CHAPTER IV

SEVENTY FOURTH CONSTITUTIONAL AMENDMENT ACT AND MUNICIPAL FINANCES
Local Self-government Institutions or Local Bodies in India, being at the cutting edge level of administration directly influence the wellbeing of the people by providing civic services and socio-economic infrastructure facilities. Urban local government institutions / municipalities are constituted for the maintenance and planned development of urban areas. The objective is to ensure that suitable levels of infrastructure and services are available to the citizens. In many parts of India, the quality of life in urban areas is miserable and the citizens lead a difficult life.

A number of problems confronting local governments began to emerge, such as excessive official control, narrow franchise, meager resources, lack of education and training, shortage of capable and committed persons, and inadequate control of local bodies over services. A need was felt to strengthen the local government institutions that would look after the day-to-day civic affairs in an efficient manner.

A number of steps were taken from time to time in an attempt to reform local governments – decentralization of authority, powers, functions and funds to lower levels of government, democratization of local governments; providing greater autonomy; granting constitutional status; amendments in municipal Acts; etc. A major achievement of the Indian Government in their Endeavour to strengthen urban local governments is the enactment of the Constitution (seventy-fourth amendment) Act during the year 1992.
The act provides for initiating reforms in the constitution, composition and functioning of urban local governments and empowers State governments to amend their municipal Acts accordingly. "Since the enactment of the Act, most State governments in India have carried out the legislative reforms at local government level. In recent times, several attempts have been made to assess the impact of the seventy fourth amendment Act Provisions."\(^1\)

This Act had accorded a constitutional status to these institutions as the third tier of the government. It also mandated grass root level democracy in urban areas by assigning the task of preparation and implementation of plans for economic development and social justice to elected municipal, councils and wards committees. It has incorporated Twelfth Schedule into the constitution of India containing a list of 18 functions as the legitimate functional domain of urban local Bodies. Further, with globalization, liberalization, the rise of the service economy and revolution in information and communication technologies, cities are being increasingly required to compete as centers of domestic and foreign investment and hubs of business process outsourcing. Civic infrastructure and services are critical inputs for the competitive edge of cities in a fast-globalizing world. However, without a commensurate enhancement of their resource-raising powers, cities are faced with fiscal stress as a result of which their capacity to contribute to national development as engines of economic growth is
severely constrained. While the Twelfth Schedule of the 74th Amendment Act, 1992 demarcates the functional domain of municipal authorities, the Amendment Act has not provided for a finances has been completely left to the discretion of the State Governments excepting in that such assignment shall be 'bylaw'. This has resulted in patterns of municipal finances varying widely across States and in a gross mismatch between the functions assigned to the ULBs and the resources made available to them to discharge the mandated functions. The ULBs depend on the respective State Governments for assignment of revenue sources, provision of inter-governmental transfers and allocation for borrowing with or without State guarantees. Constitutionally built-in imbalances in the functions and finances eventually reflect in the high dependency of urban local bodies on State Governments and of the State Governments on the Central Government. Under the constitutional scheme of fiscal federalism, funds from the Central Government are devolved to the State Governments. Following the recommendations of the State Finance Commissions (SFCs) and taking into account the devolutions made by the Central Finance Commission (CFC), the State Governments are required to devolve resources to their local bodies. However, due to endemic resource constraints, they have not been in a position to allocate adequate resources to their ULBs. This is further compounded by the fact that even the existing sources of revenues are not adequately exploited by many of the ULBs. The above factors have led to rising fiscal gaps in
these institutions, with resources drastically falling short of the requirements to meet the backlog, current and growth needs.²

**Importance of Local Public Finance**

Local self-government Institutions or Local Bodies influence welfare of the people by providing civic, social & economic infrastructure services and facilities in both urban & rural areas. Given their strategic position in delivering services in hierarchy of Government set up, following the Constitutional (73rd & 74th) Amendment Acts, more functions powers and resources have been provided to them. However, over a period of time, functions & responsibilities of LBs have increased without commensurate enhancement of the finances.
Figure 4.1
Fiscal Dependency of ULBs

Central Finances

Central FC

Planning Commission

Govt. Depts.

Dependency Level-1

GIA plan Schemes & CSS

State Finances

State FC

Govt. Depts

Dependency Level -II

GIA Plan & Non-plan schemes

ULBs
Table 4.1
Sources of Funds for Municipalities

<table>
<thead>
<tr>
<th>Internal Sources</th>
<th>Description</th>
<th>External Sources</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Taxes</td>
<td>Property tax, advertisement tax, vehicle tax etc.</td>
<td>1. Central government</td>
<td>Budgetary allocations, Central finance commission, etc.</td>
</tr>
<tr>
<td>2. Non-taxes</td>
<td>User charges; License and other fees; Cess; Duties; Tolls; Rents from properties; Receipts from markets, slaughter houses, fairs and renting of road sides, etc.</td>
<td>2. State government</td>
<td>Budgetary allocations, state finance commission, shared taxes with local government – entertainment tax, motor vehicle tax, etc.</td>
</tr>
<tr>
<td>3. Domestic institutions</td>
<td></td>
<td>3. Domestic institutions</td>
<td>HUDCO, LIC, ILFS, IDFC, etc.</td>
</tr>
<tr>
<td>4. Financial intermediaries</td>
<td></td>
<td>4. Financial intermediaries</td>
<td>TNUDF, KUIDC, GMPB, etc.</td>
</tr>
<tr>
<td>5. Capital markets</td>
<td></td>
<td>5. Capital markets</td>
<td>Municipal bonds, etc.</td>
</tr>
</tbody>
</table>

**Municipal revenue and expenditure**

As in other developing countries, the sources of income for ULBs in India are either own revenues or external transfers and loans. Own sources of revenue consists of tax and non-tax levies. Taxes include property tax, Octroi (entry tax on goods imported into the city), tax on vehicles, tax on gains / profits from professions or vocations, and tax on entertainment, show, and advertisements. Examples of non-tax revenues are fees and fines, user charges, rents from municipal assets and income from municipal investments or undertakings. External revenue sources comprise fiscal transfers.
from the central or state government such as grants-in-aid or shared taxes, and borrowings and loans from domestic and foreign sources. While earlier, local governments were not allowed to borrow directly, the burgeoning fiscal deficits led to the realization at the Centre that cities need to look beyond budgetary support for capital financing. The Eighth Five Year Plan of India 1992-97 envisaged building cost recovery into the municipal finance system, and the Ninth Plan 1997-2002 substantially reduced budgetary allocations for infrastructure and suggested mobilizing institutional and market-based financing.

