CHAPTER III

THE KERALA STATE FINANCE COMMISSION AND ITS REPORT: A CRITIQUE

3.1 Introduction

The Government of Kerala constituted the State Finance Commission (hereafter referred as SFC), under Article 243(I) of the constitution of India and Section 186 of the Kerala Panchayat Raj Act 1994, through a notification dated 23-4-94. Shri. P.M. Abraham was appointed as the Chairman and Shri. K. Mohandas and Shri. K.A. Ommer as members. The commission's term of office was one year. But the Government subsequently extended the term. An interim report was submitted to the Governor on 30-09-1995, and the final report was submitted on 29-02-1996. In this chapter, an attempt is made to critically evaluate the report of the SFC.

3.2 Terms of Reference

The terms of reference of the commission are given in the Government notification which are as follows. "The Finance Commission shall review the financial position of the Panchayats and make recommendations as to:

a) the principles which 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 which may be divided between them under part IX of the constitution and the allocation between
the Panchayats at all levels of their respective shares of such proceeds;

ii) the determination of the taxes, duties, tolls and fees which may be assigned to or appropriated by the Panchayats

iii) the grant-in-aid to the Panchayats from the consolidated fund of the state;

b) the measures needed to improve the financial position of the Panchayats''

In addition to the above the SFC has the responsibility to study the finances of municipal bodies also. There is also a provision in the Kerala Panchayat Raj Act 1994 for the Governor to refer to the SFC any other matter in the interest of the financial security of Panchayats.

3.3 Methodology and Approach

The terms of reference of the SFC has been in accordance with the constitutional provisions. The SFC has to make recommendations as to the principles for the distribution of net proceeds of the state between the state and local bodies and the grant-in-aid to the Panchayats. It is also required to suggest measures for improving the financial position of the Panchayats.

The SFC visited 13 centres in the state to give an opportunity to the elected members of local bodies and other interested persons to meet the commission and to give their suggestions and opinions on various matters in its Term Of Reference. At these sittings 181 written memoranda were received by the commission besides oral presentations. The commission met in all 13 times.
The overall financial position of the state was also studied by the SFC even though the Terms of Reference do not require it to do it. This is because the commission felt that its tasks could not be performed in a vacuum and should be performed with adequate awareness of the financial position of the state. The commission obtained information from the State Government about their current financial position as well as their projection of revenue and expenditure for 5 years.

3.4 General Observations

The commission at the outset made a remarkable observation. "The constitutional Amendments of 1992 envisage vastly enhanced expenditure responsibilities for local bodies without making any specific assignment of taxes to match the expenditure responsibilities".²

According to Article 243 H and 243 X the state legislature can authorise local bodies to collect taxes, duties, tolls and fees or to assign such taxes to them and to provide grants-in-aid to them. On this, the commission observes that the state legislatures were competent to do so even before the constitutional amendment. "The Kerala Panchayat Raj Act 1994 and the Kerala Municipalities Act 1994, while entrusting vastly enhanced functional and expenditure responsibility to the local bodies, have retained virtually the same arrangements for tax assignment and sharing as existed before the constitutional amendments. This has led to the already existing mismatch between resources and
As has been pointed out by the commission, the Kerala Panchayat Raj Act 1994 while conferring substantial additional responsibility on local bodies, has not added to the already available tax domain of local bodies. The tax domain remains almost exactly the same as were available in the pre 1994 period and those resources were insufficient even for meeting their pre 1994 responsibilities.

The responsibility of local bodies now fall into two broad categories.

1) The traditional responsibility which they have been performing even before the 73rd Constitutional Amendment.

2) The additional responsibilities conferred to them by the 73rd Constitutional Amendment and the consequent state legislation.

The funding of these responsibilities has to be made as follows.

a) The traditional activities of civic services are funded by revenues raised by local bodies supplemented by grants from state government.

b) The additional responsibilities which have now been transformed to local bodies are entirely financed from out of resources available to the state government.

The income of local bodies was being supplemented by grants from government even for the discharge of traditional functions as they existed prior to 1994 legislation. As observed by the SFC the possibility of the existing source
of revenue yielding additional income does exist, but they would not match the additional expenditure responsibility. Additional funds can accrue to a local body in a number of ways such as assignment of specific existing state taxes to local bodies, sharing the existing taxes, levy of new taxes by local bodies or even by government with a provision for tax sharing and grants or a combination of all these. In addition, funds would flow from the central government on the basis of the recommendations of the central finance commission. The SFC opines that the local bodies should continue to play an active role in raising revenue both by improving collection from existing sources as well as from new sources as may be identified.

