to meet the gap in their recurring expenditure. The latter are given to municipalities to meet the initial cost of some specific projects such as water supply, school buildings, health centre etc. The amount of grants is determined on the basis of the matching formula, per capita income and expenditure etc.
2.13.d). Loans:

Urban governments also meet their needs of capital expenditure such as purchase of land, heavy machinery and long-term projects by raising loans. Borrowings are regulated by the central law known as Local Authorities Loans Act, 1914. Loans are raised with prior sanction from the state government. In certain cases, the permission of the central government is also needed. The urban governments are permitted to borrow loans from banks, Life Insurance Corporation and other financial institutions. All proposals concerning loans from open market or LIC are required to be cleared by the Reserve Bank of India. For all practical purposes, urban governments except municipal corporations have to depend largely upon loans from their respective state governments. Every loan has its own rate of interest, term, mode of repayment, measures of utilization etc.


2.14.a). First State Finance Commission:

The State Finance Commissions are entrusted with the task of recommending devolution of funds from the State government to the local bodies – rural and urban. The commissions take into account the financial position of the state and also the local bodies, while recommending transfers from state to local bodies. The guiding factor to the commissions for making the transfers is the terms of reference given to them at the time of appointment of the Commission by the Governor (Art 243 (I) of the Constitution of India). So far two Commissions have submitted their reports. In Andhra Pradesh, during the post 74th Amendment Act phase three State Finance Commissions were appointed and they recommended measures to devolve funds to the Municipalities and Municipal Corporations. But the state government has not paid any attention to implement the recommendations of the commissions. The Third State Finance Commission submitted its report in 2008, but until now the State Government of Andhra Pradesh not taken any action.

All the recommendations made by the National Finance Commissions were generally accepted by the Government of India. There was also no watering down of the recommendations made by the finance commissions. When the First State Finance Commissions were constituted, it was expected that the State Governments would follow the same tradition. But it proved to be a hope unfulfilled. In the words of Sri Jag Mohan, the former Minister for Urban Development, Government of India “The recommendations Made by the State Finance Commissions have not been implemented by most of the states” (Report of the Second State Finance Commission, 2002:82).

In the case of the First State Finance Commission of Andhra Pradesh, out of 84 recommendations made, 24 recommendations were not accepted, 5 recommendations were accepted with modifications. Thus 34.5 percent of the recommendations were either not accepted or accepted partially. Even some of the recommendations not involving financial commitment to the State Government were also not accepted. In several cases, the reasons for non acceptance of the recommendations were not stated by the Government (Report of the Second State Finance Commission, 2008:82).

| Status of the Recommendations made by State Finance Commissions |
|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| I SFC            | Accepted        | Not Accepted    | Accepted with Modifications | Under Consideration | Total       |
|                 | 55              | 24              | 5                            | -                | 84            |
| II SFC           | 46              | 22              | -                            | 14               | 82            |


It is observed from the above table that not all the recommendations of the State Finance Commission were accepted by the state government unlike at the Central level where they are approved in toto. The recommendations of the first State Finance Commission were for three years from 1997-98 to 1999 to 1999-2000. After accepting the devolutions to some extent, the government made provisions in the state
budget for the year 1998-99 and 1999-2000 only. However, as against grants for three years, grants for only two years were released. The grant due for the year 1997-98 has not been budgeted for release to the local bodies.

Important accepted recommendations of First State Finance Commission were: (a) increasing per capita grants; (b) setting up grant-in-aid for the Rural Water Supply (RWS) schemes; and (c) pensionary grants to the municipalities etc. These above transfers are in addition to the teaching grants allocated to local bodies (Gopinath Reddy. M, and Sreedevi. N, 2004: 835).

The status of the ‘accepted recommendations’ of the First State Finance Commission, other than the above mentioned, is given below.

Keeping the cost of all duties and services, a total amount of Rs.979.16 crores per annum was recommended by the First State Finance Commission, as additional devolutions to the Rural and Urban Bodies. But the state government accepted the devolution to the extent of Rs.434.42 crores only. Thus, the percentage of devolution accepted worked out to 44.37 per cent only.