Again, there is significant variation between the states in the relative sizes of the municipalities’ own and external sources of revenue. Since the actual degree of functional and financial devolution of powers to local authorities in India is a matter for the State Government and cities differ fundamentally as regards their size, economic resources and growth prospects, the strength of municipal finances of cities begs individual analysis. Even within the ambit of own revenue sources, the application of revenue-generating powers and the rate structure of taxes and charges vary by state. For example, all states of India except Gujarat, Maharashtra, Rajasthan, Punjab and Orissa have abolished octroi. The municipalities in these exception states, including Ahmedabad Municipal Corporation in Gujarat, that are still permitted to charge octroi have a significantly stronger financial position than the other local
governments in the country. Table 4.2 provides a sample of financial strength of local governments with octroi bases. While octroi clearly empowers municipal bodies, there has been strong critique against its levy as it hinders the free flow of goods within a country and many hamper economic development. Besides, being a multi-point tax, it imposes a significant burden on tax collection and administration and is open to leakages.6

Table 4.2. Municipal finances with and without octroi

<table>
<thead>
<tr>
<th>State</th>
<th>% local expenditure financed by own revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sample of non-octroi states</td>
<td></td>
</tr>
<tr>
<td>Andhra Pradesh</td>
<td>53.50%</td>
</tr>
<tr>
<td>Assam</td>
<td>79.60%</td>
</tr>
<tr>
<td>West Bengal</td>
<td>29.90%</td>
</tr>
<tr>
<td>Sample of octroi states</td>
<td></td>
</tr>
<tr>
<td>Maharashtra</td>
<td>98.50%</td>
</tr>
<tr>
<td>Gujarat</td>
<td>112.20%</td>
</tr>
<tr>
<td>Punjab</td>
<td>94.4%</td>
</tr>
</tbody>
</table>


Within the Indian municipal tax revenues, the most significant fiscal instrument has been property taxes, which is typically levied on the annual ratable value of the land or building in most cities. This is defined as the gross annual rent at which the property may be reasonably expected to be let, to be revalued every five years accordingly to the municipal legislation. In effect, it is a hypothetical
or notional rent, held as a proxy for the market rental value of the property. Given that ratable value based assessment is often not updated and hence undervalued, some urban local governments in states such as Andhra Pradesh and Gujarat have moved to other bases of property tax assessment such as area based valuation. In this assessment type, rental values are standardized per unit area of property for a given location, use, type of building, age etc. Attempts have been made to de-link the rental value assessment from the archaic Rent Control Act.7

In India, property taxes allow the application of the benefit principle as local services are, to some degree, capitalized into the property values. A proportion of the property tax imposed includes charges for services such as water, conservancy, drainage and latrine taxes. The basis and rates of property and service taxes vary by state and are governed by the respective Municipal Act.8 The Municipal Corporations are governed by a separate Act and have higher property tax rates than Municipalities. Other municipal taxes such as vehicle tax have provided only meager revenues. Professional tax and advertisement tax are not levied by all municipalities and again have yielded limited revenues.

Municipal fee income from licenses and registrations is expected to be complimentary to economic growth. However, there is a large element of evasion in these revenues due to the large prevalence of the informal sector in the small shops and establishments sector and the lack of supervision and enforceability.
by the local governments. Finally, in terms of user charges as a source of local revenues, the economically more developed and higher income cities have an advantage with respect to the citizens' ability and willingness to pay for municipal services. Other less resourceful cities still require substantial subsidy in service provision.

Municipal expenditure vis-à-vis infrastructure and services are governed by the municipal functions described in the 12th schedule of the 74th CAA. Whilst these functions set the goalpost, the actual municipal expenditures are substantially curtailed. This is because most municipalities have negligible revenues left after paying for non-developmental expenditure such as establishment expenses that include the salaries and ages of its staff and general administration costs. In general, the allocation of public expenditure at the local level is poorly planned and calls for streamlining the administrative machinery of the local governments. The few municipalities that earn some revenue surpluses undertake developmental activities such as the operation and maintenance of the local infrastructure and services. With respect to the creation and development of public assets and infrastructure, the central and state departments bear a major share of responsibility. Hence, capital expenditure for public works is predominantly financed by transfers and loans from the central and state governments. Figure 4.2 below depicts the main sources and uses of municipal finances in India.
More recently, some of the local governments that have strong municipal structures and finances are experimenting with innovative approaches of augmenting traditional revenue sources by attracting private sector participation and financing in municipal infrastructure and services. In terms of impact, these are as yet of small magnitude vis-à-vis the growing infrastructure requirements and financing gap in cities. Nonetheless, where successful, they have triggered far reaching institutional reform and motivated the Central and state Governments to empower and support local governments in developing additional private sources of municipal revenue and PPP models. For example, the municipality of Tirupur in South India has undertaken a major PPP initiative to involve the private sector in the provision of water supply and sewerage facilities for the city,
specifically to support its export oriented industrial estate. Project viability and private sector participation has been possible due to the municipality's sound financial performance and the availability of commercial end-users for the services. In addition, many of the larger local governments have let out maintenance of gardens, parks and streets on management contracts to the private sector. In terms of mobilizing private capital, many local governments have issued municipal bonds for infrastructure development. These have usually been structured debt obligations, with several levels of credit enhancement and secured on municipal revenues. A select few bond issues such as by the Madurai Municipal Corporation in South India have been revenue bonds on the strength of estimated revenues from the project, particularly in the case of toll roads and bridges. Some of the larger issues have been credit rated and have translated into lower cost of borrowing for the municipalities. This has led to the development of a robust credit rating system for municipalities, which seek to access capital market finances for its activities.

Also, many cities of India are undertaking significant reform of the administrative and organizational machinery that supports and holds together the municipal activities. These include revamping and computerizing the accounting and financial management systems of the larger municipal corporations and municipalities in order to improve overall accountability and effectiveness. Additionally, by letting out functions such as solid waste collection, maintenance of
streetlights, and upkeep of public parks and gardens on private management contracts, some municipalities are trying to enhance efficiency of operations as well as reduce their establishment and salary expenses.

Any analysis of finances of State and Central Governments in isolation (excluding that of the local bodies will not provide a holistic picture of the public finances of the country. Recognizing the fact that India is increasingly urbanizing, and given the estimate that of more than 50 per cent of India's population will live in urban areas in another 3 to 4 decades, one cannot afford to ignore the fiscal situation of ULBs. Civic infrastructure and services in most cities and towns are in a poor state. They are grossly inadequate even for the existing population, leave alone the need for planned urbanization and peripheral development to accommodate migrants and in situ population growth. The floods in Mumbai, Chennai, Hyderabad and Bangalore in the recent past have exposed the vulnerability of cities, their fragile ecology, weak infrastructure systems, faulty planning, long records of under-investment and fiscal imbalances. With rising expectations from the public, the financing of civic infrastructure and services has assumed critical importance socially, economically and politically. The importance of local public finance also emanates from another critically important factor. i.e., increase in poverty in cities and towns seen to be accompanying
Urbanization – a phenomenon that is described as ‘urbanisation of rural poverty’.