The Kerala Panchayat Raj Act 1994 provides for the transfer of specific responsibilities so far handled by the state government to local bodies along with the connected plan and budget provisions. The view of the commission regarding this is seen in the following words "Local bodies are of course free to spend more than what is required of them by virtue of transfer of functions accompanied by transfer of budget provision. They will however come under increasing pressure from the public to provide expanded and better facilities and services than are possible by the transferred funds".4

The commission is of the opinion that there exists the possibility of better exploitation of resources even within the framework of existing access to sources of income. The commission suggests that demand for additional funds can be
met from a combination of the following steps.

a) "better utilisation of existing sources of revenue

b) additional resource mobilisation by local bodies by giving them access to new sources of revenue which satisfy the criteria that the tax base is local in nature and is not extensively used already as a base for taxation by government.

c) additional resources from the state government out of their revenue.

d) additional resources from the central government

e) loans from financial institutions for capital expenditure

f) economy in expenditure on the part of civic bodies including recourse to privatisation of selected services which can be justified on the basis of cost-benefit analysis".5

The Commission puts forward the concept of presumptive income of a local body which would be useful to encourage them to set up their resource mobilisation efforts. A related concept which helps to regulate Government grants is an index of tax effort by local bodies. But more work needs to be done to develop and refine these concepts, the Commission opines.

3.5 Revenues of Panchayats

An analysis of four year data (1990-91 to 1993-94) on revenue composition of Panchayats in Kerala has been made and presented in the SFC report. It gives an overall picture of the composition of various items of revenues of Panchayats.
<table>
<thead>
<tr>
<th></th>
<th>1990-’91</th>
<th>1991-’92</th>
<th>% of increase</th>
<th>1992-’93</th>
<th>% of increase</th>
<th>1993-’94</th>
<th>% of increase</th>
<th>Average % of increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Revenue Receipts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Own Tax Revenue</td>
<td>3035</td>
<td>3618</td>
<td>19.8</td>
<td>3589</td>
<td>-0.8</td>
<td>4386</td>
<td>22.2</td>
<td>13.7</td>
</tr>
<tr>
<td></td>
<td>(33.2)</td>
<td>(38.2)</td>
<td></td>
<td>(33.1)</td>
<td></td>
<td>(33.4)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Assigned Taxes</td>
<td>1997</td>
<td>1861</td>
<td>-5.9</td>
<td>2339</td>
<td>25.7</td>
<td>3133</td>
<td>33.9</td>
<td>17.9</td>
</tr>
<tr>
<td></td>
<td>(21.7)</td>
<td>(19.7)</td>
<td></td>
<td>(21.5)</td>
<td></td>
<td>(23.8)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Shared Taxes</td>
<td>282</td>
<td>188</td>
<td>-33.3</td>
<td>434</td>
<td>130</td>
<td>757</td>
<td>74.4</td>
<td>57.0</td>
</tr>
<tr>
<td></td>
<td>(3.1)</td>
<td>(2.0)</td>
<td></td>
<td>(4)</td>
<td></td>
<td>(5.8)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Non Tax Revenue</td>
<td>1014</td>
<td>1119</td>
<td>10.4</td>
<td>1236</td>
<td>10.4</td>
<td>1571</td>
<td>27.1</td>
<td>16.0</td>
</tr>
<tr>
<td></td>
<td>(11.1)</td>
<td>(11.8)</td>
<td></td>
<td>(11.4)</td>
<td></td>
<td>(12)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Grants</td>
<td>2823</td>
<td>2681</td>
<td>-5.0</td>
<td>3662</td>
<td>21.7</td>
<td>3298</td>
<td>1.1</td>
<td>5.9</td>
</tr>
<tr>
<td></td>
<td>(30.9)</td>
<td>(28.3)</td>
<td></td>
<td>(30)</td>
<td></td>
<td>(25)</td>
<td></td>
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</tr>
<tr>
<td>Sub total</td>
<td>9131</td>
<td>9467</td>
<td>3.7</td>
<td>10860</td>
<td>14.7</td>
<td>13145</td>
<td>21.0</td>
<td>13.1</td>
</tr>
<tr>
<td></td>
<td>(100)</td>
<td>(100)</td>
<td></td>
<td>(100)</td>
<td></td>
<td>(100)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B. Capital Receipts</td>
<td>9888</td>
<td>10001</td>
<td>1.1</td>
<td>11414</td>
<td>14.1</td>
<td>13618</td>
<td>19.3</td>
<td>11.5</td>
</tr>
</tbody>
</table>

Source: SFC report 1996 (Figure in brackets indicate percentage)
Own tax Revenue constitutes the major item of revenue to village Panchayats during the four year period from 1990-91 to 1993-94. There is not much variation in the percentage of this item to the total revenue. Only in the year 1991-92 its percentage to the total was 38.2 while in all other years it remains approximately at 33%. Own tax revenue also showed increase except in 1992-93 when it declined slightly by 0.8%. The average annual increase of this item is 13.7%.

The Assigned taxes rank third in terms of the percentage to the total revenue. It ranges from 19.7% to 23.8% of the total revenue during the four year period. In 1991-'92 it declined by 5.9% compared to its previous year figure while in other years it showed a substantial increase, the average being 17.9%.

Shared taxes constitute the smallest item in terms of its share to the total revenue. It ranges from 2% to 5.8% of the total revenue. It shows a decline of 33.3% in 1991-'92. It increases by 130% in 1992-'93 and 74.4% in 1993-'94 recording an average 5.7% increase.

