A COMPARATIVE STUDY OF STATE FINANCE COMMISSIONS IN INDIA

ABSTRACT

The concept of local self-government is not new to India; it dates back to Chola period. The British rule eclipsed this system, however, the Imperial Government later on realized the necessity of local self-government in India and initiated many measures to create local bodies under various enactments. Though several committees and commissions were appointed earlier to examine the financial requirements of Urban Local Bodies and Panchayati Raj Institutions, yet they were ad hoc in character and they did not enjoy any Constitutional status. Nevertheless, several committees and commissions strongly suggested that the chronic problem of local finance could be solved only through having any scientific method of devolution of power and resources.

In this direction, the landmark political empowerment to the grassroots was through the passage of the 73rd and 74th Constitutional Amendments in the Constitution of India by the Parliament of India in 1992, made effective on April 24, 1993. Subsequently, conformity legislation was passed in the States too. It not only provided a Constitutional status to the local bodies but also laid down, without ambiguity, that legislature could by law endow them with such powers and authority that might be necessary to enable them to function as institutions of self-government. Therefore, it was a landmark year in the State-Local relations in India. Even though issue of self governance has been stated clearly by the Directive Principles of State Policy, it is only after these Amendment Acts, the panchayats and the municipal bodies were provided with wide ranging provisions to transform these local bodies into strong and viable units of "self-government".

One of the salient features of these Amendments was the appointment of a State Finance Commission (SFC) in all the States within one year from the commencement of these Acts, thereafter, for every fifth year. The basic function of the State Finance Commissions is to devise a system of distribution of the government revenues to the local bodies; define their power of taxation and responsibilities for improving the local finances and delivery of civic services.
The institution of local bodies in India failed to acquire the status and dignity of viable units of local self-government and a responsive people's body. Over the years there has been a growing realization that local bodies have failed to provide adequate services primarily on account of the woefully insufficient resources at their command. Fiscal transfers from the State, which constitute an extremely important part of the municipal revenues, depended more on an ad hoc system of grants-in-aid rather than being a predetermined share in taxes based on well-defined criteria. No set principles were laid down in matters relating to quantum of grants to the States and the share thereof, which was required to be passed on by them to the local bodies. This gapping omission in the Constitution has been corrected with the adoption of these twin Amendments to the Constitution, which have inserted two parts-IX & IX-A dealing respectively with the panchayats and the municipalities. The enactment also provides that “the legislature of the State may by law provide for the composition of the Commission, the qualifications which shall be requisite for appointment as member thereof, and the manner in which they shall be selected” and further, “the Commission shall have such powers in the performance of their functions and the Legislature of the State may, by law confer on them.”

The second chapter deals with the theories of fiscal federalism given by eminent economists like Stigler and Oates and an attempt has been made for theoretical foundations, on which basis State-Local fiscal relation should be developed.

Fiscal federalism revolves around the two questions, (i) Which level of government provides which functions, so as to avoid potential incompatibilities and destructive competitions among the government and achieve a social welfare maximum? (ii) How much people sort themselves among the various jurisdiction again with the goal of avoiding incompatibilities and intergovernmental competitions and achieving a social welfare maximum?

Stigler gave two principles of local governance and concluded that decision-making should occur at the lowest level of government consistent with the goals of allocational efficiency and distributional equity. To achieve an optimal federalist system, various legitimate functions of government are best distributed among the governments within
the fiscal hierarchy. The national government is the proper government for resolving the
distributional question in order to avoid inconsistencies and competition among
governments. Oates solidified Stigler's principle by suggesting that the optimal form of
federal government in which each level of government, possessing complete knowledge
of the tastes of its constituents and seeking to maximize their welfare, would provide the
Pereto-efficient level of output and would finance this through benefit pricing.

Those functions that supply public services to meet the varying tastes and preferences
of citizens should necessarily go to the lower-level governments. Those functions which
are not involved in such variations in requirements and preferences and which enjoy
economies of scale should go to the higher level (national/state) of government.
Whereas in practice such clear-cut demarcation is not possible and it results in spatial
spillover of benefits and costs. The national government in such case should try to
internalize them by providing financial assistance to local self-governments. This is the
economic justification for grants from higher-level governments to lower level
governments. The resources of revenue, those whose base is spatially mobile, should
necessarily go to the national government and those, which are immobile, should go to
the local governments. Benefit levies are more efficient when they are administered at
local level, as it is easier to assess the benefits and costs. The sources, which involve
redistributive role, should go to the national government on efficiency ground.