Urban poverty alleviation and slum development are regarded as legitimate functions of urban local bodies according to the 74th Amendment Act. However, neither the ULBs have any well-defined “own” sources of finance to address urban poverty nor do they have recourse to a system of adequate and predictable inter-governmental transfers to undertake poverty alleviation. Theoretically, the three main functions of the public sector are: stabilization, redistribution and allocation. With growing number of urban poor, the redistribution function, in addition to allocation, is emerging as a critical issue for Urban India. This needs to be addressed through the public finance system – Central, state and Local. Although the theory of public finance suggests that redistribution issues are best tackled by higher levels of government through the provisioning of inter-governmental transfers, there is no appropriate model of inter-governmental finance for local bodies in India to tackle the colossal problem of urban poverty. The 12th Schedule envisages that functions like ‘safeguarding the interests of weaker sections of society, including the handicapped and the mentally retarded’, ‘slum improvement and up gradation’ and ‘urban poverty alleviation’ being to the legitimate functional domain of urban local bodies. However, there are no commensurate resources with these institutions to discharge these functions effectively. This represents a case of
expenditure assignment without a corresponding revenue assignment.\textsuperscript{11}

The 74\textsuperscript{th} Constitution Amendment Act, 1992 in India aims at a decentralization 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 part of the India 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 (73\textsuperscript{rd} Amendment) Act, 1992 and the Constitution (74\textsuperscript{th} Amendment) Act, 1992, local bodies have come to enjoy the recognition of a third stratum of government. In the case of urban local bodies, enormous responsibilities have been identified in the 74\textsuperscript{th} 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 trusted 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 ULBs 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. In order to perform these responsibilities, urban local bodies have to be financially sound,
equipped with powers to raise resources commensurate with the functions mandated. The crux of the financial problems faced by urban local bodies is the mismatch between functions and finances and that this mismatch is seen to be growing with urban growth, population concentration, liberalization and globalization. While the 74th Amendment listed the expenditure responsibilities of ULBs, it did not specify the legitimate sources of revenue for these authorities. It simply stated in Article 243 (x) 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 moneys 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 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 introduced in the Constitution of India through the Constitutional Amendments are: i) the formation of
State Finances 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, inserted into the Constitution of India by the 73rd Amendment Act, makes it mandatory on the part of the State Governments to constitute SFCs 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 SFCs 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 SFCs.

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 CFC 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.12

LEGAL AND INSTITUTIONAL FRAMEWORK 13

Framework for Municipal Governance: Here an attempt is made to bring out an analytical review of the statutory provisions relating to the revenues and expenditure of municipalities in India. It covers the provisions relating to expenditure and revenue assignment contained in the Constitution of India and in the legislations passed by State Governments. An analysis has also been made of the recommendations made by the Central and State Finance Commissions. Lastly, the vertical imbalance ingrained in India’s fiscal structure has been discussed.

Powers, Authority and Responsibilities of Municipalities (Article 243-W)

Subject to the provisions of this Constitution, the Legislature of a State may, by law, endow –

(a) the Municipalities with such powers and authority as may be necessary to enable them to function as institutions of self-government and such law may contain provisions for the devolution of powers and responsibilities upon Municipalities,
subject to such conditions as may be specified therein, with respect to:

(i) The preparation of plans for economic development and social justice.

(j) The performance of functions and the implementation of schemes as may be entrusted to them including those in relation to the matters listed in the Twelfth Schedule.

(b) The committees with such powers and authority as may be necessary to enable them to carry out the responsibilities conferred upon them including those in relation to the matters listed in the Twelfth Schedule.

The legal-institutional framework for the delivery of civic services in cities and towns as envisaged in the Constitution (74th Amendment) Act, 1992 comprises a number of mandatory institutions:

- State Election Commission (Article 243K);
- Municipalities: Municipal Corporations, Municipal Councils and Nagar Panchayats (Articles 243 Q);
- Wards Committees and other Committees (Article 243 R);
- State Finance Commission (Article 243 I);
- District Planning Committee (Article 243zD); and
- Metropolitan planning Committee (Article 243ZE)

The responsibility for the creation and operation alisation of the legal-institutional framework – the aforesaid institutions

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and other entities, including para-statals impacting on civic service delivery, however, has been left to the State Government.

- The mandates of various key institutions as prescribed by the Constitution (74th Amendment) Act 1992 are as follows:
  - State Election Commission to superintend, direct and control the preparation of electoral rolls, and conduct elections to all the rural and Urban Local Bodies (ULBs) [Article 243K(1)];
  - Municipalities to function as 'institutions of self-government'—
    - Prepare 'plans for economic development and social justice',
    - Perform civic functions and implement schemes as may be entrusted to them by the state Government, including those related to the Twelfth Schedule [Article 243W(a)];
  - Wards Committees and Special Committees to take Municipal Government physically closer to the people and carry out the responsibilities conferred upon them including those in relation to the Twelfth-Schedule [Article 243W(b)];
  - State Finance Commission to review the financial position of the rural and urban local bodies, and to make recommendations regarding the 'principles' of devolution of resources from the state Government to the local bodies and the 'measures' needed to improve their finances and functioning [Article 243I(1)];
• District Planning Committee to 'consolidate' the plans prepared by the Panchayats and the Municipalities in the district and to prepare a draft development plan for the district as a whole [Article 243ZD(1)];

• Metropolitan Planning Committee to prepare draft development plan for the metropolitan area as a whole [Article 243ZE(1)].

**Expenditure & Revenue Assignment:**

Governance of ULBs (and also rural local bodies) in India has remained a State subject in accordance with the stipulation of the Seventh Schedule and List II of the Constitution of India.

Primarily, designed for a two-tier system, the Constitution of India has specified the expenditure responsibilities as well as the resources raising domains of the Union and States through three lists given under Schedule VII. This Schedule spells out the division of functions and finances into the Union List, the State List and the Concurrent List wherein the Union and the State Governments have joint jurisdiction. However, the scenario has changed substantially after the 74th Amendment, by which the ULBs have gained constitutional status and have become an integral part of India's decentralization strategy.

The 74th Amendment Act envisaged that elected Municipalities function as effective local self-government institutions preparing and
implementing plans for economic development and social justice and discharging civic responsibilities envisaged in the 12th Schedule.

In order to perform these tasks, the urban local bodies have to be financially sound and endowed with commensurate powers to raise resources. However, while the Constitution specifies the expenditure responsibilities, it has not listed out the sources of revenue of ULBs. Article 243 X of the Constitution only stipulates that a State Legislature may, by law.

i) authorize a Municipality to levy, collect and appropriate such taxes, duties, tolls and fees in accordance with such procedure

ii) assign to a Municipality such taxes, duties, tolls and fees levied and collected by the State Government for such purposes and subject to such conditions and limits;

iii) provide for making such grants-in-aid to the Municipalities from the Consolidated Fund of the State and

iv) provide for the constitution of such Funds for crediting all moneys received, respectively, by or on behalf of the Municipalities and also for the withdrawal of such moneys there from, as may be prescribed by law.

Thus, the 74th Amendment has not clarified a critical area of fiscal federalism, i.e., the matching of resources and responsibilities.

The taxes, duties, charges and fees to be levied by the Municipalities, those to be assigned to them and the grants-in-aid to be provided to them have been left to the discretion of the State Governments. This has allowed the fiscal mismatches to continue in
the absence of adequate decentralization of resources corresponding to the decentralization of expenditures envisaged in the Constitution (74th Amendment) Act, 1992.

**Functions of Urban Local Bodies: Twelfth Schedule (Article-243W):**

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. Safe-guarding the interest of weaker sections of society, including the handicapped and mentally retarded;
10. Slums improvement and upgrading;
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; and
18. Regulation of slaughter houses and tanneries.