Non-tax revenue constitutes 11% to 12% of the total revenue in the four year period. It shows an increase in every year, the average annual increase being 16%.
Grant-in-aid is an important source of revenue next to own tax revenue during the period from 1990-'91 to 1993-'94. It was 30.9% of the total revenue in 1990-'91 while it was only 25% in 1993-'94. In 1991-'92 it declined by 5%. It however showed an increase of 21.7% in 1992-'93 followed by 1.1% increase in 1993-'94. The annual average increase is 5.9%.

The capital receipts show a decline in 1991-'92 by 29.6% compared to the corresponding figure of 1990-'91. In 1992-'93 it records an increase of 3.9%. But it declines by 14.6% in 1993-'94, the annual average decline being 13.4%.

The total revenue of Panchayats increases from year to year. The rates of increase are 1.1%, 14.1% and 19.3% in 1991-'92, 1992-'93, and 1993-'94 respectively.

3.6 Tax Revenue

The tax revenue is a major source of income to the Panchayats before the Kerala Panchayat Raj Act 1994. A study has been made by the SFC and data relating to it has been presented in its report which throws light on the composition of tax revenue.
Table - 3.2
Composition of Own-tax Revenue of Panchayats

(Rs. in lakhs)

<table>
<thead>
<tr>
<th></th>
<th>1990-91</th>
<th>1991-92</th>
<th>% of increase</th>
<th>1992-93</th>
<th>% of increase</th>
<th>1993-94</th>
<th>% of increase</th>
<th>Average % of increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Building Tax</td>
<td>1511 (50)</td>
<td>1788 (50)</td>
<td>18.3</td>
<td>1762 (49)</td>
<td>-1.45</td>
<td>2249 (51)</td>
<td>27.6</td>
<td>14.8</td>
</tr>
<tr>
<td>2. Profession Tax</td>
<td>831 (27)</td>
<td>1093 (30)</td>
<td>31.5</td>
<td>1091 (30)</td>
<td>-0.18</td>
<td>1255 (29)</td>
<td>15.0</td>
<td>15.4</td>
</tr>
<tr>
<td>3. Entertainment Tax</td>
<td>480 (16)</td>
<td>514 (14)</td>
<td>7.0</td>
<td>564 (16)</td>
<td>9.73</td>
<td>653 (15)</td>
<td>15.78</td>
<td>10.8</td>
</tr>
<tr>
<td>4. Other items</td>
<td>213 (7)</td>
<td>223 (6)</td>
<td>4.7</td>
<td>172 (5)</td>
<td>-22.87</td>
<td>229 (5)</td>
<td>33.14</td>
<td>4.9</td>
</tr>
<tr>
<td>Total</td>
<td>3035 (100)</td>
<td>3618 (100)</td>
<td>19.8</td>
<td>3589 (100)</td>
<td>-0.8</td>
<td>4386 (100)</td>
<td>22.2</td>
<td>17.4</td>
</tr>
</tbody>
</table>

Note: Figures in brackets indicate percentage
Source: SFC report 1996
Building Tax is the major source of tax revenue to the Panchayats. It is around 50% of the total own-tax revenue of the Panchayats in all the four years. Profession tax ranks second in terms of the share to the total own tax revenue which ranges from 27% to 30%. Entertainment tax ranges between 14% and 16% of the total during the four year period. Other items of tax revenue ranges from 5% to 7%.

The percentage of increase of the actual amount of receipts is also given in the table. There has been a substantial increase in Building tax in all years except in 1992-'93 where it declines by 1.45%. On an average, the percentage of increase in Building tax is 14.8. Profession tax also shows a similar trend, i.e., it shows a steady increase every year except in 1992-'93 where there is a slight decline of 0.18%. However, there is an increase of 15.4% of profession tax on an average. The entertainment tax shows a steady increase from 7% to 15.78% recording an average 10.8% increase. Other items of tax shows a mixed trend. In 1991-'92, an increase of 4.7% is noted; but it declines by 22.87% in 1992-93. It again increases by 33.4% in 1993-'94 and shows an annual average of 4.9%.

3.7 Assigned Taxes

The Surcharge on Duty on Transfer of property collected by Government after deduction of collection charges is passed on to local bodies. Basic Tax collected by Government after deducting collection charges is assigned to village Panchayats in the state. The details of assigned tax is given in table 3.3.
Table - 3.3
Receipts of Assigned Tax

(Rs. in lakhs)

<table>
<thead>
<tr>
<th></th>
<th>1990-'91</th>
<th>1991-'92</th>
<th>% of increase</th>
<th>1992-'93</th>
<th>% of increase</th>
<th>1993-'94</th>
<th>% of increase</th>
<th>Average % of increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Surcharge on stamp duty</td>
<td>1526 (77.2)</td>
<td>1397 (75.1)</td>
<td>-8.5</td>
<td>1846 (78.9)</td>
<td>32.1</td>
<td>2560 (81.7)</td>
<td>38.7</td>
<td>20.8</td>
</tr>
<tr>
<td>1. Basic Tax</td>
<td>451 (22.8)</td>
<td>464 (24.9)</td>
<td>2.9</td>
<td>493 (21.1)</td>
<td>6.3</td>
<td>573 (18.3)</td>
<td>16.2</td>
<td>8.5</td>
</tr>
<tr>
<td>Total</td>
<td>1977 (100)</td>
<td>1861 (100)</td>
<td>-5.9</td>
<td>2339 (100)</td>
<td>25.7</td>
<td>3133 (100)</td>
<td>33.9</td>
<td>17.9</td>
</tr>
</tbody>
</table>