The third chapter highlights the three-tier structure of local government in the sample
States, i.e., Tamil Nadu, Uttar Pradesh and NCT of Delhi and their legislative framework.
An attempt has also been made to draw up a comparative picture concerning what
Constitutional status is given to local governments in 73rd and 74th Amendment of the
Constitution. Local governments are democratically elected bodies whose jurisdiction is
of local level, backed by powers to levy local taxes and to exercise their functions.
However, they vary substantially both geographically and demographically. Bailey (1999)
suggests some economic principles for local government's size and structure:

(i) Local government should be as small as possible without forgoing the
potential efficiency gains of economies of scale.
(ii) The jurisdictional areas of local governments should, as far as practically possible, be conterminous with the areas benefiting from their provision of services.

(iii) These benefit areas should also match financing area so as to prevent tax exporting.

(iv) Matching of financing and benefit areas may require regional (rather than local) government for the provision of some services.

(v) Benefit areas will have to be periodically reconfigured as services technologies and transport infrastructures change over time.

There are various types of local bodies and still more diversified and their groups. In the present study, a bird’s eye view of the nature and legal structural features of these different types of governments in different States is provided. But the focus is mainly on the sample States, i.e. Uttar Pradesh, Tamil Nadu and NCT of Delhi.

Tamil Nadu State government is bifurcated into Urban Local Bodies and Panchayati Raj Institutions. Urban local bodies are again trifurcated into Municipal Corporation, Municipalities and Town Panchayats. These bodies are horizontal local bodies and not controlled by any other local bodies and are independent and directly controlled by the State government only. The PRIs are also trifurcated into three-tiers of governments which are vertical in nature, village panchayat (at the grass root level), panchayat union council (at the intermediate/block level) and District panchayat (at Commissionery / District level).

The structure of Uttar Pradesh seems almost similar to Tamil Nadu except the difference is of nomenclature. State government of Uttar Pradesh is bifurcated into urban local bodies and Panchayati Raj Institutions. ULBs are trifurcated into three horizontal bodies i.e., Nagar Nigam, Nagar Palika Parishad and Nagar Panchayat. These bodies are independent and directly controlled by the State Government. The Panchayati Raj Institutions have vertical three-tiers of rural governments i.e., Gram Panchayat at the grass root level, Kshetra Panchayat at block level and Zila Parishad at the District level. Out of the total population in Uttar Pradesh, PRIs covers 80 per cent and ULBs 20 per cent.
Structure of Local Governments in Tamil Nadu

Urban Local Bodies
- Town Panchayat
- Municipality
- Municipal Corporation

Panchayati Raj Institutions
- District Panchayat: at District or Commisionary level
- Panchayat Union Council: at intermediate level
- Village Panchayat: at grassroots level

Structure of Local Governments in Uttar Pradesh

Urban Local Bodies
- Nagar Panchayat: Transitional area
- Nagar Palika Parishad: Small Urban Area
- Nagar Nigam

Panchayati Raj Institutions
- Zila Panchayat: District level
- Kshetra panchayat: intermediate level.
- Gram Panchayat: grass root level
Delhi, being a quasi-state government, having different structure of local bodies, its urban local bodies are divided into three horizontal local bodies viz. Municipal Corporation of Delhi (MCD), New Delhi Municipal Council (NDMC) and Delhi Cantonment Board (DCB). Among all the local bodies in the NCT of Delhi, only MCD conforms to the norms of the local self-government. It is a unique municipal body in the sense that the rural local bodies come under its jurisdiction. Panchayati Raj in Delhi consist of two statutory institutions and a non-statutory body, namely the gaon sabha and the gaon panchayat, which are the democratic institutions at the grassroots level, the circle panchayats, which perform primarily judicial functions and the panchayat samiti as an advisory body at the block level.

**Structure of Local Government In National Capital Territory of Delhi**

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Structure of Local Governments in NCT of Delhi

- Municipal Corporation of Delhi
- New Delhi Municipal Council
- Delhi Cantonment Board

Rural Local Bodies

- Panchayat Samiti as an advisory body at the block level
- Circle Panchayat performs jurisdictional function
- Gram Sabha and Panchayat at the grass root level
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When the structure of rural and urban local bodies in Tamil Nadu, Uttar Pradesh and NCT of Delhi is compared, the structure of Tamil Nadu and Uttar Pradesh seems almost similar except the difference in nomenclature. Delhi, on the contrary, being a quasi-state government, (formerly an union territory) does have different structure for local bodies. In Tamil Nadu and Uttar Pradesh, there are three horizontal urban local bodies and three vertical rural local bodies.