An insight into the status of 18 functions as assigned for the municipalities, in selected states reveals that except the state like Kerala, the rest of the states have not fully assigned these 18 functions to the municipalities as shown in Table 4.3.

**TABLE 4.3**

**Status Functions as Per 74th Amendment**

| Items                  | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 | 18 | Total |
|------------------------|---|---|---|---|---|---|---|---|---|----|----|----|----|----|----|----|----|----|       |
| Andhra Pradesh         | N | N | N | Y | N | Y | N | Y | N | N  | Y  | N  | Y  | N  | Y  | N  | Y  |     | 8    | 10    |
| Gujarat                | N | N | N | Y | Y | Y | Y | Y | N | N  | Y  | Y  | Y  | Y  | Y  | Y  | Y  |     | 13   | 5     |
| Haryana                | N | N | N | Y | Y | Y | N | Y | N | Y  | N  | Y  | Y  | Y  | Y  | Y  | Y  |     | 11   | 7     |
| Himachal Pradesh       | N | N | N | Y | Y | Y | Y | Y | Y | Y  | Y  | Y  | Y  | Y  | Y  | Y  | Y  |     | 8    | 10    |
| Karnataka              | Y | Y | Y | Y | Y | Y | Y | Y | N | N  | Y  | N  | Y  | Y  | Y  | Y  | Y  |     | 16   | 2     |
| Kerala                 | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y  | Y  | Y  | Y  | Y  | Y  | Y  | Y  |     | 18   | 0     |
| Madhya Pradesh         | Y | Y | Y | Y | Y | Y | Y | Y | N | N  | Y  | N  | Y  | Y  | Y  | Y  | Y  |     | 16   | 2     |
| Maharashtra            | N | N | N | Y | Y | Y | N | N | N | N  | N  | Y  | Y  | Y  | Y  | Y  | Y  |     | 11   | 7     |
| Rajasthan              | N | N | N | Y | Y | Y | N | N | N | N  | N  | N  | Y  | Y  | Y  | Y  | Y  |     | 11   | 7     |
| Tamil Nadu             | Y | Y | Y | Y | Y | Y | Y | N | N | N  | N  | N  | N  | Y  | Y  | Y  | Y  |     | 13   | 5     |
| Uttar Pradesh          | Y | N | N | N | Y | Y | N | N | N | N  | N  | N  | N  | Y  | Y  | Y  | Y  |     | 14   | 4     |
| West Bengal            | Y | Y | N | Y | Y | Y | Y | Y | Y | Y  | Y  | Y  | Y  | Y  | Y  | Y  | Y  |     | 17   | 1     |
| Delhi                  | N | N | Y | N | N | N | N | N | N | N  | N  | N  | N  | Y  | N  | Y  | Y  |     | 8    | 10    |

**Note**: This Annexure gives the status of 18 functions as assigned to the municipalities in the 12 schedule of the Constitution defined in Page 12.
'Y' here implies for Yes: function assigned to municipalities by the state government & 'N' here implies for No: function not assigned to municipalities by the state government. Thus a state like Kerala has all the Y implying that all the 18 functions have been assigned to the local bodies by the state government.

**Source:** National Commission to Review the working of the constitution: Decentralization and Municipalities.

However, for strengthening the finances of the local governments, the two positive features in the Amendments to Constitution are:

i) provision for the constitution of State Finance Commissions (SFCs) every five years;

ii) amendment of Article 280 of the Constitution of India by inserting section 3 C)

Article 243 (l), inserted into the Constitution by the 73rd Amendment Act, makes it mandatory on the part of the State Governments to constitute SFCs once every five years to review the financial position of the Panchayats and the Municipalities. It may be noted that the role of the State Finance Commission is envisaged to be much broader (as set out subsequently) than that of the Central Finance Commission, which is primarily related to the distribution of the central divisible pool of resources among the State Governments. As stated earlier, the Constitutional Amendments also provide a safeguard regarding the implementation of the recommendations of the SFCs. Article 280 of the Constitution, under which a CFC 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 the States, has been amended.

It is now mandatory on the part of the CFC to recommend measures 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 Commission of the State. The provision for the establishment of a SFC every five years is an important step toward redressing the fiscal imbalance of ULBs. The additional responsibility cast upon the CFC, to recommended measures to supplement the resources of local self-government institutions is a clear acknowledgement of the mismatch between functions and finances at various tiers of the India federal system.

State Finance Commissions:

The Governor of a state shall as soon as may be within one year from the commencement of the constitution 73rd Amendment Act 1992 and thereafter at the expiry of every fifth year, constitute a Finance Commission. As mentioned earlier, Article 243(l) of the Constitution (Seventy-fourth) Amendment empowers the SFCs (Article 243(Y) to review the financial position of the Municipalities and to make recommendations to the Governor of the State as to the principles which should govern:
i) the distribution between the State Government and the Municipalities of the net proceeds of the taxes, duties, tolls and fees that can be levied by the state which may be divided between them, and the allocation of such proceeds between the Municipalities at all levels;

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

iii) the grants-in-aid to the Municipalities from the Consolidated Fund of the State;

iv) the measures needed to improve the financial position of the Municipalities; and

v) any other matter referred to the SFC by the Governor in the interest of the sound finance of the Municipalities.

The Twelfth CFC has reviewed the progress of the setting up of First and Second SFCs and the action taken on them by the respective State Governments. In case of First SFCs, 25 States had constituted their Commissions, of which 23 Commissions have submitted their reports. Further, 20 States have submitted the action taken report (ATR). Regarding the Second SFCs, only 19 states had constituted their Commissions, of which 16 Commissions have submitted their reports by November 2004. However, only 6 states submitted the ATRs.

With regard to the implementation of the SFC reports, the Twelfth CFC reported as follows:
i) several states did not initiate a follow-up action;

ii) recommendations under examination, met with “natural death”.

iii) very few States have honoured their commitment for the release of additional resources and

iv) budgetary provision regarding the recommendations have fallen short. It appears that the initial enthusiasm shown by the state Governments in constituting the SFCs got lost at the time of implementing the recommendations in their reports as it would have put undue pressure on the finances of the State Governments.

The analysis made by the Twelfth CFC indicates a clear time lag between the submission of reports of SFCs, actions taken by State Governments on the recommendations of SFCs and the constitution of CFCs.

The 74th Amendment, in addition to not specifying a municipal revenue list in the Constitution also did not make any stipulation regarding the period within which the recommendations of SFCs are to be implemented by the respective State Governments. As a consequence, most of the SFC recommendations were far from being implemented.

Moreover, the 74th Amendment did not specify the composition of the SFCs. Unlike the CFCs which always had eminent
personalities as members, in many States the procedure of selection of SFC members has been routine and without regard to the expertise needed in areas of fiscal federalism, local government finance, public service delivery etc.

The very procedure of empowering the local governments appears to be misleading, without much of their financial strengthening coming a reality. In this context, the Twelfth CFC recommended that:

i) the SFCs should follow a normative approach in the assessment of revenues and expenditure in order to arrive at the gap that may be considered by the CFC.

ii) principal recommendations of the SFCs may be accepted with modification as in the case of CFC.

iii) the States should constitute SFCs with people of eminence and

iv) the States should compile disaggregated time series data on finances of local bodies, and v) there is a need for synchronization of time period of the SFCs with that of CFCs.