Note: Figures in brackets indicate percentage

Source: SFC report 1996
The Surcharge on Stamp Duty is the main item of Assigned Tax. It ranges from 75.1% to 81.7% of the total assigned taxes. Basic tax ranges from 18.3% to 24.9% of the total Assigned taxes. Surcharge on Stamp Duty shows an annual average increase of 20.8% while that of the Basic Tax is 8.5%.

3.8 Shared Taxes

Only Motor Vehicle Tax collected by the Government is shared with local bodies.

Table -3.4
Receipts from Motor Vehicle Tax (Rs. in lakhs)

<table>
<thead>
<tr>
<th></th>
<th>1990-'91</th>
<th>1991-'92</th>
<th>% of increase</th>
<th>1992-'93</th>
<th>% of increase</th>
<th>1993-'94</th>
<th>% of increase</th>
<th>Average % of increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vehicle Tax compensation (VTC)</td>
<td>282</td>
<td>188</td>
<td>-33.3</td>
<td>434</td>
<td>130</td>
<td>757</td>
<td>74.4</td>
<td>57</td>
</tr>
</tbody>
</table>

Source: SFC report 1996

The annual average increase of shared taxes is 57% during the four year period. Only in 91-'92 there is a decline of shared taxes to the extent of 33.3%; the highest rate of increase is 130% which occurred in the year 1992-'93.

3.9 Non-Tax Revenue

Income from properties and licence fees are the main source of non-tax revenue. Miscellaneous receipts include registration fees, fine etc. The following table shows the composition of non-tax revenues of Panchayats...
Non-tax Revenue
(Rs. in lakhs)

<table>
<thead>
<tr>
<th></th>
<th>1990-'91</th>
<th>1991-'92</th>
<th>% of increase</th>
<th>1992-'93</th>
<th>% of increase</th>
<th>1993-'94</th>
<th>% of increase</th>
<th>Average % of increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from properties</td>
<td>631 (62.2)</td>
<td>670 (59.9)</td>
<td>6.2</td>
<td>761 (61.6)</td>
<td>13.6</td>
<td>856 (54.5)</td>
<td>12.5</td>
<td>10.8</td>
</tr>
<tr>
<td>Licence fee</td>
<td>125 (12.3)</td>
<td>155 (13.9)</td>
<td>24</td>
<td>145 (11.7)</td>
<td>-6.0</td>
<td>165 (10.5)</td>
<td>13.8</td>
<td>10.6</td>
</tr>
<tr>
<td>Miscellaneous receipts</td>
<td>258 (25.5)</td>
<td>294 (26.2)</td>
<td>13.9</td>
<td>330 (26.7)</td>
<td>12.2</td>
<td>550 (35)</td>
<td>66.6</td>
<td>30.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1014 (100)</strong></td>
<td><strong>1119 (100)</strong></td>
<td><strong>10.4</strong></td>
<td><strong>1236 (100)</strong></td>
<td><strong>10.4</strong></td>
<td><strong>1571 (100)</strong></td>
<td><strong>27.1</strong></td>
<td><strong>16</strong></td>
</tr>
</tbody>
</table>

Note: The figures in brackets indicate percentage
Source: SFC report 1996

Income from properties ranges from 54.5 to 62.2% of total non-tax revenue. It shows an increase every year, the annual average increase being 10.8%. The licence fee shows a percentage between 10.5 in 1993-'94 and 13.9 in 1991-'92, of the total non-tax revenue. The annual average increase is 10.6%. Miscellaneous receipts account for 25.5% to 35% of non-tax revenue and an annual average increase of 30.9%

3.10 Grant-in-aid

Table 7 indicates the tied and untied grants received by the Panchayats during the period from 1990-'91 to 1993-'94.
Table - 3.6
Tied and Untied Grants

(Rs. in lakhs)