At the rural grass root level, Tamil Nadu has Village Panchayat and Uttar Pradesh has Gaon Panchayat, constituted for 5 years. Village Panchayat can be constituted in Tamil Nadu with minimum population of 500 or more. Whereas the minimum limit is 1,000 in case of Goan Panchayat of Uttar Pradesh. Village Panchayat (Tamil Nadu) is headed by the President and Pradhan in Uttar Pradesh and NCT of Delhi. Village Panchayats in Tamil Nadu have 5-15 members whereas 9-15 in Uttar Pradesh depending upon the population and these members are chosen by direct election.

Intermediate level of panchayat have different nomenclature, in Tamil Nadu it is known as Panchayat Union Council, whereas in Uttar Pradesh it is called Kshetra Panchayat and in case of Delhi it is known as Panchayat Samiti. Panchayat Samiti of Delhi is a non-statutory local body that acts as an advisory body. Panchayat Union Councils are headed by Chairman and Kshetra Panchayat by Pradhan. Town Panchayat in Tamil Nadu and Nagar Panchayat in Uttar Pradesh are in a transition stage of being converted into Urban Local Bodies from Village Panchayat, having a population limit of minimum 5,000 and 75 per cent of the male population are engaged in non-agriculture activities, and 30,000 to 1 lakhs in Uttar Pradesh. Town Panchayat (Tamil Nadu) consists of 2 persons (25 years of age or more) nominated by State Government along with MP’s, MLA’s and MLCs of State. Whereas Nagar Panchayat (Uttar Pradesh) consists of 10-24 members and ex-officio members, MP’s and MLA’s representing constituencies and 2-3 MLCs.

In Tamil Nadu, a jurisdiction having minimum population 20,000 and 75 per cent of male members engaged in non-agricultural activities qualify to be a municipality. In case of Uttar Pradesh, minimum population varies between 1-5 lakhs. Municipalities of Tamil Nadu consist of a Chairman and 20-25 Councilors out of which one Councilor is the Vice
Chairman and two members nominated by the State government. The municipality of Uttar Pradesh consists of the Chairperson and 25-55 elected, ex-officio members comprising all the MPs and MLAs representing constituencies, 3-5 MLCs nominated by the State. NDMC consists of a Chairperson nominated by the Central Government, 3 MLAs of Delhi, 5 members nominated by Central Government, 2 members nominated by Central Government in consultation with the Chief Minister of Delhi and 2 MPs. Municipal Corporation of Chennai consists of 155 elected Councilor, 10 members nominated by the State Government. Municipal Corporations of Uttar Pradesh consists of Nagar Pramukh and Sabhasads whose number varies between 60-110, MP's and MLA's of that area and the State Government nominates 5-10 members. The Municipal Corporation of Delhi consists of 10 persons nominated by the Administrator, all the MP's and the MLA's of MCD and 1/5th MLA's of the NCT of Delhi nominated by the speaker of that Legislative Assembly.

The fourth chapter throws light on principles of assignment of functions of local bodies and a comparative approach between the XI and XII Schedules with the Panchayati Raj Institutions and Urban Local Bodies of the sample States. Under the decentralized governance system, each level of government namely Central, State and Local are supposed to shoulder respective responsibilities of providing public goods to the society. Under the Constitution of India while List I enlists the functions to perform by the Central Government and State Government, Lists II provides a mixed category of services, which may be discharged by the Central and State combined and for the third tier level government the Constitution has provided Schedule XI and XII for rural and urban local bodies. These are indicative lists of functions only. The respective State Governments may assign one or all and also in addition to list, other functions also to any level of government through legislature decisions.

In terms of the theory of fiscal federalism, functions whose benefits are largely confined to geographical area and which are subject to heterogeneous preferences are suitable for the municipalities. These are the "essential municipal" functions. Services with large spill over effects, distributional and stabilization attributes and providing uniform benefits need to be entrusted to the higher levels of the government. Similarly, functions that involves substantial economies of scale or are of national interest may not be assigned to small local bodies. For valid reasons certain function of higher authorities are
appropriate for entrustment to the municipalities, as if under principal-agents contracts. These are 'agency' functions that need to be financed by intergovernmental revenues.