Some of the shortcomings of the SFCs have been brought out by research as follows; 14

i) Most SFCs have failed to emphasize the link between revenue raising and expenditure responsibilities, a link that is needed to induce fiscal responsibility.

ii) No SFC seems to have devoted attention to aspects of fiscal management or the need to impose a hard budget constraint at
the local level. The accounting and budgetary practices leave many things to be desired.

iii) No suggestion has been made by any SFC so far to reduce the multiple channels of devolution that exists at the local level, viz., Line Departments, State Planning Boards, SFC devolution, MP, MLA programmes, District Rural Development Agency and the like. This may not be their direct task; yet, there is a need for suggestions to place State-Local fiscal relations on a more rational footing.

iv) In the pre-Amendment days state-local grant system was unsystematic, *ad hoc*, dependency promoting and above all operated through numerous channels; many SFCs have failed to fully address these shortcomings.

Furthermore, there has been a lack in uniformity of the SFCs across the States with regards to their approaches for delegation and devolution of resources to the ULBs.

The 74th Constitutional Amendment has envisaged greater autonomy and responsibilities for elected Municipalities for promoting social and economic development of the country. The Municipalities have been assigned the task of drawing up plans for economic development and social justice, and implementing the schemes relating thereto including the 18 functions included in the Twelfth Schedule of the Constitution. Though autonomy and discharging of the responsibilities require greater access to
resources, yet the institutional mechanisms in place are not adequate to ensure a match between municipal functions and finances. Two important reforms urgently called for are: broadening the revenue base of ULBs and reforming inter-governmental transfer system. Given the limitations to raise own resources, there is a strong argument for institutionalizing resource flow from the higher level of Governments to ULBs based on principles. However, the issues of inter governmental transfers to local bodies have not received due attention in India owning to a variety of reasons. Moreover the transfers to Municipalities in India remain discretionary in nature.\textsuperscript{15}

As per the 74\textsuperscript{th} Constitutional Amendment, enormous responsibilities have been assigned to ULBs. However, it did not specify the sources of revenues. Legally, urban local bodies have only limited powers to raise resources. They cannot have deficits in their budgets and their borrowing capacities have been contained. These local bodies have to depend on a number of institutions for resources to perform the tasks assigned to them by the Constitution and State Legislatures. They also need to be professionalized to convert outlays to outcome efficiently and effectively. In short, the issues of vertical imbalance, fiscal dependency, borrowing constraints and inefficiency in municipal management are affecting the functioning of local bodies. They need to be addressed holistically.
The Workings of State Finance Commissions

The primary objective of Article 243(l) and 243(Y) of the Constitution Amendment Acts, 1992 is to bring about an improvement in the delivered and performance of local bodies. The aim of the various provisions of the 73rd and 74th CAA regarding evolving fiscal devolution frame work by SFCs is to ensure achievement of the objective of both the CAAs. As per the provisions of both the 73rd and 74th CAA, a SFC is required to do the following while reviewing state-local fiscal relationships and devising a fiscal devolution frame work for PRIs and ULBs.16

Regarding the Fiscal Package, the State Finance Commission shall (i) Review the macro-economic environment within which the municipalities in India operate, (ii) Undertake an appraisal of the finances of municipalities in terms of Changes and shifts in the fiscal health of municipalities, referring to revenue and expenditure growth and performance; Trends in the volume and nature of transfers; and Key issues in making fuller use of revenue resources and reordering expenditure priorities. (iii) Estimate the revenue gap of municipalities in terms of Trends in gap between revenue-raising capacity and expenditure needs; and Assessment of the level of municipal under spending; (iv) Project the expenditure needs into the future in terms of Assumptions in respect of the expenditure responsibilities; Norms and standards for services and activities; Accounting for revenue
gaps and level of under spending; and Needs arising out of the fiscal disabilities of municipalities. (v) Determine a fiscal package for financing future expenditure needs and evolve Principles for assignment of taxes, duties, tolls and fees; Principles for revenue-sharing and grants-in-aid; Degree of access of municipalities to the divisible pool of state resources; Supplementing revenue resources with grants-in-aid; and Pre-conditions for making the fiscal package productive.

**Beyond the Fiscal Package**

The scope of Article 243 Y of the Constitution is not limited to determining the constituents of the fiscal package for municipalities. It extends to evolving measures that would improve the financial position of municipalities. It extends to developing strategies that would contribute to the sound finance of municipalities. In many ways, Articles 243 Y (b) and (c) are by far the most important as these permit an examination of the functioning of municipalities with a view to suggest measures that would result in the long term, a sustainable improvement in the finances of municipalities. The Constitutional amendment implies that the efficiency of the fiscal package can be significantly enhanced if it is accompanied by supplementary measures for improving the finances of municipalities. These provisions have afforded an opportunity for determining the -

i) Some soundness of the existing system of property taxations;
ii) Appropriateness of the existing system of municipal accounting, i.e., whether it is able to adequately capture the expenditure and receipts of municipalities and the need and relevance for introducing double entry, accrual based accounting system; and

iii) Feasibility of privatization of municipal services and activities.¹⁷

**State Finance Commissions – Recommendations in various States:**¹⁸

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

**Differences in the Recommendations Made by the First and the Second State Finance Commissions:**

Differences in the first and second finance commission recommendations exist in the number of recommendations, their nature, and the approach adopted by the various commissions. From
a review of the second SFC reports, it is observed that in some states, the total number of recommendations has gone down as compared to the first SFC reports, whereas in many others, numbers have increased. (vide Table 4.4) In Tamil Nadu, Uttar Pradesh and Delhi, for example, there has been a drastic change in the number of recommendations. Regarding the approach adopted by the commissions for the devolution of funds to local bodies, the main observation is that global sharing of state revenues is increasingly being accepted as a strategy to strengthen the financial condition of local bodies. It is learnt that a larger number of states/UTs are adopting this strategy. With respect to the nature of recommendations, it is observed that the general pattern is that the second SFC recommendations are more focused and specific. However, there are still some reports, which contain very general recommendations.