<table>
<thead>
<tr>
<th></th>
<th>1990-'91</th>
<th>1991-'92</th>
<th>% of increase</th>
<th>1992-'93</th>
<th>% of increase</th>
<th>1993-'94</th>
<th>% of increase</th>
<th>Average % of increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Tied Grants</td>
<td>1065</td>
<td>903</td>
<td>-15.2</td>
<td>1339</td>
<td>48.3</td>
<td>1228</td>
<td>-8.3</td>
<td>8.3</td>
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<tr>
<td></td>
<td>(37.7)</td>
<td>(33.7)</td>
<td>(41)</td>
<td>(59)</td>
<td></td>
<td>(37.2)</td>
<td></td>
<td></td>
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<tr>
<td>2. Untied Grants</td>
<td>1758</td>
<td>1778</td>
<td>1.1</td>
<td>1923</td>
<td>8.2</td>
<td>2070</td>
<td>7.6</td>
<td>5.6</td>
</tr>
<tr>
<td></td>
<td>(62.3)</td>
<td>(66.3)</td>
<td>(59)</td>
<td>(62.8)</td>
<td></td>
<td>(62.8)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>2823</td>
<td>2681</td>
<td>-5.0</td>
<td>3262</td>
<td>21.7</td>
<td>3298</td>
<td>1.1</td>
<td>5.9</td>
</tr>
<tr>
<td></td>
<td>(100)</td>
<td>(100)</td>
<td>(100)</td>
<td>(100)</td>
<td></td>
<td>(100)</td>
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</tr>
</tbody>
</table>

Note: The figure in brackets indicate percentage

Source: SFC report 1996

The Tied Grants range from 33.7% to 41% of the total grants-in-aid. In 1991-'92 there is a decline in tied grants by 15.2%. However in other years they show increase, the average increase being 8.3%. The Untied grants range from 59% to 66.3% of the total grants. They show a steady increase every year and the annual average increase is 5.6%.

3.11 Expenditure

A review of four year data (1990-91 to 1993-94) on the expenditure composition gives an overall picture of the spendings made by Panchayats
### Table - 3.7
Total Expenditure of Panchayats

(Rs. in lakhs)

<table>
<thead>
<tr>
<th>Item</th>
<th>1990-'91</th>
<th>1991-'92</th>
<th>% of increase</th>
<th>1992-'93</th>
<th>% of increase</th>
<th>1993-'94</th>
<th>% of increase</th>
<th>Average % of increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Management &amp; collection</td>
<td>3489 (37.1)</td>
<td>3723 (40.4)</td>
<td>6.7</td>
<td>3792 (36.9)</td>
<td>1.9</td>
<td>4524 (36.7)</td>
<td>19.3</td>
<td>9.3</td>
</tr>
<tr>
<td>2. Public works</td>
<td>3575 (38)</td>
<td>3269 (35.5)</td>
<td>-8.6</td>
<td>4017 (39)</td>
<td>22.9</td>
<td>5236 (42.4)</td>
<td>30.3</td>
<td>14.9</td>
</tr>
<tr>
<td>3. Education</td>
<td>367 (3.9)</td>
<td>284 (3.1)</td>
<td>-22.6</td>
<td>290 (2.8)</td>
<td>2.1</td>
<td>322 (2.6)</td>
<td>11.0</td>
<td>-3.2</td>
</tr>
<tr>
<td>4. Water supply &amp; drainage</td>
<td>238 (2.5)</td>
<td>225 (2.4)</td>
<td>-5.5</td>
<td>318 (3.1)</td>
<td>41.3</td>
<td>212 (1.7)</td>
<td>-33.3</td>
<td>0.8</td>
</tr>
<tr>
<td>5. Street lighting</td>
<td>589 (6.2)</td>
<td>623 (6.8)</td>
<td>5.8</td>
<td>762 (7.4)</td>
<td>22.3</td>
<td>792 (6.4)</td>
<td>3.9</td>
<td>10.6</td>
</tr>
<tr>
<td>6. Public health</td>
<td>308 (3.3)</td>
<td>224 (2.4)</td>
<td>-27.3</td>
<td>249 (2.4)</td>
<td>11.1</td>
<td>256 (2.1)</td>
<td>2.8</td>
<td>-4.4</td>
</tr>
<tr>
<td>7. Others</td>
<td>637 (6.8)</td>
<td>618 (6.7)</td>
<td>-2.9</td>
<td>642 (6.2)</td>
<td>3.8</td>
<td>698 (5.7)</td>
<td>8.7</td>
<td>3.2</td>
</tr>
<tr>
<td>8. Debt servicing</td>
<td>208 (2.2)</td>
<td>251 (2.7)</td>
<td>20.6</td>
<td>227 (2.2)</td>
<td>-9.5</td>
<td>297 (2.4)</td>
<td>30.8</td>
<td>13.9</td>
</tr>
<tr>
<td>Total</td>
<td>9411 (100)</td>
<td>9217 (100)</td>
<td>-2.1</td>
<td>10297 (100)</td>
<td>11.7</td>
<td>12337 (100)</td>
<td>19.8</td>
<td>9.6</td>
</tr>
</tbody>
</table>

Note: The figures in brackets indicate percentage
Source: SFC report 1996
The table shows clearly that the major item of expenditure of village Panchayats are expenditure on management and collection and expenditure on public works. Management and collection expenditure ranges from 36.7% to 40.4% of the total expenditure during the four year period while that of the public works ranges from 35.5% to 42.4%. Management and collection expenditure shows an increase every year resulting in an annual average increase of 9.3%. Even though public works expenditure decreases in 1991-92 by 8.6%, it shows an increase of 22.9% in 1992-'93 and 30.3% in 1993-'94 recording an average increase of 14.9%. Education, water supply and drainage, street lighting, public health, debt servicing and others, each constitutes a small portion of the total expenditure every year. On an average the expenditure on education and expenditure on public health declined by 3.2% and 4.4% respectively. In the case of the remaining items there are annual average increases.

3.12 Major Recommendations of the SFC

Following are the major recommendations made by the SFC

1. Constitution of a special cell in the Finance Department to watch the implementation of the recommendations of the SFC

2. Delimitation of revenue villages to ensure that no village falls in more than one Panchayat

3. Plinth area of the residential building may be adopted as the basis for arriving at the rental value for assessing building tax
4. A rebate of 10% of the annual rental value for buildings which are 25 years or below in age and a rebate of 20% for buildings which are above 25 years may be given. A surcharge of 25% may be levied for residential buildings rented out.

5. A system of filing return and making assessment on the basis of actual rent may be introduced for commercial buildings having annual rental value of Rs. 12000/- or more.

6. Property tax may be revised in every 4 years instead of 5 years.

7. Unauthorised buildings in Panchayat areas may be taxed without conferring on them any right to regularisation or immunity from punitive action.

8. A time limit for the disposal of revision and appeal petition may be prescribed.

9. Minimum building tax may be fixed at Rs. 15/- per half year in a Panchayat.

10. Entertainment tax and Additional Entertainment tax may be merged into a single item.

11. A provision must be incorporated in the Rules requiring the Heads of offices and owners of the buildings to furnish to the Panchayat details of employees and occupants.

12. The rates of Profession Tax may be uniform in urban and rural local bodies and that the number of slabs be reduced and the rates rationalised.

13. Introduce the system of collecting a tax on the sale of land from the land owners at the time of sale. In such a case the Government may abolish the provision under Sec. 201 under which Panchayat can levy a land cess.
14. The Government may fix a minimum rate of Advertisement Tax and leave it to the local bodies to fix the rate above it.

15. Rural Development Board should cease to function as a financing agency as well as construction and supervising agency. However, it should lend money to local bodies on merits and at market rates.

16. Government may specify only the minimum rate of licence fee etc., and leave it to local bodies to fix rates above it except in the case of births and deaths.

17. Include provisions in the Kerala Panchayat Raj Act 1994 to collect a daily fee from persons unauthorisedly using road 'porombokes' without conferring on such persons any right.

18. Land tax may be doubled.

19. Weights 70 for population 10 for SC/ST population 10 for total workers excluding certain categories and 10 for agricultural workers may be given for calculating the plan grants and they should be devolved on that basis.

20. Local bodies should be given the freedom to decide the application of non-plan grants.

21. Non-statutory non-plan grants may be fixed at 1% of the state revenue and distributed to local bodies in proportion to their population.

22. State level fund for village Panchayats and municipal councils may be constituted.

23. Maintenance grant should be based on current cost of construction and not on historical cost.
24. The current distinction between roads eligible for V.R.M. grants and those for M.V. Tax may be abolished and the V.R.M. may be merged with V.T.C.

25. Cable T.V. operators are to pay annual licence fee and entertainment tax

26. Government may appoint an expert group for the preparation of the format of budget and accounts and other related matters of local bodies

27. The Central Government may evolve suitable centrally sponsored schemes for transferring annually to local bodies a minimum of 5% of Central Revenue

28. 25% of the Funds of various centrally sponsored programme for poverty alleviation should be at the disposal of local bodies

29. A statutory authority should give annual reports to the Governor showing the amount of grants due to local bodies and actually paid to them

3.13 Critical Evaluation

The Finance Commission has made an elaborate study of the financial position of the Panchayats and has given many recommendations to improve their financial position. The tasks of SFC were quite difficult because of several limitations and non-availability of data. Through a survey conducted in 1995, the SFC has collected data on the income, expenditure and related aspects from local bodies. No review of individual local bodies has been attempted, but the overall position of rural and urban local bodies is analysed separately. Only the income and expenditure actually received or incurred have been taken in to account ignoring receivables and deferred expenditure.
The methodology adopted by the Commission is systematic and logical. It can be seen from the report that the objectives were kept in view in giving recommendations. Only four year data have been taken into account.

SFC has started the work by analysing the financial position of the state without which its tasks could not be performed. The commission has obtained information from the state government about their current financial position as well as their projection of revenue and expenditure for the next five years. Analysing the financial position of the state, it has been found by the commission that both revenue deficit and capital deficit are increasing at an alarming rate. On that basis, the commission underlines the point that the financial scenario presented by the state government does not offer to local bodies much to cheer. However, the commission feels that in spite of the fiscal deficit and paucity of resources, assistance to local bodies has been a long standing obligation and commitment of the state government and they have been discharging these obligations with varying degrees of adequacy and satisfaction in the past. The state government has reaffirmed this commitment and also enlarged the role of local bodies. These factors, the commission observed, cast an obligation on the state government to enlarge the scale and scope of their financial assistance to local bodies.

One of the major recommendations of the SFC is to adopt plinth area as the basis to assess building tax. It is in view of the fact that most of the local bodies have expressed themselves in favour of adopting plinth area as an
indicator of rental value. The modus operandi for the system of taking plinth area as the basis of taxation is also clearly given in the SFC report.