The State Finance Commission has taken the duties entrusted to the Local Bodies, the finances made available to them, the amount required to discharge the duties, into account to decide the quantum of devolution. It has also taken into consideration the core functions to be discharged by the Local Bodies like Drinking Water Supply, Public Health, Lighting Roads etc; and several discretionary functions entrusted to them (Report of the Second State Finance Commission,2008:83, Para, 3.2.1).

The Cabinet Sub - Committee recommended that the devolution to the Rural and Urban Bodies be in the ratio of 70:30 respectively, probably keeping in view the population of the rural areas and urban areas in the state.

The amount of devolution accepted by the Government is Rs.363.95 crores for Rural Bodies and Rs.70.47 crores per annum for Urban Bodies. This does not
conform to the Seventy - Thirty ratio which the Cabinet Sub - Committee recommended.

It is observed that while releasing the grants either for construction or for maintenance, the Seventy - Thirty sharing formula suggested by the Cabinet Sub - Committee and which was accepted by the Government has not been followed. This is pointed out to indicate that due consideration has not been given by the Government, even in implementing their own formula while allocating the funds (Report of the Second State Finance Commission, 2002:83, Para, 3.2.3).

The First State Finance Commission made certain recommendations relating to financial devolutions to the Rural and Urban Bodies. Government has not accepted some of the recommendations that are given below.

The State Finance Commission recommended a grant of Rs.54 crores to the Municipal Corporations as Block Grant to be used for their felt needs with a stipulation that it should not be used for salaries and maintenance. Government has not accepted the recommendation. Similarly, Government has not accepted the recommendations to allocate 95 percent of Profession Tax to Local Bodies and agreed to release only 90 percent. But subsequently, in G.O.Ms No.544 Rev. (CT- III) Department, dt: 12-7-1999, orders were issued to release 95 percent, on the representation made by the Panchayats Sarpanches Association. Grants for civic amenities etc., were sanctioned / announced by the Government in several cases subsequently, though the Government did not accept the recommendations of the Finance Commission.

The recommendations of the First State Finance Commission were for three years from 1997-1998 to 1999-2000. After accepting the devolutions as against grants for three years, grants for two years only were released. The grants due to for the year 1997-98 have not been budgeted for release to the local bodies (Report of the Second State Finance Commission, Government of Andhra Pradesh, 2002:83-85).
2.15. **Recommendations Relating to Urban Bodies- Not Accepted:**

The following recommendations made by the First State Finance Commission were not accepted.

1. Adhoc Block Grant of Rs.44.00 Crores to Municipal Corporations
   (Para 9.8.1 of SFC Report) – Rejected as per capita grant is being provided for taking up basic necessities.

   It may be stated that the total increase in per capita Grant for Municipal Corporations including those of Municipalities is only Rs. 5.89 crores per annum.

2. 10 per cent of betting Tax to be given to the Hyderabad Municipal Corporation (vide para 10.10.2 of SFC Report)
   It is stated that it may be counter – productive and result in Tax evasion

3. Enhancement of Octroi Compensation by 10 per cent annually- (Para 10.13.0. of SFC Report )
   Grant for Octroi abolition may be provided for under the grant-in –aid on the analogy of Property of Tax Compensation.

4. Increase of Motor Vehicle Tax Compensation to Municipal Bodies was accepted with medication (Para No. 10.14.4 of SFC Report). Only half per cent of the tax collected was accepted as devolution. Reasons were not given.

5. One time grant of Rs. 25.00 lakhs to Municipalities converted into Municipal Corporations (para 11.9.5 of SFC Report) –Rejected as not considered to be of priority concern.

6. Though it is not mandatory that all the recommendations made should be accepted by the Government, it may be considered to give reasons for non-acceptance. (Report of the Second State Finance Commission, 2002: 88-89).

2.16. **Pension Grant to Non-Teaching Municipal Pensioners:**

   In Paras 11.13.7 and 11.13.8 in its Report, the First State Finance Commission recommended a grant of Rs. 10 crores towards pension grant to the non-teaching municipal pensioners. The Government accepted this recommendation in principle,
but made a budget provision of Rs. 7.25 crores in the budget for 1998-99 as per the recommendations on the Cabinet- Sub-committee.