Table 4.4

SFC Recommendations on Global Sharing of State Revenues and Actions Taken

<table>
<thead>
<tr>
<th>SL No.</th>
<th>State / UT</th>
<th>Recommended Share of Local Bodies (urban and / or rural)</th>
<th>Recommended Share of Local Bodies (Urban and / or rural)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Andhra Pradesh</td>
<td>39.24% of state revenue from taxes &amp; non-taxes (30% for urban areas) Accepted</td>
<td>40.92% of States's tax &amp; non-tax revenue (18.5% share of ULBs) Status not specified in ATR</td>
</tr>
<tr>
<td>2</td>
<td>Assam</td>
<td>2% of state taxes Accepted</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Karnataka</td>
<td>36% of non-loan gross own revenue receipts (NLGORR) of state govt. (5.4% relative share of ULBs) Accepted – a higher % age has been transferred to ULBs</td>
<td>40% of NLGORR of State Govt (8% relative share of ULBs) information on status not available</td>
</tr>
<tr>
<td>4</td>
<td>Madhya Pradesh</td>
<td>8.67% of net revenue (taxes &amp; non-taxes) of state govt. for ULBs Accepted</td>
<td>1.07% of net own tax revenue of state govt. for ULBs Accepted</td>
</tr>
<tr>
<td>SL. No.</td>
<td>State / UT</td>
<td>Recommended Share of Local Bodies (urban and / or rural)</td>
<td>Recommended Share of Local Bodies (Urban and / or rural)</td>
</tr>
<tr>
<td>---------</td>
<td>------------</td>
<td>--------------------------------------------------------</td>
<td>--------------------------------------------------------</td>
</tr>
<tr>
<td>5.</td>
<td>Punjab</td>
<td>First SFC: 4% of net receipts from all state taxes</td>
<td>Second SFC: Accepted</td>
</tr>
<tr>
<td>6.</td>
<td>Rajasthan</td>
<td>First SFC: 2.18% of net state tax proceeds Accepted</td>
<td>Second SFC: 2.25% of state’s net own tax revenue.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Exclu. Entertainment tax (23.4% for ULBs) Accepted</td>
</tr>
<tr>
<td>7.</td>
<td>Tamil Nadu</td>
<td>First SFC: 8% of revenue from at state taxes, exclu.</td>
<td>Second SFC: 8% of state’s own tax revenue, exclu.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Entertainment tax (40% for ULBs) Accepted with</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>modification – Instead of 40% ULBs to be devolved</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>45% share</td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td>Uttar Pradesh</td>
<td>First SFC: 105 of net own tax revenue receipts of</td>
<td>Second SFC: 12.5% of net proceeds of taxes duties,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>state govt. (7% for ULBs) Accepted</td>
<td>tolls &amp; fees, exclu. Entertainment tax &amp;</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>land revenue (7.5% for ULBs) Accepted</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>regarding share of Nagar Panchayats. It is mentioned</td>
</tr>
<tr>
<td>9.</td>
<td>West Bengal</td>
<td>First SFC: 16% of net proceeds of all state taxes</td>
<td>Second SFC: Information on status not available</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Accepted-however, only a small amount of fund was</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>released to ULBs</td>
<td></td>
</tr>
<tr>
<td>10.</td>
<td>Andaman &amp; Nicobar islands</td>
<td>First SFC: 10% of total net tax proceeds (20% for ULBs) Accepted</td>
<td>Second SFC: Information on status not available</td>
</tr>
<tr>
<td>11.</td>
<td>Daman &amp; Diu</td>
<td>First SFC: 10% of total net tax proceeds (20% for ULBs) Accepted</td>
<td>Second SFC: Information on status not available</td>
</tr>
<tr>
<td>12.</td>
<td>Delhi</td>
<td>First SFC: 9.5% of Govt. of National Capital Territory of Delhi is tax revenue Accepted</td>
<td>Second SFC: 5.5% of tax revenue (net proceeds of all taxes &amp; duties) Accepted</td>
</tr>
</tbody>
</table>

**Source:** State Finance Commission Reports and Action Taken Reports

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

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

The total number of recommendations in the second SFC reports is highest in the state of Uttar Pradesh, followed by Tamil Naidu, Punjab, Madhya Pradesh, and Andhra Pradesh, and low in Karnataka, West Bengal and Daman and Diu. Further, the emphasis on urban areas is higher in Madhya Pradesh, Punjab, Tamil Nadu, Uttar Pradesh, West Bengal and Daman and Diu. (Table 4.4)

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

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

**KEY AREAS OF RECOMMENDATIONS**

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

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

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

A review of the fist ATRs reveals that acceptance is 100 per cent in the states of Haryana, Himachal Pradesh and Uttarakhand. The other states / UTs showing high acceptance include Gujarat, Kerala, Madhya Pradesh, Punjab, Tripura, Uttar Pradesh, West Bengal and Delhi. The states /UTs of Assam, Orissa, Andaman and Nicobar Islands and Daman and Diu have shown low acceptance (Table 4.5) Limited information is available on the acceptance of second SFC recommendations (Table 4.6). A comparison of first and
second SFC recommendations, which have been accepted, shows that this proportion has decreased between the two points of time.

Table 4.5
Proportion of First SFC Recommendations Accepted in Selected States

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Proportion of Recommendations Accepted</th>
<th>Name of State/Union Territory</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>100 per cent</td>
<td>Haryana, Himachal Pradesh, Uttarakhand</td>
</tr>
<tr>
<td>2.</td>
<td>80-100 per cent</td>
<td>Gujarat, Kerala, Madhya Pradesh, Punjab, Tripura, Uttar Pradesh, West Bengal, Delhi</td>
</tr>
<tr>
<td>3.</td>
<td>60-80 per cent</td>
<td>Andhra Pradesh, Goa Rajasthan, Tamil Nadu, Pondicherry</td>
</tr>
<tr>
<td>4.</td>
<td>Less than 60 per cent</td>
<td>Assam, Orissa, Andaman &amp; Nicobar Islands, Daman &amp; Diu</td>
</tr>
</tbody>
</table>

Source: State Finance Commission Reports and Action Taken Reports.

Table 4.6
Proportion of Second SFC Recommendations Accepted in Selected States

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Proportion of Recommendations Accepted</th>
<th>Name of State/Union Territory</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>100 per cent</td>
<td>Nil</td>
</tr>
<tr>
<td>2.</td>
<td>80-100 per cent</td>
<td>Madhya Pradesh</td>
</tr>
<tr>
<td>3.</td>
<td>60-80 per cent</td>
<td>Uttar Pradesh, Delhi</td>
</tr>
<tr>
<td>4.</td>
<td>Less than 60 per cent</td>
<td>Andhra Pradesh, Punjab, Rajasthan, Tamil Nadu</td>
</tr>
</tbody>
</table>

Source: State Finance Commission Reports and Action Taken Reports.

An important objective of this study was to examine the current status on the implementation of the SFC recommendations:
The recommendation of **Global Sharing of State Revenues** has been accepted by most State Governments. However, the recommended share of local bodies from state revenues has been either partly devolved or is yet to be devolved in some states.

State governments have generally accepted recommendations on **property tax** reforms. In Assam, the quinquennial assessment of ULBs is delayed due to frequent transfer of part-time assessors. In Kerala, necessary revisions have been made in the Municipal Act regarding revision of tax every four years. In Punjab, provisions have been made in Punjab Municipal Bill. 1999 to de-link property tax. However, no decision has been taken by the government to compensate ULBs for loss of revenue due to exemptions granted by the state government. In Rajasthan, simplification of assessment procedure is in process.

The recommendations in respect of **profession tax** have been accepted by most states as per the available information. In Kerala, the suggestion on a reduction in the number of slabs and the rationalization of rates has been accepted, however, new slabs have not been notified for ULBs. In Punjab, tax on professions, individuals, traders, commission agents and shopkeepers has still not been levied. Moreover, the power to fix rates of local taxes continues to remain with the state government.