The rates of profession tax are recommended to be uniform in urban and rural local bodies and the number of slabs are recommended to be reduced and rates rationalised. This is a logical recommendation because different rates of taxation for individuals in the same income level in Panchayats and municipalities does not have any rationale and need to be abolished. The rates of profession tax has been proposed by the commission for local bodies for various slabs of income.

The system of collecting tax on the sale of land from land owners at the time of sale of property by the Panchayat has also been recommended. But it is doubtful whether it is logical to have such a system because generation of income does not take place at the time of the sale of property and it created practical difficulties for the assesees.

The SFC recommends that provision must be made for the local bodies to collect a daily fee from persons unauthorisedly using road 'porombokes' without in any way conferring on such person any right. It is true that encroachment should be discouraged and there are adequate provisions in the general law to avoid such encroachment. It is neither reasonable nor practicable for local bodies to collect a daily fee for using the 'porombokes'.
The SFC has suggested a formula for the devolution of plan grants for rural local bodies which is as follows.

Table 3.8
Formula for the Devolution of Plan Grants

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Population</td>
<td>70</td>
</tr>
<tr>
<td>2 Population of SC/ST</td>
<td>10</td>
</tr>
<tr>
<td>3 Total worker excluding workers in manufacturing, processing, servicing and repair outside household industry</td>
<td>10</td>
</tr>
<tr>
<td>4 Proportion of agricultural workers among workers</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>100</td>
</tr>
</tbody>
</table>

It has been justified that population is a neutral index and hence a high weightable is given to this factor. The modified Gadgil formula allocates only 60% of plan assistance on the basis of population.6 The range of inter state differences in the level of socio-economic development is far more than such differences among local bodies in Kerala. So a higher weightage for population is justifiable. The group of workers in manufacturing, processing, servicing and repairs outside household industry represents employment in more organised sector of the economy and the higher their proportion among total workers, the better is the index of economic development. Hence the exclusion of these workers can be justified. Agricultural workers belong to the unorganised sector
of employment and the higher their proportion, the greater is the state of economic backwardness. So the last indicator is also justified.

The untied funds for plan purposes constitute a substantial portion of the revenue of Panchayats. With this, Panchayats will have the freedom to initiate programmes for the development of the local area. In this context it is worthwhile to note the recommendation of the SFC in this regard. The commission recommends that with the activation of the planning process contemplated in the PRI legislation, the untied funds should taper off and become part of the grants being given for the approved plan.

The SFC is of the opinion that local bodies should be given the freedom to decide on the application of non-plan grants according to their own priority and perception of their needs. It is a constructive and practicable suggestion especially because the Government is not exercising any effective control over the actual utilisation of specific purpose grants by local bodies. The SFC also opines that the distinction between non-plan specific purpose and general purpose grants need not be maintained and the entire non-plan non-statutory grant may be given as a single general purpose grant.

The recommendation of the SFC to provide maintenance grant on the basis of the current cost of construction and not on historical cost is reasonable. The current cost of construction for schools and primary health centres are estimated by the commission at a rate of Rs. 2750 per square metre and Rs. 4200
per square metre respectively at 1995 prices. 2% and 3% respectively of these should be the annual maintenance grant in respect of such buildings. It is also recommended that the current rate of inflation should be taken in to account for fixing the maintenance grant. The commission has gone deep to work out a reasonable maintenance grant to be given to local bodies.

The distinction between roads eligible for Village Road Maintenance (VRM) grant and those for Motor Vehicles Tax grant is recommended to be abolished. It is suggested to merge VRM with Motor Vehicle Tax and all roads are made eligible for the grants. The justification for this recommendation is also given in the SFC report. Motor Vehicle Tax is collected from all motor Vehicles registered under the Central Motor Vehicles Act. About 59% of Motor Vehicles are two wheelers and three wheelers. The state also has witnessed the emergence of a large number of mini lorries and vans which are capable of using the available network of roads including the village roads.

It is also recommended that cable television operators may be required to pay annual licence fee as well as entertainment tax. Proprietors of cable television and video parlours derive income from their business. Cinema exhibitors who are in a similar position are liable for entertainment tax. So it is justified that the former should also be taxed.

A very important recommendation is that 25% of the funds of various centrally sponsored programmes for poverty alleviation should be at the disposal
of local bodies for programmes formulated by them. This recommendation holds good in the context of the assigned role of local bodies as initiators of programmes of economic development and social justice. Local bodies ceased to be treated as mere agents of central government delivering services under its scheme.

It is also recommended that a statutory authority should give annual reports to the Governor showing the grants due to local bodies and which are actually paid to them. Government grants play an important role in the financial health of local bodies. Hence it should be seen that statutory as well as non-statutory grants should reach the local bodies in adequate quantities. It is also suggested by the SFC that such annual report should be placed before the state legislature before the expiry of six months of each financial year.

3.14 Response of the Government

The State Government has responded in the following manners to the recommendations of the State Finance Commission.