But in the subsequent year 1999-2000 budget provision was not made. It is understood that the Department took it as one-time grant and therefore, did not include the amount in the departmental budget for 1999-2000. The Finance Commission did not recommend it as one time grant but recommended it as annual grant on the lines of the grant for non-teaching pensioners of the Panchayati Raj Bodies. However, a provision of Rs.6 crores is made in the budget for 2001-02. An extent of the recommendations of 1st State Finance Commission is given below:

“Though the services of municipal employees are not provincialised, the scales of pay applicable to State Government employees are made applicable to them and the other benefits are also applicable to them. Viewed from this angle and also to avoid discrimination between the two sets of local body employees, the Commission considers from the point of view of equity and recommends that Government may release grants-in-aid to the municipalities towards payment of pension to the non-teaching municipal employees” (Report of the Second State Finance Commission, 2002:94-95).

The commission recommends that the procedure suggested above in respect of Panchayati Raj Pensioners be followed for Municipal Bodies also. According to the data available, annual commitment towards the pensionary benefits the non-teaching municipal employees works out to about Rs. 10 crores (para 11.13.7 of 1st State Finance Commission Report).

Grants for the years 1999-2000 and 2000-2001 were not released. As the First State Finance Commission recommended release of Grant-in-Aid in the case of Panchayat Raj Pensioners, the pension grant should be budgeted for every year and released to municipalities. The amounts not released for pension should be released coming years (Report of the Second State Finance Commission, 2002:95).

2.17. Percentage of Devolution to Local Bodies from State Revenues:

A total amount of devolution recommended by the 1st State Finance Commission was 979.16 crores (i.e., 814.84 crores for panchayati raj and Rs.160.32 crores for urban bodies) per annum was recommended by First State Finance Commission. It works out to 10.93 per cent of the tax and non-tax revenue of the State. The First State Finance Commission recommended that 39.24 percentage of state’s revenues both tax
and non-tax be the entitlement to the local bodies and it may be given statutory effect by suitable enactment (Report of the First State Finance Commission, 1997–2000: 79 -80).

The above recommended total (39.24 per cent of the state revenue) includes both central and state grants. According to the action taken report of the State Finance Commission, the grant exclusively given by the state government to the local bodies is 11.09 per cent of the state revenue (Rs 1,087. 74 crore) in the year 1998-99. This amount is exclusive of salaries, pensions, establishment cost, allocations made as matching contribution to centrally sponsored schemes and central grants (Gopinath Reddy. M 2003: 1287).

2.18. **Second State Finance Commission:**


The Second State Finance Commission made 82 recommendations which included both financial and non-financial aspects. Out of which the Government accepted 46 recommendations and 14 were stated to be under consideration (Report of the Third State Finance Commission, 2008:25). The status of ‘accepted recommendations’ of the Second State Finance Commission is discussed below.

**Table: II.II  
Recommendations Accepted – Not Implemented**

<table>
<thead>
<tr>
<th>S.No</th>
<th>Para Nos.</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Para Nos. 4.4.8 to 4.4.11</td>
<td>State Finance Commission Cell may be created immediately to maintain continuity in correspondence.</td>
</tr>
<tr>
<td>2</td>
<td>Para No.5.9.1</td>
<td>It is recommended to include the following items in the list of items of the village produce that are proposed to be taxed: 1. Sugarcane, 2. Coffee, 3. Black Pepper.</td>
</tr>
<tr>
<td></td>
<td>Paragraph</td>
<td>Recommendation</td>
</tr>
<tr>
<td>---</td>
<td>-----------</td>
<td>----------------</td>
</tr>
<tr>
<td>3</td>
<td>Para No.6.4.7 - iv</td>
<td>Small scale industries including Food Processing Slate manufacturing, Basket manufacturing etc, be transferred to Local Bodies.</td>
</tr>
<tr>
<td>5</td>
<td>Para No.7.4.1</td>
<td>In 81 Municipalities in the State, the total tax demand is not sufficient to meet the salary bill of non-teaching employees. The total deficit works out to Rs.39.22 crores per annum. A special grant of Rs. 39.22 crores may be provided to the said 81 municipalities from the year 2002-03.</td>
</tr>
<tr>
<td>4</td>
<td>Para No. 10.21.4</td>
<td>The requirements of Science equipment in the schools be assessed and sufficient grants provided to Local Bodies.</td>
</tr>
<tr>
<td>5</td>
<td>Para No. 10.4.1</td>
<td>Release of grant may be linked to the performance of the Local bodies in the matter of collection of Taxes and Non – Taxes.</td>
</tr>
<tr>
<td>6</td>
<td>Para No. 11.4.3</td>
<td>Government may consider to revert back to the procedure of adjustment of Profession Tax to the Local Bodies, existing before the issue of revised orders in G.O.Ms.No.317 Finance (Exp. PR and RD) Department dated 29-6-2001.</td>
</tr>
<tr>
<td>7</td>
<td>Para No. No.15.4.1</td>
<td>Government may take action immediately to constitute a Committee to study the problems on all aspects of Municipal Administration in detail and prepare a draft bill for enacting a single comprehensive Andhra Pradesh Municipal Corporations Act.</td>
</tr>
<tr>
<td>8</td>
<td>Para 13.26 &amp; 13.2.7</td>
<td>Rs. 19.70 crores per annum may be released towards 5 per cent increase on half yearly D.A. and Revision of Scales of Pay of Municipal staff.</td>
</tr>
</tbody>
</table>