Recommendations on **entertainment tax** have been either accepted fully or with minor modifications. For instance, in Haryana, instead of the recommended 50 per cent, only 25 per cent of net proceeds are accepted for transfer to the ULBs, and it is learnt that this share has been transferred. In Kerala, the recommendation on merging entertainment tax and additional entertainment tax has been accepted and implemented.
Bengal government has accepted to hand over this tax (collected by state) to local bodies however, at the time of collection of data from the state, it was learnt that no action had been taken. It is learnt that though almost the entire amount of fund collected on this account is being given to local bodies, this tax has neither been assigned to them, nor they have been given any discretionary powers for fixing the rates. The main reason for this is that the state government already had elaborate machinery for collection of this tax, which would become redundant. Hence, it is suggested that the arrangement of sharing of this tax should be continued.

Suggestions on user charges have been accepted in the states of Assam, Kerala, Madhya Pradesh, Punjab and Uttar Pradesh. The Madhya Pradesh government has accepted the recommendation that the cost of public utility services should be recovered by charging appropriate fees from the users of services. In Punjab action is being taken to provide metered water supply and to revise water rates and sewer charges.

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

- The Finance Commissions of Andhra Pradesh, Gujart, Orissa, Rajasthan, Tamil Nadu, Uttaranchal and Uttar Pradesh have given importance to devolution of functions, functionaries and powers along with a transfer of funds. In Andhra Pradesh, the state government has accepted the recommendation, but it is pointed out that this cannot be implemented immediately, since the quantum of financial devolution has to be examined carefully in relation to the delegation of functions.

- The SFCs of Andhra Pradesh, Assam, Himachal Pradesh, Kerala, Punjab and Rajasthan have suggested for the monitoring and review of their recommendations by the state governments concerned. This recommendation has been accepted by the state governments of Andhra Pradesh, Himachal Pradesh and Punjab. Kerala Government has taken steps to constitute a special cell in the Finance Department for this purposes and it is further recommended that the cell should be revamped and assigned the task of regular
monitoring of finances. In Uttar Pradesh, the state government has not accepted the second SFC recommendation on reconstitution and strengthening of the SFC cell.

In the status of Assam, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Tripura and Uttar Pradesh, the development and maintenance of a database on municipal finance is recommended. In addition, emphasis is also given on development of Management Information System / Computerisation of data in the states of Haryana, Punjab, Rajasthan and Uttaranchal. As per the SFC reports and ATRs, some progress has been achieved, however, much remains to be done. In Delhi, the recommendation on computerization of public dealing departments has not been accepted, since there already exists a plan scheme for the purpose. In Andaman and Nicobar Islands and in Daman and Diu, emphasis is given on a periodic revision and updating of data in order to determine the size of the tax base.

Operationalising Thirteenth Finance Commission Recommendations – Urban

The thirteenth Finance Commission (13th FC) recommendations relating to urban local bodies inter alia 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 others words can be called reforms. They are:19

- The State Government must put in place a supplement to the budget documents for local bodies.
- The state Government must put in place Audit System.
- The State Government must put in place a system of independent local body Ombudsmen.
- The State Government put in place a system to electronically transfer local body grants provided by the Commission.
- The State Government must prescribe through an Act the qualifications of persons eligible to appointment as a members of the SFC.
- All local bodies should be fully enabled to Levy Property Tax without hindrance.
- The State Government must put in place a State Property Tax Board.
- The State Government must gradually put in place standards for delivery of essential services.
- 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 ULB level.

The Thirteenth Finance Commission has, for the first time, linked devolution of funds to local bodies to a dedicated share of the divisible pool of central revenue. It has suggested a quantum jump in the revenue allocation, which would be 4 to 5 times higher than the allocation of Rs. 5 crore per annum as per norms laid by the 12th CFC. The revised allocation would be available from the financial year i.e. 2010-11. A part of the allocation referred to as performance grant has been linked to the implementation of certain reforms such as Implementation of Double Entry Accrual based systems by the local bodies, assignment of technical guidance and supervision of audit to the CAG of India, appointment of Independent Local Body Ombudsman, electronic transfer of grants by the states to the local bodies to ensure transparency and timely disbursement, removal of exceptions in the levy of property tax, notification of current as well as expected levels of improvements in service standards etc. 12 states are likely to qualify for this performance grant during the year 2012-12. 20

Recommendation of the Second Administrative Reforms Commission on Local Bodies

A number of recommendations of the Sixth Report of the second Administrative Reforms Commission titled “Local Governance An Inspiring Journey into the Future” have accepted by Government
The following recommendations have been accepted by the Government of India. 21

The accounting system for the urban local bodies (ULBs) as provided in the National Municipal Accounts Manual (NMAM) should be adopted by the State Governments.

The financial statements and balance sheet of the urban local bodies should be audited by an Auditor in the manner prescribed for audit of Government Companies under the Companies Act, 1956 with the difference but in the case of audit of these local bodies, the C & AG should prescribe guidelines for empanelment of the Chartered Accountants and the selection can be made by the State Governments within these guidelines. The audit to be done by the Local Fund Audit or the C & AG in discharge of their responsibilities would be in addition to such an audit.

The existing arrangement between the C & AG of India and the State Governments with regard to providing Technical Guidance and Supervision (TGS) over maintenance of accounts and audit of PRIs and ULBs should be institutionalized by making provisions in the State Laws governing local bodies.

It should be ensured that the audit and accounting standards and formats for Panchayats are prepared in a way which is simple and comprehensible to the elected representatives of the PRIs.
The independence of the Director, Local Fund Audit (DLFA) or any other agency responsible for audit of accounts of local bodies should be institutionalized by making the office independent of the State administration. The head of this body should be appointed by the State Government from a panel vetted by the C & AG.

Audit reports on local bodies should be placed before the State Legislature and these reports should be discussed by a separate committee of the State Legislature on the same lines as the Public Accounts Committee (PAC).

Access to relevant information / records to DLFA / designated authority for conducting audit or the C & AG should be ensured by incorporating provisions in the State Laws governing local bodies.

Each State may ensure that the local bodies have adequate capacity to match with the standards of accounting and auditing.

The system of outcome auditing should be gradually introduced. For this purpose the key indicators of performance in respect of a government scheme will need to be decided and announced in advance.

To complement institutional audit arrangements, adoption and monitoring of prudent financial management practices in the local bodies should be institutionalized by the State Governments by legislating an appropriate law on Fiscal Responsibility for Local Bodies.
Comptroller and Auditor General of India has been requested by the Ministry of Urban Development to work out the methodologies for implementation of the same in consultation with the Ministries.

FINANCIAL CONTROL BY STATE GOVERNMENTS:

The State control over Urban Local Bodies is pervasive in the field of finance. A local government is required to keep account of receipts and expenditure, and the form in which the account is to be maintained is also prescribed by the State Government. Elaborate rules and regulations governing financial transactions have been prescribed by the government.