1. The basis of calculation of building tax which was relatively subjective assessment of rental value, has been changed to the transparent system based on plinth area of the building assessed.

2. A provision has been made for assessing entertainment tax based on tickets sold or on gross collection capacity.

3. The profession tax slabs have been rationalised and enhanced.

4. The licence fees prescribed in various rules have been enhanced.
5. Cable television has been brought under entertainment tax.
6. In order to ensure prompt payment of dues to local governments, penal interest at 2% per month has been stipulated for over dues.
7. The land revenue has been doubled and additional revenue generated is being divided among block Panchayats and district Panchayats. The Vehicle Tax Compensation has been fixed at 20% of the net collection.
8. A rural pool has been set up merging different grant-in-aid formerly given to the village Panchayats and adding 25% of surcharge on stamp duty to it.

Objective criteria have been laid down for allocation of tax. Arbitrariness in the inter local body distribution of grants has been abolished. The non-plan grant-in-aid would be distributed to local bodies based on a formula with 90% weightage for population and 10% for the area. This has been accorded a statutory basis through amendments to the Kerala Panchayat Raj Act and Kerala Municipality Act.

3. 15 The Second State Finance Commission

By a notification No.33384/SFC.A1/99/Fin dated 23-6-99, the Government of Kerala constituted the second Finance Commission, consisting of Prof. Prabhat Patnaik as the Chairman and Dr. K.M. Abraham and Shri. S.M. Vijayanand as members.

According to the notification, "the Finance Commission shall review the financial position of the Panchayats and Municipalities and make
recommendations as to:

(a) The principles which should govern.
   (i) the distribution between the State, Panchayats and Municipalities of the net proceeds of the taxes, duties, tolls and fees leviable by the State, which may be divided between them under Part IX and Part IX-A of the Constitution and the allocation between the Panchayats at all levels and the Municipalities of their respective shares of such proceeds;
   (ii) The determination of the taxes, duties, tolls and fees which may be assigned to or appropriated by, the Panchayats and the Municipalities;
   (iii) the grants-in-aid to the Panchayats and the Municipalities from the Consolidated fund of the State;

(b) The measures needed to improve the financial position of the Panchayats and the Municipalities with reference to:
   (i) the scope for local bodies to raise institutional finance, and suggest a framework for local self-governments to take recourse to such sources along with procedures to be followed limits, if necessary, to raising such resources;
   (ii) the need for sharing the cost of maintenance of assets and institutions transferred to local self-government and evolving criteria for it, with due regard to the fiscal position of the State Government and the local self-governments;
(iii) steps necessary for efficient financial management with particular reference to efficiency mobilization and economy in expenditure;

(iv) settlement of claims and dues of Panchayats and Municipalities vis-a-vis Government and Government agencies;

(v) procedures to be followed for smooth flow of funds to local self government and for ensuring financial accountability.

Part (a) of the terms of reference of the second finance commission are the same as those of the first state Finance Commission. In part (b) of the terms of reference of the first SFC, it has been only generally stated, “the measures needed to improve the financial position of the Panchayats”

In part (b) of the terms of reference of the second SFC five points have been specifically given to give recommendation to improve the financial position of local bodies.

The Finance Commission submitted a report on 8-1-2001. As it is not so far approved by the government, the report remains confidential and the details are not available. Hence an analysis of the report cannot be made now.

3.16 Conclusion

Panchayati raj institutions should have a desirable degree of fiscal autonomy in order that they play a decisive role in the local development. The recommendations of the Commission are in line with this idea. It emphasises the need to give freedom to local bodies to fix the rates of taxes and to levy them.
Its observation that the local bodies are not tapping the resources in full, which are available to them and its suggestion to exploit them to a satisfactory level are quite apt. Giving more financial autonomy to the local bodies without much state control as recommended by the Commission will foster in them the process of quick decision making. No doubt if these recommendations are implemented it would strengthen the financial position of Panchayats. Resource crunch, the usual problem faced by the local bodies, can be solved through fiscal discipline and efficiency in tapping the resources. If the recommendations of the SFC are adopted by the Government in full, the local bodies can be made agents and initiators of social and economic development. The measures to rationalise the tax structure and providing grants in a rationalised and systematic manner will provide a boost to Panchayats in this process.

The constitutional provisions regarding the appointment of SFC assumes that there is elasticity in taxation potential in each state. It also recognizes that in addition to the taxing and other fund raising powers devolved to local bodies, it is necessary to supplement them with devolution of finance by state governments. While determining the adequate funds to be devolved to various tiers of local bodies, SFC should consider the functions and responsibilities assigned to local bodies.
Notes and References


3. Ibid, para 3.4. p. 17.

4. Ibid, para 3.14., p. 22


6. Central Government allocated plan funds to states during fourth five year plan on the basis of Gadgil formula. It was modified in 1980 and again in 1991. As per the current modified formula, 60% of the central assistance is on the basis of population, 25% on the basis of per capita income, 7.5% on the criteria of fiscal management and attainment of national objectives and 7.5% on the basis of special problems.