In conformity with the 73rd and 74th Amendment, all the States have amended their respective Panchayati Raj Acts and Municipal Acts called Conformity Acts. They enlisted the functions assigned to the different levels of their respective Panchayati Raj Institutions and Urban Local Bodies. In the present study the functions assigned to different levels of Panchayati Raj Institutions and Urban Local Bodies across the country has been discussed and it can be concluded that there are certain differences in the adoption of the functions assigned by the XI and XII Schedule of the Constitution.

It may be argued that in Tamil Nadu among ULBs of various nature the non-uniformity in adopting XII Schedule in on the functions of maintenance of roads and bridges, water supply, public health, vital statistics, regulation of slaughter houses, public and private drainage, plantation of trees and provision of public bathing. In case of Uttar Pradesh, it is on the function of Planning of Social & Economic development, fire services, poverty alleviation programme, vital statistics, plantation of trees, public bathing and provision of rest houses. In case of NCT of Delhi, both the Urban Local Bodies have adopted all the functions to perform. The function which are performed by all the local government in these three States are public amenities including street lighting, parking lots, bus stops, public conveniences and public and private latrines. It means upkeeping of the city has been recognized as the sole function to be performed by them.

In case of Panchayati Raj Institutions the assignment of functions among VPs, Panchayat Samiti and District Board are of different nature in all the States. The basic unit of Panchayati Raj Institutions remain village level of local body. Therefore it would be interesting to see that the common functions are minor irrigation, water management, maintenance of roads, culverts, bridges, ferries, waterways and means of communication, libraries & cultural activities, health and sanitation. Relief work and promotion of tourism has not been taken up by any Panchayati Raj Institutions. Among all the three States the indicative list under XI Schedule on paper has been adopted to the maximum extent by the Uttar Pradesh.
The fifth chapter has been devoted to various theories of local taxation given by Musgrave, Oates, Foster and Pelman, etc on principles of taxation in federal system and own resources generated by different local bodies. An attempt has been made to study the suggestions made by the State Finance Commissions for enhancing these resources.

For smooth functioning of local bodies they are assigned certain powers to raise resources at their own and it being in addition to what subvention they receive from higher-level governments. In this respect, appropriate expenditure, tax assignment and other revenue sharing powers for each tier of government is a crucial component.

The Constitution provides in the 7th Schedule, three lists, namely, a Union List, a State List and a Concurrent List. Out of the State List, the legislature of a State is expected by law, to endow the panchayats and municipalities, with such powers and authority, as it may consider necessary to enable them to function as institutions of self-government and such law may contain provisions for the devolution of powers upon panchayats and municipalities.

The principles to devolve taxation powers to local body should envisage the taxes over which the local governments should have full control in terms of determination of the tax rate, assessment, collection and appropriation of the proceeds. It should depend on the sustainability to meet the civic obligations, since the local governments provide many essential services. Their tax resources should be such that ensure the smooth discharge of local functions.

After going through all the taxes imposed by different local bodies in the sample States, it may be observed that there are certain differences in imposing of various taxes and non-taxes. The taxes imposed by Urban Local Bodies of Tamil Nadu, Uttar Pradesh and NCT of Delhi are not uniform, the only tax which is common is professional, trade & calling and employment tax. Whereas Property tax is the main source of revenue for all the Urban Local Bodies except Town Panchayat of Tamil Nadu in lieu of Property Tax it imposed House Tax.
In the sixth chapter, the intergovernmental fiscal transfers, theory of intergovernmental grants, and revenue sharing given by Oates and Bradford have been discussed. Structure and types of grants given to local bodies, principles recommended by the Taxation Enquiry Commission and State-wise pattern of revenue sharing and receiving of grants have also been discussed.

The statistical information covered in the chapter shows that these resources are not sufficient to meet expenditure needs of these local bodies. Therefore they have depended on inter-governmental fiscal transfers from their parent States. These transfers to bridge this gap, comes in the form of revenue sharing, statutory grants and also non-statutory grants. Apart from certain grants in certain cases, the ratio of total transfers in total revenue receipts provides a measure of dependency of these local bodies on their parent government.