Borrowing by the local bodies is subject to the control of the State Government. As far as municipal finance is concerned government auditocracy reigns supreme in the administration of local bodies which tightens 'State Control over them, through the Examiner, Local Fund Accounting who is glorified as an administrator and a Financial Advisor. He or his subordinates can only judge figures but not facts 22. He audits the accounts of urban local governments, gives advice on financial matters to the government as well as to local bodies, and provides interpretation of financial rules when asked by either the state government or the local body; 23
Municipal Finance Loans

At times Municipal Councils are obliged to raise loan from State Government and other agencies to meet the emergent expenditure of capital nature, which they cannot meet from their own funds. Municipal Council with the prior permission of the State Government can only raise loan. Municipal Councils from HUDCO, LIC, WORLD BANK through Water Supply and Sewerage Boards raise finances.

It has been seen several times that loan amounts received has not been utilized properly and the requisite assets have not been created for earning the projected revenue. Hence, it resulted in a loss of revenue as liability for the payment of interest was made on the municipal bodies as the loan is to be paid within a stipulated period.

From personal discussion with the experts and other academicians it was found that both the Government and bureaucracy shun in making local bodies financially autonomous. Recently, in the 74th amendment to the constitution of India, the State Governments are to set-up the State Finance Commission to distribute resources among the local bodies. The Government of Andhra Pradesh had constituted this first Finance Commission on June 22, 1994. It submitted its report to the State on 31st May 1997, which was put up before the Assembly and its 60 to 80 percent recommendations were accepted. But the recommendations have not
been implemented so far and the State has not passed the share to the local bodies. The second State Finance Commission was constituted on December 8, 1998 and it submitted its report on August, 2002. Less than 60 per cent of its recommendations were accepted by the Government. The financial problems of the local bodies, hence still have not been solved. These bodies were hopeful that its recommendations would mitigate the earlier problems. This is still being resolved and in the mean time the government has constituted the Second Finance Commission.

**Jawaharlal Nehru National Urban Renewal Mission: (JNNURM)**

The urban local bodies would have to play a key role, being the 'most affected' institutional stakeholders and being the public authorities mandated to undertake the functions listed in the 12th Schedule of the Constitution. Hence the issue of local government finance assume critical importance. Recognizing the urban policy and finance challenges in the country, Jawaharlal Nehru National Urban Renewal Mission (JNNURM) was launched by the Prime Minister of India on December 3, 2005. The Mission encourages cities to initiate steps to bring about improvement in the existing service levels in a financially sustainable manner. The objectives of the Mission, *inter alia*, include planned development of identified cities including semi-urban areas, outgrowths and urban corridors, and improved provision of basic services to the urban poor. The admissible components under the Mission include urban renewal,
water supply and sanitation, sewerage and solid waste management, urban transport, development of heritage areas, preservation of water bodies, housing and basic amenities to the poor etc. A provision of Rs. 50,000 crore has been agreed to as Central Assistance to States under JNNURM spread over a period of seven years over 2005-12. Given that grants from the Central Government would constitute between 35 to 80 per cent of the JNURM financing plan, the Mission would entail investment in urban infrastructure and basic services over Rs.1 lakh crore. JNNURM aims at the following outcomes by ULBs at the end of the Mission period:

- Modern and transparent budgeting, accounting and financial management systems, designed and adopted for all urban services and governance functions;
- City-wide framework for planning and governance will be established and become operational;
- All urban poor people will have access to a basic level of urban services;
- Financially self sustaining agencies for urban governance and service delivery will be established through reforms to major revenue instruments;

The goal of JNNURM, however, is to upgrade urban infrastructure and to further reform the urban situation. The centrally devised program has identified over 60 Indian cities for the improvement program. Funding provision for the improvement is to
be divided according to a defined ratio for mega cities and those with more than a million plus population. This is to be 35 per cent from the national government, 15 per cent from the state and the remaining 50 per cent from financial institutions. For other cities, the formula is to be 80:10:10. However, release of funding is tied to the states and their urban local units becoming signatories to a tripartite memorandum of understanding with the national government of accepting to undertake the reforms required. The reform agenda includes core reforms, mandatory reforms and five optional reforms.

The core reforms include implementation of decentralization measures as envisaged in the 74th Constitutional Amendment, the drawing up of public-private-partnership (PPP) models for development, management and financing of urban infrastructure the adoption of an accrual based double entry system of accounting, passage of public disclosure law to facilitate quarterly performance information to all stakeholders and a community participation law to institutionalize citizen participation.

There is also the requirement for the states to transfer, over a period of five years, all special agencies that deliver civic services in urban areas and the creation of an accountability framework for all urban civic service providers during the transitional period. This is an effort, it seems, to reduce the "too many cooks in the urban
kitchen" scenario that has prevailed thus far. Its degree of success will be learned over the course of time.

Other core reforms include introduction of e-governance for property tax collections, with the goal of at least 85 per cent collection efficiency within five years and the introduction of similar practices in the case of financial accounting systems, work management, water tax billing and collection systems, the trade licensing system and the approval of building plans. Compulsory reforms to be undertaken by the states include repeal of the Urban Land Ceiling and Regulation Act, reforms to the rent control law to stimulate private investment, reduction of Stamp Duty to bring it down to no more than five per cent within the next five years and the introduction of independent regulators for urban services.26

AN OVERVIEW:

This review has shown that the form of urban local governments in India has changed over time. An appraisal of the evolution process of municipalities in India reveals that this change is due to a series of reforms initiated from time to time. In the ancient period, municipal administration was in the hands of the ruling class or the ruling government and their subordinate offices and departments. Subsequently, steps have been taken to make municipalities more and more autonomous, participatory, representative, transparent, accountable and dynamic.
The Constitution (Seventy-fourth Amendment) Act enacted by the government of India during the year 1992 is a landmark initiative in this direction. It is for the first time that a number of provisions to strengthen municipalities have been inserted in the Indian Constitution. Before the enactment of the Act, local government was a State subject and its administration was entirely left in the control of the State Legislature. Although, municipalities continue to be governed by the respective State Legislatures, it has been made mandatory for the State governments to revise their municipal laws in accordance with the recent Constitutional provisions. It is understood that municipalities in India are being, slowly empowered in various ways with the objective that they would emerge as viable units of governance at the local level and would be able to discharge their duties and powers in an efficient manner.

With the enactment of the 74th CAA, 1992, the Municipal Amendment Act, were enacted by States and the Finance Commissions were established and Furthermore, the Finance Commission Rules have been formulated. The state Governments have made strenuous efforts to raise additional resources by strengthening tax administration, effecting better recoveries from existing sources and exercising austerity measures to contain non-development expenditure. The SFC recommendations laid emphasis on sharing of taxes, levies and fees, etc. between State and local bodies and measures to improve the financial position of ULBs to
make them self reliant. Other SFC recommendations include: freezing staff strength to bring establishment expenditure to a manageable level; improve efficiency and productivity by privatizing services and mechanization of operations; creation of two apex level organizations which would provide access to institutional finance; simplification in house tax assessment procedure; need to recover user charges from beneficiaries; etc. Some SFC recommendations have not been accepted by the State Government due to financial constraints. Keeping above factors in the frame of research study, an attempt is made to study the financial aspects of Kurnool Municipal Corporation in Andhra Pradesh as a case study in the successive chapters.
REFERENCES


18. *State Finance Commission Reports and Action Taken Reports*


25. Mohanty, P.K., et. al., op.cit., p.42