Though the Constitution does not provide that all recommendations of the Finance Commission should be accepted by government, the Government of India has established a tradition of accepting all the recommendations of its Finance Commissions. The state government should have adopted the same practice or it would have given appropriate reasons for not accepting the recommendations. But, for the reasons not known, the state government neither accepted all recommendations nor gave the reasons for not accepting some recommendations (Sreedevi. N and Gopinath Reddy. M , 2004:12).

The distribution of the amount of Rs. 100 crores per annum accepted for Municipalities and Municipal Corporations towards the Second State Finance Commission grants was indicated in the Action Taken Report as follows:
Table: II.III

Municipal Bodies in Andhra Pradesh

<table>
<thead>
<tr>
<th>S.No</th>
<th>Name of the Local Body</th>
<th>Rs.in crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Municipalities</td>
<td>80.00</td>
</tr>
<tr>
<td>2</td>
<td>Municipal Corporations</td>
<td>20.00</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>100.00</td>
</tr>
</tbody>
</table>


Regarding utilization of the above amounts the following guidelines have been laid down in the Action Taken Report.

“Government considered that instead of allocating amount for individual schemes / items the total amounts may be placed at the disposal of the Local Bodies. They may utilize the amounts for their felt needs prioritizing the schemes / items. Broadly, the items may be divided as Capital, maintenance and civic amenities. Out of the amounts released of them, they may spend an amount not less than 25 percent and not exceeding 50 per cent of the grant for maintenance. The remaining amount may be utilized for capital works and civic amenities depending upon the necessity.” (Report of the Third State Finance Commission, 2008:26).

This Commission, therefore, recommends that while accepting the recommendations relating to devolution of finances to Rural and Urban Local Bodies the Government may consider making budget provision covering all such recommendations” (Report of the Third State Finance Commission, 2008 : 29).

In the Action Taken Report on the recommendations of the Second State Finance Commission, the Government has stated that, based on the review of the cabinet sub-committee the Government agreed for devolutions to the extent of Rs.200 Crores to Panchayati Raj Institutions and Rs.100 Crores for Municipalities and Municipal Corporations towards Second State Finance Commission grants and that there was provision in the budget for 2003-2004 for the above purpose.

Having accepted the devolution, it does not appear proper to short release and divert the funds for other purposes. So, the Third State Finance Commission felt that “the grants to the extent of short release may be released to the Panchayati Raj

The Second State Finance Commission recommended that 40.92 percent of the tax and non-tax revenues of government including the share of Central taxes (Report of the Second State Finance Commission, 2002:198). The total amount recommended for devolution was 1793.94 Crores (Rs.1167.73 Crores for Panchayati Raj Institutions and Rs.621.61 Crores for Municipalities) and the amount accepted for devolution was Rs.300 Crores, (Rs.200 Crores for PRIs and Rs.100 Crores) to Municipalities and corporations accounting to an ignorable 17 per cent (Report of the Third State Finance Commission, 2008:25).