In the seventh chapter a comparative analysis of recommendations made by the State Finance Commission's of the sample States, has been made. The SFCs were constituted in different States under different set of circumstances. The prevalent conditions of State-Local fiscal relations were different but the constitutional mandate required that in future these relations should become as per the provisions of the 73rd and 74th Amendment to the Constitution. In retrospection it may be observed that the three different reports of the Commissions are based on three different settings in terms of geographical location, political scenario, different stages of development of State local relation and empowerment of local bodies. Therefore the recommendations also have different hues and colours on various aspects of local government and fiscal position. The uniformity among all these reports are in terms of such subjects as setting up of finance cell at State level, need for the reform in property tax, etc.

The report recommends on Global Sharing of revenues, Grants-in-aid, Reform in resource raising, Constitution of nucleus cell, Improvement of services, Maintenance of accounts, etc.

The eighth chapter contains the main findings regarding the study and suggestions emanating from the study.
On going through the terms of references, it may be observed that the principle references are the same for all the three States but on minutely examining it may be observed that the government of Uttar Pradesh has entrusted more tasks, to its State finance commission, whereas the scope of NCT of Delhi is limited. The State of NCT of Delhi is different than other two States, as it does not have Panchayati Raj Institutions and the rural bodies are merged with MCD. There was a long pending demand of local bodies for a scientific devolution of taxes between State and local bodies. A large number of persons living in rural areas and for their welfare local bodies need financial support. Many important taxes which were collected by the local bodies, had been taken up by the State, therefore there was a fall in tax revenue to the local bodies for example Octrai duties in Uttar Pradesh collected by municipalities were abolished and in lieu of this levy of surcharge was entrusted to the trade tax department.

Though the terms of references are almost same for different State Finance Commissions but their approach for devolution of taxes and for determination of tax rate are different, may be due to the different local needs. Tamil Nadu and Delhi examined the property tax in much detail and they have also suggested a detailed scheme for levying of this tax, to achieve progress of the taxation and better compliance.

The SFC of Tamil Nadu has laid special emphasis on the measures for increasing resources for Urban Local Bodies. They have enumerated certain taxes for this purpose: to name a few these are library tax, lighting tax, surcharge from sales tax, income from minor minerals, land revenues, tax on luxuries in hotels and lodging houses, betting tax, State excise revenue, sugarcane cess, urban land tax, terminal taxes etc. It has been observed that these taxes are imposed only by Urban Local Bodies of Tamil Nadu. Taking their benefits in view, it is advised that the other States of India should also follow suit. Uniquely, only the Chennai Municipal Corporation imposes timber tax. Though it has contributed a little in the financial position of the Corporation, yet it is worth following by other Urban Local Bodies of the other States.

It has been examined from the financial positions of the Uttar Pradesh and NCT of Delhi that betterment tax, tax on transfer of immovable property, theater tax, tax on boats have been levied to raise the revenues but these have not been adopted by the Tamil Nadu. It is suggested that Tamil Nadu should not hesitate in introducing these taxes for the
betterment of the financial position. It is also recommended that these taxes should also be imposed by other States of India, wherever they do not exist.

The Uttar Pradesh Government took the initiative in introducing the trade and calling tax and toll for cleaning of private latrine and thus helped the Urban Local Bodies in raising their resources for the improvement of living conditions of their residents. It would be healthy step for other States of India to do the same if they have not as yet introduced it. Similarly NCT of Delhi levied the tax on consumption and sale of electricity and tax on buildings. It is recommended that the other States may follow this step taking into the local phenomena in view.

It has been observed that Property Tax has been imposed by Zila Parishads in Uttar Pradesh whereas Village Panchayats of Tamil Nadu have levied House Tax in its place. If feasible, this sort of tax may be introduced by other States of India also. Not only this, Panchayati Raj Institutions of Uttar Pradesh have taken bold steps by levying circumstances on property tax, land revenue, entertainment tax, sales tax, electricity tax, market fees, toll tax, sanitary fees, exhibition and fair fees, construction and management fees, fees for registration of animal, library fees, school fees, irrigation water charges, water charges and slaughter fees. It is suggested that other States should not lag behind in these respects if they have not already imposed these taxes.

The Panchayati Raj Institutions of Tamil Nadu came forward in levying local cess surcharge on land revenue, professional tax, and pilgrim tax and thus improved their lot to a great extent. It is opined that other States should take this step for their economic betterment as well.

It is for the general information that SFC of Uttar Pradesh emphasized the quality improvement of services like, street lighting, sanitation, maintenance of roads and public lamps. These recommendations would prove as beacon lights for the amelioration of lives of the peoples of the Urban Local Bodies and it is proposed that the Urban Local Bodies of other States should also incorporate these recommendations in their civic services.