2.19. Third State Finance Commission:

The Third State Finance Commission was originally constituted in January 2003. The commission was reconstituted in December, 2004 with the new members and chairman. The reconstituted commission started functioning from 29-12-2004 and its term was up to 28-12-2007. However, its term was extended up to 31-01-2008 (Report of the Third State Finance Commission, 2008: 2).

The total devolution of funds recommended by the commission by way of grants and assignments to the Rural and Urban Bodies is Rs.1763.72 crores per annum. It works out to 6.77 percent of the total tax and non-tax revenues of the State Government including the share of central taxes for the year 2004-05.

2.20. Recommendations:

1. An officer is appointed three months before the constitution of the Fourth Finance Commission to make all administrative arrangements for the functioning of the Commission from the date of its constitution (para2.10).
2. The Per Capita grant of the Municipalities and Municipal Corporations may be enhanced from Rs.8/- to Rs. 12/- from the year 2005-06. The additional
commitment of Rs. 8.32 crores as per annum in this regard may be released to urban bodies (para 5.52).

3. An amount of Rs. 11.92 crores per annum may be released from excise income to urban bodies (para 6.26).

4. Orders may be issued to the Regional Transport Authorities to adjust Motor Vehicle Tax Compensation direct to the Municipal Bodies (para 6.32).

5. The Third State Finance Commission recommends to pay 5 per cent of income of the Market Committees to the local bodies instead of levying 5 per cent extra surcharge (para 7.4).

6. The Government may permit the Municipal Bodies to advertise the construction of commercial complexes and construct them by taking advance money from the lessee (para 7.19).

7. A separate Budget Head may be opened for the 13 Municipal Corporations to provide amounts towards payment to the Property Tax and Water Charges annually on Government Buildings (para 8.13).

8. Government may consider the acceptance of the proposal for the release of Rs. 17.50 crores towards increase on half yearly D.A. and revision of scales of pay to Municipal Staff (para 9.3).

9. Rs. 20 crores per annum may be released to the Municipalities towards Pension grants (para 9.8).

10. A Comprehensive drainage network may be taken up in 20 or 25 select Municipalities by entrusting the work to an expert committee (para 9.22).

11. An amount of Rs. 6.08 crores per annum may be released to the Municipalities for the maintenance of Municipal Buildings (para 10.37).

12. An amount of Rs. 200 crores per annum may be provided and released to the Municipalities for civic amenities (para 10.40).

13. The Third State Finance Commission generally recommends to implement all the recommendations of the First and Second State Finance Commissions which are not fully implemented or partially implemented (Report of the Third State Finance Commission, 2008:139-148).

However, the report made it clear that “there is no provision that all the recommendations of the Finance Commission should be accepted by government. Therefore, the State Government may accept all or some of the recommendations
made by the State Finance Commission and in some cases; they may partly accepted or accepted in a modified form.

Even after accepting the recommendations relating to devolutions, it is possible that actual transfers by way of sanctioning grants in aid etc; may not take place for some for some reason or the other. Even in respect of non - financial recommendations of First Finance Commission, action is not taken after accepting the same” (Report of the Second State Finance Commission, 2002:97).

The object of amending the constitution and making provision for constitution of State Finance Commissions is to regularize devolution of funds from the State Government to local bodies in a systematic manner. Unless the funds are transferred regularly in a systematic manner and action is taken on other recommendations, the purpose of amending constitution and constituting State Finance Commission will not be fulfilled. It is necessary that some authority watches whether the devolutions are really made every year by the State Government and whether action is taken on the recommendations and reports to the governor and the legislature on their status (Report of the Second SFC, 2002: 97).

All along the history of local self-government, the inadequate and unsound financial base has impaired the working of the local bodies. It is realised that any talk of the effectiveness of the local bodies, in the absence of a strong financial base, is of no use. Accordingly, 74th Amendment Act has made it mandatory for all state governments to constitute state finance commissions to work out the proper allocation of devolution of state funds to the local bodies.

There are non-tax sources of revenue also to the Corporations such as “Charges, Fees, Rents and other Contributions”. Excess water charges and Tap rate charges collected by the Corporation come under “Charges”. The fees collected on Markets, Slaughter Houses, Encroachments, Building licences, Lay-outs

Since urban finances are popular and problematic areas, extensive work has been done by a number of scholars on urban finances. Some important works were selected for review and the major findings will be discussed in the next chapter.
References:


