Study
No. 29

Development Research Group

STRENGTHENING DECENTRALISATION - AUGMENTING THE CONSOLIDATED FUND OF THE STATES BY THE THIRTEENTH FINANCE COMMISSION: A NORMATIVE APPROACH

Abhay Pethe

B. M. Misra

Rakhe P. B.

Department of Economic Analysis and Policy
Reserve Bank of India
Mumbai

ACKNOWLEDGEMENTS

I take this opportunity to express my sincere gratitude to the Reserve Bank of India for sponsoring the Study "Strengthening Decentralisation - Augmenting the Consolidated Fund of the States by the Thirteenth Finance Commission: A Normative Approach" under the ambit of Development Research Group (DRG).

I express sincere thanks to Dr. Rakesh Mohan, Deputy Governor, who offered valuable comments on an earlier version of the Study.

Thanks are due to Dr. G. S. Bhatti, former Principal Adviser, Department of Economic Analysis and Policy (DEAP), Reserve Bank of India (RBI) who provided encouragement at the initial level. Involvement of Dr. R. K. Pattnaik, Adviser, DEAP, RBI helped in improving the quality of the Study.

Sincere thanks are also due to the RBI officers, DEAP, RBI for their suggestions at the work-in-progress seminar of the Study. The peer comments offered by Dr. Mala Lalvani deserve special mention. The help offered by the students of Bombay University in extracting the relevant data for the Study is thankfully acknowledged. Thanks are also due to the anonymous referee for suggesting constructive modification of the Study.

It was a pleasure to work with the RBI team consisting of Shri. B. M. Misra, Adviser and Kum. Rakhe. P. B., Research Officer in DEAP, RBI whose hard work and cooperation lead to the timely completion of the Study.

I express sincere thanks to Director and officials of DRG in providing the necessary support during the course of the Study.

I hope the findings of the Study would provide inputs to policy makers in designing a better scheme of transfer of funds to the third tier Government, thereby strengthening the fiscal decentralisation process in the country.

Abhay Pethe

CONTENTS

STRENGTHENING DECENTRALISATION - AUGMENTING THE CONSOLIDATED FUND OF THE STATES BY THE THIRTEENTH FINANCE COMMISSION: A NORMATIVE APPROACH

Page No.

List of Tables

List of Charts

EXECUTIVE SUMMARY

One of the terms of reference of the Thirteenth Finance Commission (ThFC) calls upon the Finance Commission to look at 'Measures needed to augment the consolidated fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State'. In view of this, the present study examines issues related to fiscal federalism at the third tier in general and grants to local bodies in particular. It is well documented in the literature that the state of finances of local bodies, both urban and rural, displays a dismal picture in India. In contrast, the finances of the Central and State Governments are on a healthier track with the implementation of the rule-based fiscal policy framework. The study opines that there is a need to fine tune the micro design of grants for local bodies (both urban and local) and their devolution across the States.

The process of devolving funds to the local bodies based on the recommendations of the State Finance Commissions (SFCs) is not working efficiently in India. The issues in this area range from timing of setting up of SFCs to attitude of the State Governments to the recommendations of the SFCs. In this context, the study urges the ThFC to provide a uniform template for the SFCs along with a time line to make progress in the area. This would help the successive Finance Commissions to use the SFC reports as inputs for their recommendations.

The study presents a normative framework to estimate the requirements of operation and maintenance (O&M) expenditure at the local body level based on three important public services *i.e.* water, education and roads. The study estimates a quantum jump in the local body grants from Rs.25,000 crore given by the Twelfth Finance Commission to Rs.94,451 crore during the award period of the ThFC. This would mean roughly 0.3 per cent of GDP per year. The study provides devolution formulae for distributing this amount among the States. The aspects considered while designing the formula are: share in O&M expenditure, fiscal capacity of the State Governments, population pressure on assets and inverse of asset density.

The study makes suggestions with regard to supplementing the resource base of the local bodies (urban and local) such as making the local bodies grants unconditional, evenly distributing the grants to local bodies over the fiscal year in a predictable manner, incentivising State Governments for setting up of data warehouses for local bodies, constitution of a pool of fiscal experts for selection of SFC members, setting up an incentive fund for assisting the local bodies to access capital market and talking to local bodies directly until decentralisation truly takes place and SFCs are well established.

STRENGTHENING DECENTRALISATION – AUGMENTING THE CONSOLIDATED FUND OF THE STATES BY THE THIRTEENTH FINANCE COMMISSION: A NORMATIVE APPROACH

Abhay Pethe, B. M. Misra and Rakhe P. B.*

If a man does not keep pace with his fellow companions;
It is perhaps because he hears a different drummer.

—— *Henri Thoreau*

I. Introduction

The Thirteenth Finance Commission (ThFC) has been set up by the Presidential order and has begun its work in the right earnest. One of the terms of reference – of interest in the context of this study – calls upon the Finance Commission to look at **'Measures needed to augment the consolidated fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State'.** In this context, the present study attempts to outline a framework which can strengthen decentralisation at the third tier of the Government in India which has a constitutional status after the 73rd and 74th constitutional amendments in 1992. The study also attempts to estimate the grants to local bodies for the operation and maintenance expenditure and details how to distribute the grants among the State Governments, while leaving the responsibility to distribute the same among the local bodies with the respective State Governments. It may be noted that as per the terms of reference of the Finance Commission, this *has* to be done on the basis of the inputs received from the State Finance Commission (SFC) reports. Thus, the study reviews the third SFC reports of few States which are publicly available to assess their usability as inputs for the recommendations of the ThFC related to the local body grants. The study also reviews the approaches of the previous Finance Commissions with regard to the local body grants to understand how the question was handled in the past. As a

* Dr. Abhay Pethe is Director & Professor at the Department of Economics, University of Mumbai. Shri. B.M. Misra is Adviser and Ms. Rakhe, P. B. is Research Officer, Department of Economic Analysis and Policy, Reserve Bank of India.

relevant aside, the study also provides a backdrop of the state of finances at the State level and at the local body level.

The study has five sections. Section II followed by introduction – by way of a preamble – sets out the parametric environment, in particular, the overall macroeconomic situation and the political scenario, which constitute the '*relevant givens*' of the system and may be of interest to the ThFC in carrying out its task. Section III briefly traces the journey thus far in terms of the state of finances of the State Governments and local bodies and also reviews the SFC reports as well as the approaches followed by earlier Finance Commissions. Section IV presents a framework for strengthening decentralisation at the third tier of Government in India, provides estimates for local body grants based on operations and maintenance requirements of three important services, *i.e.* water, education and roads and also provides a devolution formulae for distributing the local body grants among the States. Section V summarises the recommendations and concludes.

II. Preamble

The great Indian growth story and the nature of polity that currently exists in India are the two major defining factors of the parametric environment relevant to the ThFC while making its recommendations to strengthen decentralisation. The recent upswing in the economic growth, with which the economy managed to significantly break away from the 'Hindu rate', has had positive impact on the macro-level fiscal and income variables at the Centre and State levels. As a result, the affordability of the Indian economy to bring in more inclusion in all the social spheres has gone up significantly. This assumes significance in the context of the existence of an exclusionary sub-plot to the growth story. At the macro level, this sub-plot is displayed in terms of the stagnant economies of the poorer States and at the micro level by the depressing standard of living of some of the sections of population and the sluggish development of some sectors. Thus, with the new opportunities opened up by the growth momentum, this is an opportune time for the policy makers to ensure that all the policy efforts have inclusion at its soul. To make inclusion plausible, greater attention needs to be paid to the rural sector of the economy (farm and non-farm) with more focus on core services such as water, education, roads, health and power. Further, it is crucial that the economic growth, even though it is exclusionary in nature, has to be sustained. This is important for increasing the distributable resources in the economy. Thus, along with including the excluded, attention needs to be paid to the better performing States and sectors to make the policy strategy compatible with incentives.

Although India has a federal structure *albeit* not in the classical sense (see Roy, 2007), it is essentially an Union with a strong centripetal bias with the constitution ensuring an overwhelming and overriding power to the Central Government. However, over the decades the nature of polity has undergone a dramatic change from single party domination to coalitional politics. The regional parties with their local agendas have gained substantial bargaining power at the national level in this new era of coalitional politics. Or in other words, the bargaining power of the States ruled by these regional parties have gone up under the coalitional political set up. This is important in the context of decentralisation because most of the important public goods - such as education, health, water, roads – are largely provided by States and below. Thus, under the present political set up, the States are in a better position to demand more funds from the Central Government.

These political developments can bring in more progress on the front of empowerment of local bodies. This belief is supported by a couple of hazy propositions about the link between political structure and decentralisation. First, Central Government is far more pro-decentralisation (including financial devolution) than the State level Government. As far as the Central Government is concerned, the disutility arising out of sharing resources (economic and political) with others is invariant to whether the sharing takes place with one or more sub-national governments. Instead, for the State Governments it matters how much it actually devolves to lower level. Second, regional parties would – *ceterus paribus* – be more inclined to decentralisation. More specifically, political parties which derive their strength from regional agenda (which are necessarily people-touching and participatory) and generally parties that are cadre based are more positive about decentralisation. This is because the party structure continues to be prominent whether the party is in office or out of it, thus official/ elected positions do not grant sufficient powers to provide a threat to higher level functionaries (in office as well as the party). Finally, coalitional government at the central level – especially with one national and others essentially with regional identification – will augur well for an effective big push towards effective decentralisation. These are the reasons for our seemingly sanguine hope and assertion for higher level of devolution to the third tier of Government.

III. The Journey Thus Far

This section traces the journey thus far in terms of three important requisites for decentralisation such as the State finances, the Finance Commissions (State and Union) and the financial condition of local bodies. The implication of each of these to the status of and the demand on, the consolidated fund of the State is too obvious to require elaboration.

III.1 State Finances

The context here is provided by the enactment of Fiscal Responsibility and Budget Management (FRBM) Rules by the Centre and Fiscal Responsibility Legislations (FRLs) by the States (26 so far) and how to improve the State finances further keeping in view that one needs to fine tune the performance of the States. We take off from the mid-eighties when the fiscal stress on the States was rather pronounced. There has been a severe fiscal stress in respect of finances of State Governments since the mid-eighties. The fiscal stress emanated from inadequacy of receipts in meeting the expenditure requirements. The low and declining buoyancies in tax and non-tax receipts, constraints on internal resource mobilisation due to losses incurred by State Public Sector Undertakings and decelerating resource transfer from Centre contributed to worsening of State finances. Following the reform measures introduced in 1991, the State Governments adopted fiscal adjustment resulting in improvement of consolidated fiscal position of the States as reflected in the major deficit indicators for the period 1990-95 (award period of 9th Finance Commission). But the trend reversed shortly thereafter largely on account of fall in tax buoyancy, decline in transfers from the Centre, slowdown in Public Sector Undertakings' restructuring and continuation of uneconomical user charges. The implementation of award of the Central Fifth Pay Commission by the State Governments for their employees added to the fiscal deterioration. The fiscal deterioration continued up to 2003-04 (Chart 1).

In recent years, State finances have witnessed a noticeable improvement with all but two States (Sikkim and West Bengal) operating under a rule based framework in terms of FRLs enacted by them (Misra and Khundrakpam, 2008). The consolidated revenue balance of the State Governments is approaching surplus mode while the gross fiscal deficit is contained below 3 per cent of GDP (Table 1).

A crucial issue is that whether the fiscal correction during recent years has been revenue led or on account of expenditure compression/

Chart 1: Trends in Deficit Indicators

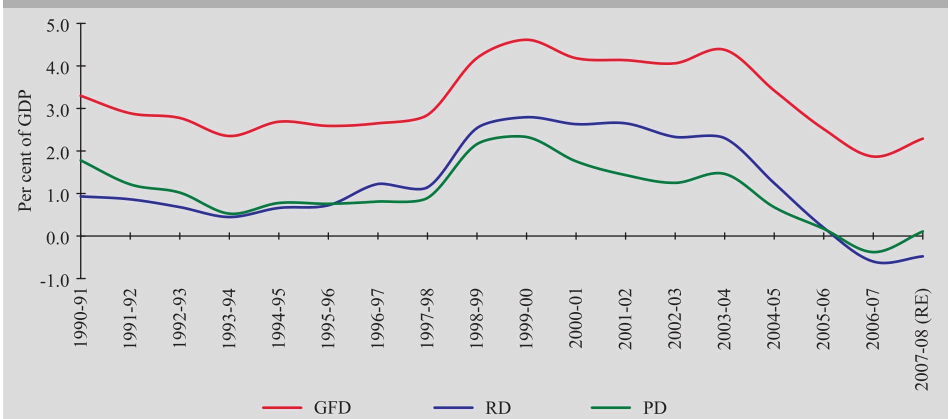

Table 1: Trends in Deficit Indicators							
							(Rs. crore)
Item	**1990-95** (Avg.)	**1995-00** (Avg.)	**2000-05** (Avg.)	**2005-06** (Accounts)	**2006-07** (Accounts)	**2007-08** (RE)	**2005-08** (Avg.)
RD	**5,330** (0.7)	**28,400** (1.7)	**55,091** (2.2)	**7,013** (0.2)	**-24,857** (-0.6)	**-22,526** (-0.5)	**-13,457** (-0.3)
GFD	**21,250** (2.8)	**54,860** (3.4)	**102,063** (4.0)	**90,084** (2.5)	**77,508** (1.9)	**107,958** (2.3)	**91,850** (2.2)
PD	**7,646** (1.1)	**23,439** (1.4)	**32,378** (1.3)	**6,060** (0.2)	**-15,672** (-0.4)	**5,081** (0.1)	**-1,510** (0.0)

RD: Revenue Deficit GFD: Gross Fiscal Deficit PD: Primary Deficit
BE: Budget Estimates RE: Revised Estimates Avg.: Average
Note: Figures in brackets are percentage to GDP.
Source: Budget Documents of State Governments.

rationalisation. On the revenue side, the States have two sources, *i.e.*, own revenue (tax and non-tax) and devolution and transfers from the Centre (share in Central taxes and grants-in-aid). The revenue receipts of the States as a ratio to GDP have moved up to about 12.8 per cent of GDP in the recent years from below 12.0 per cent of GDP in the earlier periods (Table 2). The revenue enhancement of the States has been largely facilitated by devolution and transfers from the Centre through shareable taxes and grants-in-aid based on recommendations of the Twelfth Finance Commission (TFC). Improved macroeconomic fundamentals also aided the process. The own tax revenue as a ratio to GDP also moved up, *albeit* slowly, to reach more than 6.0 per cent of GDP in recent years compared to about 5.5 per cent of GDP in earlier years largely on account of implementation of value added tax (VAT) by the States. There has been, however, decline in own non-tax revenue of the States relative to GDP.

Total expenditure of State Governments had moved up from the average level of 15.9 per cent of GDP in first half of 1990s to 17.1 per cent of GDP in first half of 2000s. The ratio has started declining in recent years primarily on account of reduction in revenue expenditure. Expenditure

Table 2: Trends in Revenue Receipts

(Rs. crore)

Item	1990-95 (Avg.)	1995-00 (Avg.)	2000-05 (Avg.)	2005-06 (Accounts)	2006-07 (Accounts)	2007-08 (RE)	2005-08 (Avg.)
RR (1 + 2)	**92,679** (12.0)	**165,416** (10.7)	**285,661** (11.2)	**431,021** (12.0)	**530,556** (12.8)	**628,742** (13.3)	**530,106** (12.7)
1. OR (a +b)	**55,546** (7.2)	**103,542** (6.7)	**178,171** (7.0)	**260,247** (7.3)	**315,812** (7.6)	**355,970** (7.6)	**310,676** (7.5)
a. OTR	41,158 (5.3)	78,733 (5.1)	141,933 (5.6)	212,307 (5.9)	252,548 (6.1)	293,392 (6.2)	252,749 (6.1)
Of which: Sales tax	24,238 (3.1)	47,317 (3.0)	86,008 (3.4)	128,769 (3.6)	153,573 (3.7)	178,198 (3.8)	153,513 (3.7)
b. ONTR	14,388 (1.8)	24,809 (1.6)	36,238 (1.4)	47,939 (1.3)	63,263 (1.5)	62,578 (1.3)	57,927 (1.4)
2. CT (a + b)	**37,133** (4.8)	**61,874** (4.0)	**107,491** (4.2)	**170,774** (4.8)	**214,744** (5.2)	**272,772** (5.8)	**219,430** (5.2)
a. SCT	19,790 (2.6)	37,608 (2.4)	61,047 (2.4)	94,024 (2.6)	120,293 (2.9)	148,134 (3.1)	120,817 (2.9)
b. Grants	17,343 (2.3)	24,267 (1.6)	46,444 (1.8)	76,750 (2.1)	94,451 (2.3)	124,638 (2.6)	98,613 (2.4)

RR: Revenue Receipts OR: Own Revenue OTR: Own Tax Revenue
CT: Current Transfers SCT: Share in Central Taxes ONTR: Own Non-Tax Revenue
BE: Budget Estimates RE: Revised Estimates Avg.: Average.

Note: Figures in brackets are percentage to GDP.

Source: Budget Documents of State Governments.

rationalisation of the States has not been easy with several non-discretionary components such as interest payments, pension and administrative services. With increase in the fiscal deficits and rise in interest cost, interest payments as a ratio to GDP went up gradually from 1.7 per cent during 1990-95 to 2.7 per cent in 2000-05. It has come down to around 2.2 per cent of GDP in recent years, primarily due to the Debt Swap Scheme (DSS) (2002-05) and Debt Consolidation and Relief Facility (DCRF) recommended by the TFC. Pension payments have moved up sharply during 2000s compared to 1990s; it, however, stabilised around 1 per cent of GDP in recent years.

There was decline in level of development expenditure of States to about 9.4 per cent of GDP during 1995-2005 from 10.7 per cent of GDP during 1990-95. Presently the ratio is hovering around 10.0 per cent. One distinguishing development is the rise in capital outlay to about 2.5 per cent of GDP in recent years from about 1.5 per cent of GDP during 1995-2005 (Table 3).

Thus, it can be seen that the fiscal situation of the States presents a healthier picture as compared to the one that presented itself at the onset of the TFC. As Karnik (2005) in one of the commentaries noted, 'We are

Table 3: Trend in Expenditure

(Rs. crore)

Item	1990-95 (Avg.)	1995-00 (Avg.)	2000-05 (Avg.)	2005-06 (Accounts)	2006-07 (Accounts)	2007-08 (RE)	2005-08 (Avg.)
Total Expenditure	**122,270**	**233,441**	**437,299**	**561,682**	**657,280**	**787,489**	**668,817**
	(15.9)	(14.9)	(17.1)	(15.7)	(15.9)	(16.7)	(16.1)
of which:							
Revenue Expenditure	**98,009**	**193,794**	**340,752**	**438,034**	**505,699**	**606,216**	**516,650**
	(12.7)	(12.4)	(13.4)	(12.2)	(12.2)	(12.9)	(12.4)
of which:							
Interest Payments	13,605	31,421	69,685	84,024	93,180	102,878	93,361
	(1.7)	(2.0)	(2.7)	(2.3)	(2.2)	(2.2)	(2.3)
Pension	4,588	13,617	30,816	40,648	46,861	56,002	47,837
	(0.6)	(0.8)	(1.2)	(1.1)	(1.1)	(1.2)	(1.2)
Administrative Services	9,172	17,525	27,718	34,298	38,964	47,694	40,319
	(1.2)	(1.1)	(1.1)	(1.0)	(0.9)	(1.0)	(1.0)
Capital Outlay	**11,893**	**21,044**	**41,656**	**77,559**	**38,964**	**128,331**	**101,318**
	(1.5)	(1.4)	(1.6)	(2.2)	(0.9)	(2.7)	(2.4)
Memo item:							
Development Expenditure	81,989	145,852	239,576	330,044	392,165	493,563	405,257
	(10.7)	(9.4)	(9.4)	(9.2)	(9.5)	(10.5)	(9.7)
Social Sector Expenditure	44,690	85,823	139,612	189,430	222,988	285,512	232,643
	(5.8)	(5.5)	(5.5)	(5.3)	(5.4)	(6.1)	(5.6)

Avg.: Average BE: Budget Estimates RE: Revised Estimates

Note: Figures in brackets are percentage to GDP.

Source: Budget Documents of State Governments.

afraid that the report of Twelfth FC, while it is critical of current situation of State finances is rather sanguine about future prospects'. Kelkar (2004) clearly believes that it is much better to concentrate on revenue raising effort with its powerful side effect of strengthening State finances which is not the consequence of expenditure cuts.

The growth dividend in the form of tax revenue buoyancy has clearly had good effect on the fiscal situation of the States. The expenditure as a ratio to GDP has, however, been stabilising. The outstanding liabilities have increased, though as a per cent to GDP, it has witnessed a declining trend during the recent years. The revenue buoyancy, reduction of compulsory borrowings from the NSSF to 80 per cent along with the Central schemes such as DSS and the DCRF helped the State Governments to keep the interest payments at about 16 per cent of revenue receipts on an average. However, the increasing trend in the rate of interest on market loans during the recent years may dim the picture in future. It may be mentioned that the introduction of VAT provided a new momentum to the revenue collection at the State level, with the help of which the State Governments are on track with the targets set out in the respective FRLs.

In this context, the implications of holding the cap of revenue deficit for expenditure on the crucial sectors such as health and education will require to be watched closely. Much ingenuity – by way of micro-design – in neutralising the negative impact on the 'good' revenue expenditure in this area will have to be exercised by the ThFC. Thus, further refinements are called for in the on-going fiscal correction and consolidation process so as to 'sensibly' impose micro-caps so that the State finances are buoyant and healthier. This will lead to augmentation of the consolidated fund of the States which will endow them with a greater capability for onward transfers to the local bodies.

III.2 Finance Commissions

The theoretical efficiency and welfare gains to be made from decentralisation are well established for some time now (see *e.g.* Tiebout, 1961 and Oates, 1972). However, one needs to be mindful of the institutional and administrative capacity constraints, *inter alia,* other factors that undermine the actual operational aspects of decentralisation (see *e.g.* Tanzi, 1996 and Prud'homme, 1995). It then follows that in countries like India that do not face serious macroeconomic crisis, decentralisation of revenues and expenditure will require the active engagement of the Central Government, both for management reasons as well as for directing concerted and coordinated efforts towards attaining national goals. The Finance Commissions derive their importance in this context. Apart from the State Governments, the spirit of 73rd and 74th Constitutional amendments required simultaneous transfer of functions as well as empowerment of the local governments. The finance, functions and functionaries have to be completely on board for the Constitutional Amendment Act to be meaningfully implemented.

Finance Commissions are a progeny of the constitution and have performed their functions so far in a manner that has earned them a reputation (especially the Central Finance Commissions) for conducting their duty with utmost integrity and not being easily swayed by the partisan political considerations. The State Finance Commissions are relatively of recent origin. They have been constitutionally mandated only about fifteen years ago and continue to be beset with problems. Their awards do not seem to attract the same respect when it comes to either acceptance or indeed implementation. In the following sub-sections we look at the issues related to the SFCs and the relevant treatment reported in the last three Central FCs since we wish to naturally consider only those constituted after the 73rd and 74th Constitutional Amendments.

III.2.1 State Finance Commissions

The SFC Reports, their awards, acceptance and implementation were reviewed with a view to judge their utility to serve as inputs to Central Finance Commission award. This is a huge area which has been widely researched (see *e.g.*, World Bank/ Geeta Sethi, 2004, India Infrastructure Report, 2003 and Shubham Chaudhary, 2007). However, the public domain knowledge about these reports continues to be woefully sparse. The SFCs have been required by the constitutional mandate as a part of the 73rd and

74th Constitutional Amendment Acts. There are only few States that have rigorously kept to a time table of setting up SFCs. The timing of setting SFCs up have also not been synchronised with the CFCs, thus, depriving CFCs of the crucial inputs as envisaged. The newly formed States are only initiating the process of setting up their first SFC (Chhattisgarh, Uttarakhand and Jharkhand). The status of the SFCs of the different State Governments is given in Appendices I(a) and I(b). Though the SFCs have mostly been set up rather mechanically, not much thought seems to have gone into the exercise in the composition of the SFCs, especially from the view point of inherent expertise.

The quality of the SFC reports in different States shows heterogeneity. Some of the SFCs have recommended revenue (tax and non-tax) (Andhra Pradesh) and sometimes only the tax measures (Assam), shares to be devolved as well as the sharing between the urban and rural local bodies. The *inter se* distribution between the different tiers is also recommended based on criteria that vary from simple and straight forward to complicated and detailed formula based formats that reflect social concerns. Some of the SFC reports have gone to the extent of working out first level demarcation in terms of advanced, ordinary and backward local bodies along with weights. Recommendations about assignments of taxes such as taxes on advertisement, profession and property have routinely been made. In addition, some SFCs have suggested newer revenue handles to the local bodies and improvement in the efficiency of the existing ones. Some have recommended (and implemented) special grants for weak PRIs as well as incentive grants for well performing ones (*e.g.*, Haryana, Punjab, Maharashtra). However, it is difficult to justify the efforts taken by the SFCs resulting in *ad-hoc*, non-formulaic and paltry grants being handed down to the local bodies.

It can be seen that some of the SFCs have taken their jobs seriously and come up with useful recommendations. However, by and large, *most of these recommendations have been rejected* and when they have been accepted in principle, the States have *dragged their feet in the matter of actual implementation* of the awards. Fewer still have actually gone through the process of acceptance and Action Taken Report (ATR) by the respective Governments and legislatures. It is surprising to note that even several years have passed after the submission of reports, States in their response to the query use phrases like ‘accepted in principle’, or ‘under active consideration’, or ‘yet to be ascertained’ (Assam, Tripura and Goa) or indeed the more drastic, ‘details are not available’ (Maharashtra). In most cases the conditional acceptance means non-acceptance of recommendations that have financial implications.

Obviously, there are exceptions wherein not only the recommendations have been accepted but actual implementation and quick releases of funds have happened (Gujarat, Haryana, Sikkim and Punjab). In a rare case, Haryana has released advance grants rather than awaiting for the report of the next FC. Several new schemes have been initiated with strides in implementation backed by financial releases is another best practice that is reported. *This shows the proactive stance of the State which should be considered a good practice especially in contrast to the generally prevalent attitude of finding excuses or shifting blame*.

In some States such as Jammu and Kashmir and Orissa, parallel bodies such as the *Halqua* Panchayats and *Pani*-panchayats, respectively are responsible for devolving funds. While they may be doing good work whether such parallel bodies are to be allowed is a moot point. Quantum of aggregate and specific schematic funds that reaches each Panchayat is as high as 20 to 30 per cent in some cases (Himachal Pradesh and Kerala). The enabling practice in some States of allowing outsourcing especially the technical matters and mandate to raise resources through borrowings is a good practice that deserves emulation. The transfer of rights for extraction of minerals whilst keeping the revenues is another good practice worth mentioning (Madhya Pradesh). The study of a few third SFC reports that are available show a natural progression. Although they continue to lament the lack of reliable data, they have come up with detailed (formulaic) recommendations (Rajasthan). Some good practices with regard to process and quantum of flow of funds are undoubtedly in evidence, but these are largely in States that have already been converted to the dharma of decentralisation. However, the role of SFCs in converting the significant majority of other States is non-existent. Thus, it is clear from the above review that the SFCs as an instrument of devolution of funds seem to have been a singular failure and there is no way that the CFC will be in a position to take the inputs from SFC recommendations.

This cannot continue and the ThFC must create a template that could be recommended to all the States. This should detail the data requirement and provide formulaic boxes that all the SFCs must use (with perhaps differing weights duly justified). As in the case of the manner of transfer of funds to the lower governments, the 'best practices' needs to be documented and other States should be encouraged to emulate. Perhaps the centripetal bias of our federation needs to be invoked to take concrete steps (including constitutional amendment) to force the issue of empowering properly constituted SFCs, who would in their turn become agents of real change.

III.2.2 Earlier Central Finance Commissions

In this section we provide a bird's eye-view of the approach followed by earlier Central Finance Commissions. We look at the Tenth, Eleventh and Twelfth Finance Commission Reports – recommendations and methodologies particularly related to strengthening of the local bodies. By and large, the treatment by the different Finance Commissions has been *ad-hoc*, however each successive FC has brought something new to the table. The constraints are fairly obvious and how to circumvent these is a major problem facing the Central Finance Commissions. The tabular form presentation that follows is self explanatory (Table 4).

Thus, whilst the successive CFCs have been trying to do their bit to put the finances of the local bodies on firmer foundation, they need help from three fronts. The States must devolve more funds, the local bodies must be enabled to raise more revenue and the SFCs must be accorded their rightful esteem so that their awards can, *inter alia*, provide useful inputs for action by the CFCs.

Table 4: Central Finance Commissions and Local Bodies

Item	Tenth Finance Commission	Eleventh Finance Commission	Twelfth Finance Commission
Terms of reference relating to local bodies	-	To make recommendations on the measures needed to augment the Consolidated Funds of the States to supplement the resources of the panchayats and the municipalities on the basis of the recommendations of the State Finance Commissions (SFCs).	To make recommendations on the measures needed to augment the Consolidated Funds of the States to supplement the resources of the panchayats and the municipalities on the basis of the recommendations of the State Finance Commissions (SFCs).
Recommendations	Recommended Rs.100 per capita for rural population as per the 1971 census for the panchayats and Rs.1,000 crore for the municipalities for the five year period covered by the finance commission.	Recommended a total grant of Rs.1,600 crore for the panchayats and Rs.400 crore for the municipalities for each of the five years starting from the financial year 2000-01.	Recommended a sum of Rs.25,000 crore for the period 2005-10 as grants-in-aid to augment the consolidated fund of the States to supplement the resources of the municipalities and the panchayats. This amount may be divided between the panchayats and the municipalities in the ratio of 80:20, *i.e.*, Rs.20,000 crore for the PRIs and Rs.5,000 crore for the municipalities.
Criteria for distribution of grant among States	The amount recommended for the urban local bodies has to be distributed amongst the States on the basis of the inter-state ratio of slum population derived from urban population figures as per 1971 census.	• Population – 40 per cent • Index of decentralisation – 20 per cent • Distance from highest per capita income – 20 per cent	• Population – 40 per cent • Geographical area – 10 per cent • Distance from highest per capita income – 20 per cent • Index of Deprivation – 10 per cent • Revenue effort – 20 per cent

Table 4: Central Finance Commissions and Local Bodies *(Concld.)*

Item	Tenth Finance Commission	Eleventh Finance Commission	Twelfth Finance Commission
		• Revenue effort – 10 per cent • Geographical area – 10 per cent	*of which* • with respect to own revenue of states – 10 per cent • with respect to GSDP – 10 per cent
Conditions	• These amounts should be additionality over and above the amounts flowing to the local bodies from State Governments. • The State Governments were required to prepare suitable schemes with detailed guidelines for the utilisation of the grants. • The local bodies should be required to provide suitable matching contributions by raising resources. • The grant is not intended for expenditure on salaries and wages.	• These amounts should be over and above the normal flow of funds to the local bodies from the States and the amounts that would flow from the implementation of SFC recommendations • The amounts indicated for maintenance of accounts and audit and for development of database, would be the first charge on the grant recommended by EFC and would be released by the concerned Ministries of the Government of India, after the arrangements suggested by EFC have become operational. The remaining amount should be utilised for maintenance of core civic services by the local bodies, on the principles indicated in the EFC report.	• Of the grants allocated for panchayats, priority should be given to expenditure on the O&M costs of water supply and sanitation. • At least 50 per cent of the grants-in-aid provided to each State for the urban local bodies should be earmarked for the scheme of solid waste management through public-private partnership. • States may assess the requirement of each local body in building data base and maintenance of accounts and earmark funds accordingly out of the total allocation recommended by TFC. • It is for the State concerned to distribute the grants recommended for the State among the local bodies including those in the excluded areas in a fair and just manner. • No conditionality over and above those recommended by TFC need to be imposed by the Central Government for releasing the grants-in-aid.

Source: Central Finance Commission Reports.

III.3 Finances of Local Bodies

It may be mentioned that during early 2000s, the local bodies revenue accounted for around 1.75 per cent of GDP with Urban Local Bodies (ULBs) accounting for about 0.75 per cent of GDP and PRIs accounting for 1.0 per cent of GDP.

III.3.1 Urban Local Bodies

The state of ULBs in India is slightly better as a whole compared to the Panchayati Raj Institutions (PRIs). Here too there is a great deal of heterogeneity with some doing rather well (especially the Municipal Corporations) whilst others smaller municipal councils increasing their dependency on the higher governments even to deliver the core local public goods and services. This is explained by the fact that the Indian economic growth in recent times has been driven by urban areas and with reforms some of the ULBs have been able to help themselves improve their situation. There have been comprehensive studies in this sphere (see Pethe and Lalvani 2005, 2006 as well as Mohanty *et al*, 2007 to mention a few) and so we shall be rather brief in our treatment here.

As per the TFC Report, India has as many as 3,723 Urban Local Bodies (ULBs), of which 109 are Municipal Corporations, 1432 are Municipalities and 2182 are Nagar Panchayats. The major sources of revenues of the urban local bodies include taxes on property, profession, vehicles, advertisement, lighting, pilgrim, entertainment, *etc*. Presently, property tax at the municipal level is not tapped to the full extent. However, it may be noted that property tax is a promising revenue source for the urban local bodies considering the expansion of cities with accelerating house construction and increasing project value. It can be made a more buoyant revenue source in future by switching over to the capital-value based system from the existing ratable-value system (Pethe, *et.al.*, 2004). The total revenue of the ULBs rose from Rs.11,515 crore in 1998-99 to Rs.15,149 crore in 2001-02 accounting for about 0.75 per cent of GDP of the country. Municipal revenue forms a small proportion of the State, Central and Combined State and Central Government revenues. It has marginally declined during 1999-2000 and 2001-2002 (Table 5).

Table 5: Revenue Significance of Municipal Sector					
Year	**Total Municipal Revenue** (Rs. crore)	**Percentage of GDP**	**Relative share of Total Municipal Revenue** (as per cent of Total Revenue of)		
			State Govt.	**Central Govt.**	**Combined State & Central**
1990-91	3,931	0.73	5.91	7.15	3.71
1998-99	11,515	0.73	4.38	5.84	2.50
1999-00	13,173	0.75	4.24	4.42	2.46
2000-01	14,581	0.77	4.17	4.48	2.43
2001-02	15,149	0.73	4.05	4.18	2.33

Source: (i) Reports of Eleventh and Twelfth Finance Commission
(ii) Economic Survey, GoI, 2004-05.

It is important to analyse the trends in finances of the ULBs in the recent past. On revenue side, own revenue of the ULBs constitutes 60 per cent of total revenue receipts, and, on expenditure side, revenue expenditure constitutes 75 per cent of total expenditure. The relative share of own revenue *vis-à-vis* other revenue declined by about 2 percentage points during 1998-99 to 2001-02, thus increasing the level of dependency of local bodies on State Governments. During this period, the share of capital expenditure has been less than one-fourth of the total expenditure with a declining trend. However, there is one healthy trend. Municipal bodies as a whole are in revenue surplus, *i.e.*, revenue receipts are exceeding revenue expenditure (Table 6).

It may be noted that whereas the state of fiscal health of large Municipal Corporations is reasonable, the smaller urban local bodies are generally in a bad shape. They are not too differently placed as compared to some of the PRIs and need the same kind of succor if they have to be strengthened and allowed to stand on their own feet so that they may provide local public goods and services efficiently and effectively given the number of services they are mandated to deliver (Appendix II).

In sum, we may say that the financial position of many of the urban local bodies is far from good. However recognising this does not take us far, except to say that 'more ought to be devolved'. The point is that in

Table 6: Revenue and Expenditure of ULBs in India

(Rs. crore)

Item	1998-99	1999-00	2000-01	2001-02
Revenue				
Total Revenue (i+ii)	11514.63	13172.96	14581.05	15149.20
(i) Own Revenue (a+b)	6873.42	7379.85	8260.52	8760.16
Share of Own Revenue in Total Revenue (per cent)	59.69	56.02	56.65	57.83
(a) Tax Revenue	4755.52	5151.01	5617.57	5885.81
(b) Non-Tax Revenue	2117.90	2228.84	2642.95	2874.35
(ii) Other Revenue (a+b+c)	4641.21	5793.11	6320.53	6389.04
Share Other Revenue in Total Revenue (per cent)	40.31	43.98	43.35	42.17
(a) Assignment & Devolution	2208.32	2646.60	2981.84	2744.63
(b) Grants-in-Aid	1807.86	2251.21	2239.24	2671.65
(c) Others	625.03	895.30	1099.45	972.76
Expenditure				
Total Expenditure (i+ii)	12034.94	14451.66	15743.05	15914.29
(i) Revenue Expenditure	9059.47	10690.30	11665.88	12204.78
Share of Revenue Expenditure in Total Expenditure (per cent)	75.28	73.97	74.10	76.69
(ii) Capital Expenditure	2975.47	3761.36	4077.17	3709.51
Share of Capital Expenditure in Total Expenditure (per cent)	24.72	26.03	25.90	23.31

Source: Report of the Twelfth Finance Commission.

relative terms, some of the local bodies (urban and rural) are reasonable enough so that we could exploit this fact to enable them, to singly or collectively access financial markets. This alone will help them garner the tremendous amount of resources they require for financing their infrastructure requirements.

III.3.2 Panchayat Raj Institutions (PRIs)

Panchayat Raj Institutions are large in number distributed across the country. There are 2,43,685 PRIs in India of which 2,36,350 are Gram/ Village Panchayats (including Village Councils & Boards), 6,795 are Panchayat Samities, 531 are Zilla Panchayats and 9 are Autonomous District Councils (Report of TFC, 2004).

As per the Eleventh Schedule of the Constitution of India, agriculture including agriculture extension, animal husbandry, minor irrigation, land reforms, fisheries, rural housing, drinking water, rural roads, rural electrification and primary and secondary school education are some of the important functions of the PRIs (Appendix III). The major sources of the revenue of the PRIs constitute profession tax, entertainment tax, taxes on residential buildings and property, tolls on roads, advertisement tax, *etc*. It is well documented in the literature that the state of finances of the PRIs portrays a dismal picture in India[1] (Oommen, 2005, Agarwal (2005), Goel and Rajneesh (2003), Rao and Rao (2008).

It may be noted that most of the tax revenue sources assigned to the panchayat raj institutions have very low tax bases coupled with low buoyancies. A recent study by Pethe and Lalvani (2008) documents that a decade after the path breaking Constitutional Amendment Acts, own revenues (per capita) still form a mere 9 per cent of the total expenditure (per capita) of the PRIs. The revenue receipts of panchayat raj institutions are given in Table 7 and the per capita revenue and expenditure of the PRIs (15 major States) are given in Table 8.

Table 7: Revenue Significance of Panchayat Raj Institutions

(Rs. crore)

Year	Total Panchayat Revenue	Percentage of GDP	Relative share of Total Panchayat Revenue (as per cent of Total Revenue of):		
			State Govt.	Central Govt.	Combined State & Central
1998-99	17,296	0.99	10.0	11.6	6.0
1999-00	22,264	1.14	11.0	12.3	6.5
2000-01	23,244	1.11	10.0	12.1	6.1
2001-02	22,470	0.99	9.0	11.2	5.6
2002-03	24,011	0.98	8.8	10.4	5.3

Source: Report of the Twelfth Finance Commission.

[1] Data on rural local bodies in the various States are available from the CFCs both 11th and 12th FCs. However, this data set needs to be used cautiously. A few studies (Govinda Rao, 2007 and Oommen, 2005) have drawn attention to several examples to explain why they find the data set to be suspect.

Table 8: Key Indicators of Panchayat Raj Institutions (15 Major States)
(in Per Capita Terms)

(Amount in Rupees)

Year	Own Tax Revenue	Own Revenue	Total Revenue	Total Exp	GSDPP (current)	GSDPPR (93/94 prices)	Grants
1993-94	3.13	9.21	160.91	158.51	4466.66	4573.31	N.A.
1994-95	3.75	10.87	178.42	167.69	5190.48	4797.91	N.A.
1995-96	4.18	11.80	203.46	202.32	5550.55	4681.05	N.A.
1996-97	4.79	12.62	247.66	238.88	6390.17	4986.09	N.A.
1997-98	5.25	13.87	302.75	295.42	6724.35	4846.38	N.A.
Average (1993-94 to 1997-98)	**4.22**	**11.67**	**218.64**	**212.56**	**5664.44**	**4776.94**	
1998-99	15.28	28.11	306.70	318.79	7459.26	4975.00	166.03
1999-00	15.86	31.62	382.41	373.07	7674.06	4881.51	212.70
2000-01	17.66	33.06	403.51	404.27	8438.17	4830.20	220.82
2001-02	18.87	32.90	380.37	394.55	8627.50	5035.47	211.23
2002-03	20.60	37.07	405.27	399.70	8617.37	4665.48	223.07
Average (1998-99 to 2002-03)	**17.65**	**32.55**	**375.65**	**378.08**	**8163.27**	**4877.53**	**206.77**

N.A.: Not Available.

Note: *GSDPP*: GSDP from Primary Sector; *GSDPPR*: GSDP from Primary Sector at constant 93/94 prices

States= Andhra Pradesh, Assam, Bihar, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal

Source: Pethe and Lalvani, 2008.

The study by Pethe and Lalvani (2008) also opined that the average PRI own revenues are below 1 per cent of the States' own revenue for fifteen major states and PRIs depend on upper tiers to the extent of 77.0 per cent. Thus the broad story that emerges is clear – despite the much spoken about decentralisation *de facto* fiscal empowerment of rural local bodies has moved at snails' pace. Further, it may be noted that the shares allocated to various States by the TFC from the funds set aside for PRIs does not seem to be in consonance with the incremental performance of these States in the arena of fiscal decentralisation (Pethe and Lalvani, 2008). The classification of States as per fiscal decentralisation and buoyancy is given in Table 9. Only five States appear in the 'good' category both in terms of their ranks in fiscal decentralisation and buoyancy.

Thus, the key indicators suggest that while there has been some progress in terms of increase in own sources of revenue, it has been very slow and the PRIs continue to depend heavily on the upper tiers of government for their expenditure. *It is also seen that the good behavior on the part of the States yield benefits in terms of improved buoyancy and hence a reduction in the fiscal stress on the States.* ***This further implies that decentralisation is an advantageous virtue.***

IV. Core: What can the Thirteenth Finance Commission do?

We recommend a bouquet approach for the empowerment of local bodies through enablement, transfers encompassing incentive structure and loan/ bond exposure (pooled finance enablement). We are of the view that as far as the local body grant is concerned, the ThFC may concentrate on the operations and maintenance (O&M) requirements of the local bodies which is a major

Table 9: The Good and Not Good Matrix

		FISCAL DECENTRALISATION GRAND RANK	
		GOOD	***NOT GOOD***
BUOYANCY RANK	***GOOD***	**(I)** Kerala M.P. Karnataka Goa Maharashtra	**(II)** Assam Tamil Nadu Punjab
	NOT GOOD	**(III)** Andhra P. Gujarat	**(IV)** Haryana Orissa West Bengal Rajasthan UP

Source: Pethe and Lalvani, 2008.

fiscal lacuna at the local body level. In the present study, we have concentrated on the O&M requirements of the local bodies on water, education and roads, mainly due to data and other constraints. The ThFC may consider expanding the coverage by including other relevant sectors. The ThFC may suggest a uniform template for the SFCs so that their reports can be used by the successive Finance Commissions, may incentivise the States to develop data warehouses for the local bodies and may also incentivise the local bodies to access the capital market as a group.

IV.1 Strengthening Decentralisation – Some Qualitative Suggestions

In principle, decentralisation was seen to be unanimously acceptable, yet at the real ground level the States have not decentralised in the true sense. Local bodies have been treated as 'creatures' of the States rather than as those of the constitution. Hence the States having devolved the functions, have shied away from devolving either the requisite resources in a predictable and certain manner or indeed enabled the local governments (especially in case of urban bodies) by vesting them with sufficient legislative powers to raise resources. The 73rd and 74th amendment do not go far enough to bring in the decentralisation in its full sense owing to the discretion with the State Governments that they 'may' rather than 'shall' transfer the resources to the local Government level. In this context, the work of Ministries such as Ministry of Panchayat Raj (MoPR) in trying to transfer the resources directly through treasury and banks is note-worthy. Further, it may also be noted that the local bodies have also by and large not fully exploited the potential possibilities to help their cause.

The CFC can strengthen decentralisation in two ways. First, incentivise the States to decentralise more through its recommendations. This can be done by including a 'measure of decentralisation' in the *inter se* devolution formula for statutory tax transfers so that States that are decentralising would receive a reward and nudge others to follow suit. The States may decentralise more on two accounts (i) by transferring more resources to the local governments and (ii) by handing over more revenue handles to the local Government. In this context, we wish to suggest a two pronged approach. First, the obligatory tax handles have to be seriously implemented along with the floor rates prescribed in a mandatory manner. For example the issue of property tax for ULBs and the issues of agricultural levies for PRIs, as suggested by Rajaraman (2007) amongst others, will have to be faced. There are two things to be mentioned here. One, that some of the 'local taxes' that collected by the State need to be fully transmitted to the local bodies and two, exploitation of such taxes as land revenues, and property taxes must be made mandatory with specified 'floors'. Proper design of incentives for such effort is necessary (with implication for design of ***statutory*** transfers) and will help expand the fiscal base of the local bodies so that the trade-off between efficiency and equity is carefully worked out. It may be emphasised that the study do not advocate use of incentive grant for effort by the local bodies or indeed for decentralisation just yet when it comes to devolution to local bodies. Apart from granting greater taxation powers to the local bodies, in any case, newer revenue handles will have to be innovatively unearthed; this is especially important because the GST regime might take away some of the existing ones (see Rao and Rao, 2008). Many times the argument is advanced that the requirements are so huge that clearly such efforts will not help solve the problem. This is true, *however what is not recognised is that such efforts help create a far healthier balance sheet for the local bodies. In their turn the local bodies can present a decent rating and a viable borrowing-risk that is acceptable to the Financial Institutions. The financial institutions can hence be approached for underwriting or taking exposure, and this is the second prong of our suggestion".*

The idea can be extended to creation of virtual entities formed by considering different local bodies. The entire set of local bodies will have to be classified into different classes according to economic criteria and strengths and then schemes can be worked out for 'cross-overs' that will allow even the weaker local bodies to access credit. ***Such a scheme has been proposed by Pethe and Lalvani (2006) in the case of Urban Local Bodies. Indeed, we would suggest the coming together of some PRIs with their urban counter parts too.*** There is something to be said for a ‘regional’ approach in these matters (see Pethe and Lalvani, 2007), for example consider the case of Mumbai Metropolitan Region (MMR) which is being looked at for Mumbai Transformation Project. It has been noted that the thoughtless legitimisation of the artificial dichotomy between urban and rural bodies has done more harm than good (see Jha and Mathur, 1999). ***This implies that we should be looking at the entire space as one integrated continuum dotted with local bodies***.

In this context, we suggest the setting up of an incentive fund by the ThFC, which can be used for data compilation and accounting reforms but most importantly as seed money for projects which will access financial markets. ***The minimum amount per project could be 5 per cent of the project cost thus creating a leveraging effect which is almost 20 times over***. The total amount of the incentive fund could be about 6 per cent of total devolution to local bodies and should be devolved across States on the basis of properly weighted variables such as population, area, number of local bodies (rural/ urban with types *i.e.*, Corporations, A, B, C types appropriately weighted) *etc*. Thus, anticipating what comes later in the study, the total amount of the incentive fund will be about 5.5 to 6 thousand crore[2]. This fund should be used for project feasibility or consultancy as well as underwriting and such other costs but overwhelming proportion should be used as seed capital for the project. ***The most important condition that we would recommend is that this must be a project that is undertaken by more than one local body and must have at least one ‘weak’ local body, including a PRI. Thus, our suggestion should incentivise inclusive regional approach and break down of the artificial ‘urban rural’ dichotomy***[3]***.*** The stronger local bodies will have an incentive to work at spatial fringes (where typically the service delivery is below average) and come together with weaker local bodies (urban or rural) thereby unwittingly

[2] The total money kept aside for local bodies will be to the tune of 1 lakh crore implying a fourfold increase in devolution.

[3] The Government of India launched a Pooled Finance Development Scheme in November 2006 to assist ULBs to access market borrowings. Similar scheme may be extended to all local bodies including PRIs as well.

serving the tenet of inclusive development mandate. ***The incentive fund(not to be confused as incentive for doing things right – although that may well be the case with the local bodies who can benefit from this – is to be explicitly used as a leveraging fund (since FC cannot involve itself with in 'capital' expenditure). It is documented in the literature that those states that have decentralised more have shown significantly greater revenue buoyancies for their local bodies. This is a clear incentive for the states to decentralise (whether through increasing revenue handles or assignments). As far as the access to financial markets by group is concerned, the incentives for all the parties are reasonably clear. All that remains is for some side(s) to take the first step. I do not think that one should stop at saying that this is not done! If there is something in the rules we could change them to enable.***

The second way to strengthen decentralisation is to effectively transfer funds to the local bodies that represent a quantum jump from the past and hence increase the local government size. There have always been doubts regarding the absorptive capacity as well as the governance at the local level while transferring large scale resources to the local level. However, there is good argument in favour of just devolving funds with faith, that the capacity will be created. Thus, while recognising the need and the efforts that are required to be taken for capacity building, it is not necessary to treat it as an essential prerequisite for transferring resources to the local level. This would require well funded institution building and it will be worth looking into the financing of it.

In the context of resource transfers from the CFC to the local bodies, the CFC should ensure that the amount of transfers to the local bodies is not decided on an *ad hoc* basis rather it is estimated based on the needs and capacities of the local governments in a normative sense. It is important that the CFC should make the local body grants unconditional, *i.e.*, it should not demand matching contributions from the State Governments or local bodies. It is observed that the Central Government releases a substantial part of the share in Central taxes in the last month of the fiscal year, *i.e.*, March. This makes it difficult for the State Governments to plan their expenditure. In the case of grants to local bodies, the CFC should ensure that the release of the grant is evenly distributed over the fiscal year. Further, after releasing resources to the State Governments, the CFC has to ensure that the State Governments are transferring these grants promptly and efficiently to the third tier of the Government. This is a matter of efficient processes and institutional practices and requires clear and well formulated recommendations by the SFCs, that are formed with good sense and responsibility and whose awards are – as a rule – accepted and implemented. In this context, the creation of a uniform template for SFCs assumes significance.

Though the setting up of the SFCs is constitutionally mandated, most of the State Governments are setting up SFCs in a casual manner not necessarily keeping in mind the skill sets required to do a competent job. Similarly, the State Governments are not taking the SFC awards seriously and sometimes treat them with hostility. *Thus, to repeat, the non-synchronic setting up of SFCs (even when they are set up) and non-uniform treatment by different State Governments has meant that they are not useful as providers of inputs to the Central Finance Commissions.* It is in this context, the present study opines that the CFC may attempt to suggest a uniform template for the SFCs.

The CFC may include the following aspects in SFC template (Table 10).

The specification of the year of setting up the SFC and its uniform award period are very important in the context of CFC. The report of the SFCs should contain a chapter on what percentage of the requirement of the local bodies CFC should bear and augment the consolidated fund of the State Governments accordingly. While projecting the requirements of the local bodies on a normative basis, the major hurdle faced by the SFCs is the lack of adequate and reliable data on various parameters at the local body level. Thus, *the State Governments may set up data warehouses on local finances by using the resources and expertise of Universities/ Research Institutes/State Governments. Since O&M expenditure is the primary concern of the SFCs, it would be ideal if the data warehouse*

Table 10: The Outline of a Model SFC Template	
Item	**Template**
Time of setting up of SFC	At least two years before the setting up of the Fourteenth FC – 2011
Number of SFC members	Same as in CFC
Qualifications of the members	As applicable to CFC
Award period of the SFC	2015-16 to 2019-20
Duration of SFC	One and a half years, extendable up to 2 years
Transfers	Share in State's Taxes and Grants-in-aid
Requirement of local bodies	Based on normative assessment
Distribution of transfers	Based on devolution formula
Components of devolution formula	1. Economic backwardness 2. Social backwardness 3. Rural urban divide 4. Needs on a normative basis 5. Efforts of the local bodies 6. Quality of service delivery
Method of distribution of funds	First to the district and then to the local bodies within the district
Central Finance Commission	Detailed discussion on how much the CFC should augment the consolidated fund of the State for transferring the required amount to the local government level

attempts to prepare an asset map, public and private separately, for each local body.

The lack of authentic data base also poses challenges for distributing the vertically decided amount among the local Governments[4] . In this context,

[4] There are several methods in existence for formulating an approach towards devolution of funds to Local Bodies. Some of these have, at least, a partially theoretical basis, while some others are purely *ad-hoc* (informed by political and such other exigencies). Pethe, Karnik and Karmarkar, 2006 developed a methodology, which comprises of five cardinal principles or '*Panchtatva*', abbreviated as **PEACE**. PEACE stands for (a) **P**olitical Feasibility (b) **E**quity (c) **A**dequacy (d) **C**omputational Transparency and (e) **E**fficiency. In a study for the UNDP/UNCHS (2002) the authors have worked out the devolution of funds for all the ULBs in Maharashtra.

it may be noted that most of the detailed information, such as distance from highest income, index of backwardness, *etc.* is available at the district level, which is the largest geographical entity inside a State. As far as the local bodies are concerned, with some effort, financial data and information on their population and area should be available. Given the difficulty involved in reconciling the characteristics at the district level and those at the local government level we suggest a two-stage strategy for the devolution of funds:

- **Stage 1**: Use some specially selected criteria in combination with estimated shares for each district to arrive at the disbursement to each district.
- **Stage 2**: Having obtained the disbursement for each district, develop a method for distribution of funds to each local body.

Regarding the devolution formula for distributing the transfers to the local bodies[5], the CFC may outline some major components such as economic backwardness, social backwardness, effort of the local bodies, needs of the local bodies, *etc*. while leaving the freedom to select the specific indicators in each category with the respective SFCs. To illustrate, economic backwardness can be quantified in a number of ways such as distance from the highest per capita income, per cent of agricultural income to the total income, per cent of population below poverty line, *etc*. The SFCs can select appropriate indicator in each category depending upon the regional specificities and data availability. Similarly, the CFC should leave the freedom to attach weight to each criterion with the SFCs, which the SFC would be in a better position to do owing to its closeness to the State-specific issues.

Further, with regard to the normative assessment, the CFC may provide some broad guidelines in the template. To illustrate, the CFC may suggest

[5] The formulae must be credible and compatible to incentives. The weights in the formulae used for devolution must be seen to be fair. Pethe and Lalvani (2005) suggested a scheme called 'FAIR PLAN' approach. The conceptual framework of this approach comprises eight cardinal principles. Each of the alphabets in the acronym 'FAIR PLAN' stands for: Fairness, Adequacy, Incentive Compatibility, Responsiveness, Political Feasibility, Level Playing Field, Accountability and Need Based.

a general approach on how to assess the needs on a normative basis in the following lines: Proportion of norms achieved by the local body with regard to the assets identified. For each of the spheres there are underlying norms in terms of area/population *etc*. The extent of achievement gap clearly indicates how much more needs to be done. Based on this, the SFCs will be able to estimate the required expenditure for the development of the region in various sectors. The SFCs may calculate the expenditure gap by comparing the estimated required expenditure with the actual expenditure. Further, by calculating the ratio of actual expenditure to the required expenditure, the SFCs may calculate the effort of the local bodies in each of the spheres.

It is reported that lack of competent people to accomplish the SFC job efficiently is a problem faced by the State Governments. **In view of this, the Central Government may set up a pool of fiscal experts with adequate regional representation. The State Governments, while setting up the SFC may select at least one member of the SFC from this central pool.** Further, the Central Government may consider extending some technical guidance to the SFC members of all States. The Central Government may request the help of previous CFC members for this.

We feel that just providing the uniform template may not help much in the matter. Thus, it would be better if the CFC can put forward a time line of events linked to the release of FC transfers from the Central Government. A model timeline is provided in Table 11.

Table 11: Time line for the Release of Share in Central Taxes

Release of Share in Central Taxes	**Time line**
For the year 2010-11	After setting up the SFC
For the year 2012-13	After getting the report of SFC
For the year 2013-14	After getting the accepted recommendations
For the year 2014-15	After getting the action taken report

The FC grants should not be linked to the progress made in the area of SFCs, because these grants are mostly directed towards specific sectors and States who are backward in respect of those sectors. We feel that the development of these sectors or States should not be adversely affected by the condition of SFC. On the other hand, share in Central taxes is a right of the State Governments. Under normal circumstances fiscal federalism does not prefer conditions for the release of these amounts to the State Governments. However, it should also be remembered that under fiscal federalism the local governments should also enjoy the same right to receive funds from the higher levels of Government. If the State Governments are denying this right of the local Governments by not transferring enough resources to them, the Central Government can step in with some conditions on the release of transfers to the State Governments in the interest of fiscal federalism at the third tier. If the State Governments are following the time line indicated in Table 10, in 2013 the Fourteenth Finance Commission will be in a position to use the SFC reports as inputs for their recommendations. This can give a great fillip to the fiscal decentralisation at the third tier of the Government in India.

Till such time as the decentralisation truly takes root and SFCs are established and recognised, the CFC may think of talking directly to the local bodies (at the district level) and may try to directly transfer funds to them.

IV.2 Grants to the Local Bodies – the Estimation and the Devolution Formula

Why Operation and Maintenance

Operations and maintenance (O&M) expenditure are recognised as crucial recurrent outlays necessary to optimally sustain a project or program. In addition to macro-economic consequences there are beneficial social welfare effects attached to them. These are in terms of better delivery of services and indirectly through labour intensive maintenance leading to greater employment. However, the political preference is not for O&M which is the first casualty in face of scarcity of resources. This is myopic and reflects an inadequate understanding of costly down stream effects of neglecting the efficient maintenance. Failure to provide adequate O&M has consequences for the returns on public investments and the ramifications are confined not only locally but also at the level of macro-economy, in terms of growth and employment. Thus, it is essential that routine, periodic and renewal or rehabilitation components of maintenance are treated in an integral fashion so as to maximise benefits. As an aside, and by way of an illustrative example, we may mention that even in a leading and progressive state like Maharashtra, there are 50,000 assets related to 'water project' in a state of disrepair and disuse. It is claimed that this is so for want of funds. There is a talk about 'handing over the ownership' of local assets created through various schemes to the local bodies to ensure better O&M as well as accountable delivery (Mujumdar, 2007).

It is in this context it is proposd that the ***single external locus of O&M be vested with the Central Finance Commission***. This is not to exempt the responsibility of the other authorities (State Government for example) of properly budgeting O&M costs in its project and program formulation but given the strain on their resources for some time at least it is unrealistic to expect them to shoulder the entire responsibility. Our position is further refined – in the current context – to cover not only the projects that are small and strictly local public goods, but also within that to those related to water, education and roads in a well defined and delimited fashion.

When one is talking about the O&M expenditure, it is important to recognise that inequality of stocks should not be a consideration. For rectification of such inequalities there are other avenues. Thus, O&M expenditures are not equalising in this sense (as they *ought not* to be). Indeed misallocation of resources (*i.e.* funds flowing without commensurate stocks that are to be maintained) will lead to either diversion of resources or inefficient utilisation of the same. It would be a simple matter to gauge the relative valuation of the relevant assets and use it for determining the fund flow using this criterion with the condition that these be used for precisely the purpose of O&M of water, education and road assets.

Why Water, Education and Roads

As far as water is concerned it is the life line of civilisations, it is said that the next world war will be fought about water. It is important to combine all the assets created via schemes that look at the consumption (drinking/conservation/wells) as well as the investment (minor irrigation schemes/harvesting) aspects and play them through the instrumentality of local bodies. The water programmes are not functioning properly especially the ones with respect to minor irrigation. Indeed the technical committee on water shed development has opined that given the estimate of about Rs.1,50,000 crore and the actual devolution is woefully short, there is a good case for combining all related centrally sponsored schemes. It has been noted that such programs alone will be the saviors of agriculture in rain fed regions. Of course, in case of drought prone areas there would have to be a different approach. **There is evidence to show that the political empowerment of women have also thrown up such schemes as perceived priorities so that acceptability will not be an issue** (for all assertions made above see, India Infrastructure Reports especially 2007 dealing with Rural Infrastructure, also see Annual Report of RDD, GoI 2007, Shubham Chaudhary, 2007 and N.A. Mujumdar, 2007).

Education as a *constituent* of development – rather than an instrument – needs no argument, especially post Amartya Sen's Development as Freedom (Sen, 1999). But its delivery through various schemes (notably Sarva Shiksha Abhiyan) as now designed is unsatisfactory. Whilst we have – because of constraints of data – considered only Primary and Secondary level education, the vocational component needs to be considered too. The externality of such reorganisation will be that the utilisation/service delivery – via accountability – will improve and through impetus to the rural hubs initiative, livelihoods will be created, which alone is the surest way of empowerment.

The road connectivity leads to remarkable impact on the lives of the rural folk, as has been amply documented. As Narayan *et al* have pointed out (See, India Infrastructure Report 2007), the prevailing conditions make it difficult for people to get their goods to the market or for people to get to their place of work or indeed to access health in emergency and generally to access public services.

Here one ought to emphasise that there are two elements *viz*., health and power that we have left out that are generally recognised as important. The reason is that whilst some elements (extension) can be incorporated, prioritisation requires that things be kept at manageable levels and also that there are indications (from experience elsewhere) that given the skill demands of both these sectors and the prevailing situation these are not sectors that lend themselves to easy and successful decentralisation. Before we get on with the job of estimation of O&M and hence devolution to local bodies, we may enter a caveat. The data and the norms are not completely satisfactory. ***It is clear that once the SFCs perform their task properly will this problem be settled meaningfully. The question is that in the absence of such an event and in the interim what is to be done. Making use of some of the well known studies/sources we have given thumb-rule norms (that could well be refined).***

Estimation of Grants to Local Bodies

In the present study, analysis is confined to the computation of local body grants and State-wise shares in the total local body grants, without segregating urban and rural local bodies, owing to the data and time constraints. As already mentioned, we have concentrated on the operation and maintenance expenditure on water, education and roads. We have considered wells and minor irrigation projects in the area of water, primary and secondary schools in education and municipal and surfaced and un-surfaced village/ZP roads in the case of roads[6] . The O&M expenditure norms in rupees terms used in the present study for the different types of assets are given in Table 12.

[6] We have collated the state-wise data on these assets from the website indiastat.com. The limitations of the data are detailed in Appendix IV. The raw data on all the assets used in the present study are also provided in Appendix IV.

Table 12: O&M Expenditure norms for Assets		
Asset	**O&M Expenditure Norm**	**Source**
Wells	Rs.2,000/year/well	10 % of the amount needed for the minor irrigation
Minor irrigation	Rs.20,000/year/ minor irrigation	5 % of the total cost of minor irrigation*
Primary schools	Rs.5,000/teacher/month	Education Budget Allocation and National Education Goals: Implications for Teacher Salary Level by Pankaj. S. Jain, 2006
Secondary schools	Rs.6,000/teacher/month	10 % more than the primary school
Surfaced road	Rs.20,000/km/year	India Infrastructure Report, 2007
Un-surfaced road	Rs.2,000/km/year	10 % of the expenses for surfaced road

*The maximum limit for setting up a minor irrigation project is Rs.400000.

Based on these information, we have estimated the O&M expenditure requirement of the local bodies at Rs.1,88,902 crore for the period 2010-11 to 2014-2015[7]. It may be recalled that the TFC had recommended Rs.25,000 crore (0.7 per cent of GDP for the year 2005-06) as grants to local bodies. If the ThFC wants to retain the ratio of local body grants to GDP at 0.7 per cent, it would have to increase the local body grants to Rs.47,880 crore. However, given the pathetic fiscal position of local bodies, the urgent need for maintaining the public assets and the problems associated with the SFCs and their recommendations, an increase in the ratio of local body grants to GDP from 0.7 per cent to at least 1.4 per cent seems legitimate. Further, as already mentioned, the size of local government in India (1.75 per cent of GDP) is far below the international standards. Thus, apart from enabling the local bodies to raise more revenues on their own, there is an urgent need to increase the revenue transfers from the higher levels of Government to the local bodies in India. In this context, it

[7] Detailed tables are given in Appendix V.

is important to ensure a gradual increase in the local body grants to GDP ratio by the successive Finance Commissions.

Further, the share of grants in the total FC transfers stands at 13 per cent in India. The TFC has already opined that there is a need to increase the amount of grants in the total FC transfers with a view to bringing in more predictability to the FC transfers. As per the recommendations of the Twelfth FC, grants for local bodies is the most important grant after the post devolution non-plan revenue deficit grant, constituting 17.5 per cent of the total FC grants. However, with the revenue account of the State Governments turning into a surplus in the recent years, the post devolution non-plan revenue deficit grant will become insignificant during the award period of the Thirteenth FC. Thus, the Thirteenth FC may afford to raise the ratio of local body grants to the total FC grants as well as ratio of FC grants to the total FC transfers during its award period. This will be a welcome development from the point of view of the predictability of the FC transfers.

It may be mentioned that a FC grant of 1.4 per cent of GDP would be able to finance at least 50 per cent of the O&M requirements of the local bodies. Out of the remaining requirement, a part may be financed by the respective State Governments and a part may be financed by the local bodies themselves. Accordingly, the respective State Governments may finance 30 per cent of the total requirement and 20 per cent may be financed by the local bodies themselves. Thus, the respective shares of each tier of the government in the total O&M requirement are given in Table 13.

Table 13: Shares of different tiers of Government in the total O&M Requirement of the local bodies

(Amount in Rs.crore)

Tier of Government	Share of O&M requirement	As per cent of GDP 2010-11
Central Government	94,451	1.4
State Governments	56,671	0.8
Local Governments	37,780	0.6
Total Requirement	1,88,902	2.8

Note: GDP for year 2010-11 has been projected using three year moving average growth rate.

Distribution of Local Body Grants among the State Governments

In this section a formula has been presented for distributing the local body grants among the State Governments. It may be recalled that the Eleventh Finance Commission (EFC) and the TFC had distributed the grants based on formulae. The various components of the formula included population, area, revenue effort and distance from the highest per capita income. The EFC had used index of decentralisation and the TFC had used the index of deprivation apart from the above-mentioned criteria. In the present study, we present two different devolution methodologies: (i) one simple formula based on population, area and share in O&M requirements and (ii) a refined formula by incorporating fiscal capacity and taking population and area in relation to the assets along with the respective shares in O&M requirements.

We admit the relevance of population and area for distributing the local body grants. Thus, in our simple devolution formula, we have used these two criteria to calculate the shares of States. However, we have decided to use them in relation to the assets in the refined version of the formula.

We are not fully convinced with the logic of using revenue effort of the State Government as a criterion for distributing the local body grants. We are of the view that the local bodies should not be penalised for the fiscal laggardness of the State to which they belong. We can take revenue effort of the State Governments as a criterion if the end use of the grant rests with the State Government. In the case of local body grants the State Government is only a mediator between the Central Government and the local bodies. The revenue effort of the local body too is circumscribed by the over bearing State Acts that are biting and non-uniform across States. We do not therefore believe that the time is yet ripe for this to be a part of the devolution formula at the local body level.

As a proxy for the fiscal capacity of the State Governments, distance from the highest per capita income is a good indicator for distributing the local body grants. However, in the present Study we have calculated the fiscal capacity of the State Governments in relation to the O&M

requirements of the local bodies. We feel that this is more appropriate because the whole purpose is to distribute grants for the O&M requirements of the local bodies.

It is true that decentralisation in its all forms, fiscal, political and administrative, have to be encouraged in the country. The comprehensive one available through the NCAER report is – we fear – not very practical given the data constraints. Perhaps the present FC could evolve a simple and transparent (and verifiable) formula that follows the 3Fs and uses it. However, we do not agree with the idea of using index of decentralisation in the devolution formula for achieving this end. Decentralisation in a particular State depends on the political ideology of the ruling party of the State. The local bodies should not be punished for the anti-decentralisation stand of the State Governments. Instead, ***some measure of decentralisation can be a good criterion for the statutory tax devolution to the States so that the pro-decentralisation States may receive an add-on while others lose out.***

We are of the view that the index of deprivation which is calculated on the basis of lack of safe drinking water, lack of latrines within the house and lack of access to good sanitation facilities is not a good indicator for distributing the local body grants. It may be mentioned that creation of assets for reducing deprivation is not under the purview of FC. Instead Planning Commission through the plan grants can take care of this aspect. Under the present federal set up in India, FC is concerned only about the O&M expenditure of the assets which are already created through the plans.

Thus, we feel that for distributing the local body grants which is primarily meant for meeting the O&M expenditure of the local bodies on water, education and roads, the FC should give utmost priority to the share of each State in the total O&M requirements. Thus, in the simple devolution formula we have given 60 per cent weight to this criterion, the other two criteria being population and area with a weight of 20 per cent each. The share of each State in the total grants to local bodies based on this devolution formula is given in Table 14.

Table 14: State-wise Shares in Local Body Grants (Formula 1)			
State	**Share in Local body Grant**	**State**	**Share in Local body Grant**
Andhra Pradesh	7.3	Maharashtra	10.3
Arunachal Pradesh	0.7	Manipur	0.5
Assam	3.1	Meghalaya	0.5
Bihar	4.3	Mizoram	0.3
Chhattisgarh	3.0	Nagaland	0.4
Goa	0.1	Orissa	5.2
Gujarat	4.3	Punjab	1.9
Haryana	1.6	Rajasthan	8.8
Himachal Pradesh	1.1	Sikkim	0.1
Jammu and Kashmir	2.6	Tamil Nadu	4.6
Jharkhand	1.4	Tripura	0.6
Karnataka	5.8	Uttar Pradesh	13.3
Kerala	3.0	Uttarakhand	0.9
Madhya Pradesh	10.3	West Bengal	4.1
		Total	100.0

The merit of formula 1 is its computational simplicity. However, the lack of consideration of fiscal capacity of the States while distributing the grants to the States is the major drawback of this formula. Thus, in the next section we present a refined formula by incorporating fiscal capacity.

A Refined Variant of the Devolution Formula

In the refined devolution formula, we have given a weight of 50 per cent to the share of O&M requirement of each state in the total requirement.

The fiscal capacity of the State Governments is the second factor which should receive priority after the O&M requirement while distributing the local body grants among the State Governments. This is because of the fact that different State Governments are differently placed in their capacity to finance expenditure. As already mentioned, the respective State Governments have to bear 30 per cent of the respective O&M requirement of the local bodies. We have calculated the 30 per cent of the O&M requirement of each State as a per cent of respective GSDPs (Table 15).

Table 15: State's shares in the total O & M Requirements

(Amount in Rs. crore)

State	State's Share in O&M Requirements	Per cent to GSDP	State	State's Share in O&M Requirements	Per cent to GSDP
Andhra Pradesh	3915	0.9	Maharashtra	6131	0.7
Arunachal Pradesh	168	3.1	Manipur	262	3.3
Assam	1995	2.9	Meghalaya	295	3.3
Bihar	1929	1.9	Mizoram	145	2.5
Chhattisgarh	1620	2.2	Nagaland	224	1.8
Goa	68	0.2	Orissa	3325	3.1
Gujarat	1948	0.5	Punjab	1020	0.6
Haryana	851	0.4	Rajasthan	5277	2.5
Himachal Pradesh	584	1.0	Sikkim	88	2.9
Jammu and Kashmir	985	2.6	Tamil Nadu	2452	0.6
Jharkhand	345	0.4	Tripura	423	2.7
Karnataka	3397	1.0	Uttar Pradesh	8083	1.6
Kerala	1994	0.9	Uttarakhand	419	0.1
Madhya Pradesh	6866	3.5	West Bengal	1864	0.4
			Total	56671	0.8

Note: GSDP for the year 2010-11 estimated based on three year moving average growth rate has been used in this table.

It is evident from table 15 that some of the States, especially the north eastern States and poor States such as MP, Orissa, *etc*. have to transfer a larger share of their GSDP to the local bodies to finance 30 per cent of O&M requirements. We feel that while distributing the local body grants the FC may consider this factor. In the present Study, we attach 25 per cent weight to this criterion, *viz*., 'fiscal capacity of the States'.

We have included a new criteria 'population pressure on the assets' with a weight of 12.5 per cent in the devolution formula instead of using population shares directly. We feel that this is a meaningful criterion as far as the O&M expenditure are concerned since wear and tear of the assets will be more if there is more population pressure on the assets.

We have used the following equation to arrive at the population pressure on assets[8].

PPA = {w*(P/S) + w*(P/W) + w*(P/R)}/10000

Where,

PPA = Population Pressure on Assets

w = equal weight given to all the assets. We have fixed the value of w at 0.3333.

P = Population

S = schools (both primary and secondary)

W = assets in the area of water (wells and minor irrigation projects)

R = roads (both surfaced and un-surfaced)

In this context, it may be mentioned that population pressure on the public assets will be less in a particular sector if the role of the private sector is more in that sector. This may be a relevant argument in the case of developed regions as well as sectors like education and health. However, we have decided to include this criterion in our devolution formula because in the case of poorer rural areas and sectors like roads and water, we feel that the role of private sector is insignificant.

The next criterion we have included in the devolution formula is the 'inverse of asset density' with a weight of 12.5 per cent. It is well documented in the literature that there exists cost differentials in providing public services first due to low density of population and secondly due to mountainous terrain. We feel the same applies to O&M cost too. Thus, if asset density is less, then maintaining those assets situated in isolated far off places will also be high. Conversely, if inverse of asset density is more the State should receive more grants for the operation and maintenance of assets. This is relevant in the hilly areas of the country, the north eastern States, *etc*.

We have used the following equation to calculate the inverse of asset density[9].

[8] Detailed tables are given in Appendix VI.

[9] Detailed tables are given in Appendix VII.

IAD = {w*(A/S) + w*(A/W) + w*(A/R)}/10000

Where,

IAD = Inverse of Asset Density

w = equal weight given to all the assets. We have fixed the value of w at 0.3333.

A = Area of the State

S = schools (both primary and secondary)

W = assets in the area of water (wells and minor irrigation projects)

R = roads (both surfaced and un-surfaced)

Based on the above discussion, the devolution formula for distributing the local body grants is presented in Table 16.

Based on the formula presented in Table 16, we have worked out each State's share in the total local body grant of Rs.94,451 crore, which is given in Table 17[10].

The shares calculated using the refined formula provided higher shares to the poorer States, particularly Special Category States[11].

Table 16: Devolution formula for distributing Local Body Grants

Criterion	Weight
Share in total O & M requirements	50 %
Fiscal Capacity of States	25 %
Population Pressure on Assets	12.5 %
Inverse of Asset Density	12.5 %

[10] Detailed tables are given in Appendix VIII.

[11] However, there are exceptions to this general trend. Among the special category States Jammu and Kashmir and Uttarakhand and among the poorer States Bihar, Jharkhand, Rajasthan and Uttar Pradesh experienced deterioration in their shares with the refined formula. Relatively low values for the population pressure on assets and inverse of asset density for these States are the reasons for these.

Table 17: State-wise Shares in Local Body Grants (Formula II)

State	Share in Local body Grant	State	Share in Local body Grant
Andhra Pradesh	5.7	Maharashtra	9.6
Arunachal Pradesh	1.5	Manipur	1.7
Assam	3.9	Meghalaya	1.7
Bihar	3.4	Mizoram	1.3
Chhattisgarh	3.5	Nagaland	1.0
Goa	0.2	Orissa	5.8
Gujarat	3.4	Punjab	1.6
Haryana	1.3	Rajasthan	8.2
Himachal Pradesh	1.2	Sikkim	1.3
Jammu and Kashmir	2.4	Tamil Nadu	4.3
Jharkhand	0.6	Tripura	1.7
Karnataka	5.5	Uttar Pradesh	11.7
Kerala	3.1	Uttarakhand	0.6
Madhya Pradesh	10.8	West Bengal	2.8
		Total	100.0

Table 18 provides a comparative picture of devolution based on both the formulae.

However, it may be mentioned that our analysis is tentative due to the inherent limitations of the data we have used. The basic objective of this study is to illustrate a norm-based methodology for estimating the local body grants as well as designing devolution formula for distributing the same among the State Governments. The Thirteenth Finance Commission with richer data and other resources may take a view based on further analysis.

V. Recommendations and Conclusion

To sum up, the fiscal position of local bodies both urban and rural does not seem to be promising in India. These local level institutions have to be strengthened by giving more revenue handles on the one hand and by transferring more resources on the other. The State Governments have an

Table 18: Comparison of Formula I and II			
State	Formula I	Formula II	Improvement (+)/ Deterioration (-)
Andhra Pradesh	7.3	5.7	-1.6
Arunachal Pradesh	0.7	1.5	0.7
Assam	3.1	3.9	0.8
Bihar	4.3	3.4	-0.8
Chhattisgarh	2.9	3.5	0.5
Goa	0.1	0.2	0.1
Gujarat	4.3	3.4	-0.8
Haryana	1.6	1.3	-0.2
Himachal Pradesh	1.1	1.2	0.1
Jammu and Kashmir	2.6	2.4	-0.2
Jharkhand	1.4	0.6	-0.7
Karnataka	5.8	5.5	-0.3
Kerala	3.0	3.1	0.2
Madhya Pradesh	10.4	10.9	0.5
Maharashtra	10.3	9.6	-0.7
Manipur	0.5	1.7	1.2
Meghalaya	0.5	1.7	1.2
Mizoram	0.3	1.3	1.0
Nagaland	0.4	1.0	0.7
Orissa	5.2	5.8	0.6
Punjab	1.9	1.6	-0.2
Rajasthan	8.8	8.2	-0.6
Sikkim	0.1	1.3	1.1
Tamil Nadu	4.6	4.3	-0.3
Tripura	0.6	1.7	1.1
Uttar Pradesh	13.3	11.7	-1.6
Uttarakhand	0.9	0.6	-0.3
West Bengal	4.1	2.8	-1.3

active role to play in strengthening the local bodies. The finances of the State Governments display a healthier picture subsequent to enactment of FRLs. However, the fiscal correction process needs to be fine tuned by providing a micro design to the targets. This may enable the State Governments to devolve more funds to the lower level without jeopardising the normal expenditure both revenue and capital of the State Governments.

The functioning of SFCs in different States documents a dismal picture in India even after the 73rd and 74th constitutional amendments. In view of this, the CFC may bring in tightened policy suggestions to enforce fiscal federalism at the third tier. The CFC may suggest a uniform template for the SFCs and may treat the progress made in the arena of SFC as a condition for the release of share in central taxes.

The FC grants to the local bodies may be determined on the basis of a normative approach. The CFC may concentrate on the O&M expenditure requirement of the local bodies since that is the major fiscal lacuna at the local level. Based on a normative assessment with the available data the present study proposes a quantum jump in the grants to local bodies from Rs.25,000 crore to Rs.94,451 crore (1.4 per cent of GDP for the year 2010-11) for the five year period 2010-11 to 2014-15. This would amounts to roughly 0.3 per cent of GDP every year. This could be split up into 20:80 shares for the urban and rural local bodies respectively. In addition, the study also urges the CFC to set up an incentive fund flow of around Rs.6,000 crore for helping the local bodies to access the capital market.

In nutshell, the following important suggestions are made in the present study.

- Include a measure of decentralisation in the devolution formula for the share in central taxes.
- Keep the grants to local bodies unconditional.
- Ensure that the release of local body grants is evenly distributed over the fiscal year.
- Ensure that the State Governments are transferring the local body grants promptly and efficiently to the local Government level.
- Provide a uniform template to the SFCs.
- Incentivise the State Governments to set up a data warehouse for the local bodies.

- Set up a central pool of fiscal experts from which the State Governments may select at least one member of SFC.
- Provide a time line to the State Governments in link to the release of share in central taxes for making progress in the arena of SFC.
- Estimate the grants to local bodies on a normative basis.
- Provide Rs.94,451 crore as the local body grant.
- Set up an incentive fund of Rs.6,000 crore for assisting the local bodies to access capital market.
- Devolve the local body grant on a formula basis among the State Governments.
- Till such time as the decentralisation truly takes root and SFCs are well established and recognised, talk directly to the local bodies (at the district level), and think of transferring resources directly to them.

The study is an exercise to estimate local body grants based on a normative approach. Based on operations and maintenance expenditure required for three major assets, *i.e.*, water, education and roads, the amount of grants is estimated at Rs.94,451 crore for the local bodies (both urban and rural). The study has also devised formulae (one simple and the other refined) for distribution of the grants across the States. The Thirteenth Finance Commission may take a view on the matter, based on further analysis with richer data.

References

Agarwal, Amba (2005) **Fiscal Decentralisation: Financing of Panchayati Raj Institutions in India**, Serials Publications, New Delhi.

Alagh, Y. K. et al., (2008) **The State of Panchayats: 2007-08, An Independent Assessment, Vol. I Thematic Report,** IRMA for Ministry of Panchayati Raj

Alagh, Y.K. (2005) **Panchayati Raj and Planning in India: Participatory Institutions and Rural Roads**, Mimeo.

Bardhan, P. and D. Mookherjee (eds) (2007) **Decentralisation and Local Governance in Developing Countries: A Comparative Perspective**, OUP, New Delhi.

Bird Richard and Christine Wallich (1993) **Fiscal Dentralization and Intergovernmental Relations in Transition Economies,** Policy Research Working Papers (Public Economics) No 1122, The World Bank.

Chattopahyay, R. and E. Duflo (2004) **Impact of Reservation in Panchayati Raj: Evidence from a Nationwide Randomised Experiment**, Economic and Political Weekly, February 28.

Chaudhary, Shubham (2007) **What Difference Does A Constitutional Amendment Make? The 1994 Panchayati Raj Act and the Attempt to Revitalise Rural Local Governments in India,** in Bardhan, P. and D. Mookherjee (eds) (2007) **Decentralisation and Local Governance in Developing Countries: A Comparative Perspective**, OUP, New Delhi.

Dillinger, William and Steven Webb (1999) **Fiscal Management in Federal Democracies: Argetina and Brazil,** Policy Research Working Paper 2121 The World Bank.

Goel, S.L. and Shalini Rajneesh (2003) **Panchayat Raj in India: Theory and Practice**, Deep and Deep Publications Private Limited, New Delhi.

GoI (1987) **Mid-Term Appraisal of Seventh Five Year Plan**, Planning Commission, New Delhi.

GoM (2005) **Consolidated Annual Report of the PRIs for the Year 2003-04**, CAG, GoM, Mumbai.

GoM (2006) **Third State Level Review: Yeshwant Panchayat Abhiyan 2006**, RDD, GoM, Mumbai.

GoM (2007) **State of Panchayati Raj: Status Report**, Internal Mimeo, Department of Panchayati Raj, GoM, Mumbai

Govinda Rao and U.A. Vasanth Rao (2008) **Expanding the Resource Base of Panchayats: Augmenting Own Revenues**, Economic and Political Weekly, January.

Jain, L.C. (2005) **Decentralisation and Local Governance**, Orient Longman Private Limited, Hyderabad.

Jha, S.N. and P.C. Mathur (eds) (1999) **Decentralisation and Local Politics**, Sage, New Delhi.

John, M.S. and J. Chathukualm (2003) **Measuring Decentralisation: The Case of Kerala (India),** Public Administration and Development, 33.

Karnik, Ajit, Anita Rath and J.C. Sharma (2004) **Reforming Property Tax System: Simulated Results for Mumbai City,** Economic and Political Weekly, August 21.

Karnik, Ajit (2005) **State Finances: Continuous Deterioration, Bleak Prospects**. Journal of Indian School of Political Economy. Vol. XVII No (3), July-September.

Kelkar, Vijay (2002) **Consultation Paper of the Task Force on Indirect Taxes**, Committee constituted by the Ministry of Finance and Company Affairs, GoI.

Kelkar, Vijay (2004) **Report of the Task Force on Implementation of the Fiscal Responsibility and Budgetary Management Act, 2003,** Ministry of Finance, GoI.

Konrad, Adenauer Foundation (1998) **Local Government Finances in India**, Manohar, New Delhi.

Mathew, George (2000) **Status of Panchayati Raj in India**, Institute of Social Sciences, New Delhi.

Mathur, Mukesh (2003) **Panchayati Raj Institutions and the State Finance Commissions – A Report**, 3i Network (ed) **Indian Infrastructure Report: Public Expenditure Allocation and Accountability**, OUP, New Delhi.

Ministry of Panchayati Raj (2006) **The State of Panchayati Raj: A Mid-Term Review and Appraisal**, November, New Delhi.

Misra, B.M. and J.K.Khundarkpam (2008) "**Fiscal Consolidation by Central and State Governments: The Medium-Term Outlook**", Paper presented at Seminar on "Issues Before the Thirteenth Finance Commission" organised by the National Institute of Public Finance and Policy at New Delhi on May 24.

Mohanty, P. K. *et al*, (2007) **Municipal Finance in India: An Assessment**, DRG Study No. 26, RBI.

Mujumdar, N.A. (2007) **Inclusive Growth: Development Perspectives in Indian Economy,** Academic Foundation, New Delhi.

NCAER (2007) **Working Index of Devolution for Assessing Environment for Panchayati Raj Institutions in the States: Empirical Assessment**, Final Report submitted to UNDP and MoPR, mimeo.

Oates, Wallace (1972) **Fiscal Federalism**, New York, Harcourt Brace and Javanovich.

Oommen, M.A. (2005) **Rural Fiscal Decentralisation in India: A Brief Survey of Literature**, in Jain, L.C. (ed) **Decentralisation and Local Governance**, Orient Longman Private Limited, Hyderabad.

Oommen, M.A. (2005) **Twelfth Finance Commission and Local Bodies**, Economic and Political Weekly, May 14.

Pethe, Abhay (2008a) **Issues for the 13th Finance Commission: Welcome to the Grey World of Trade Offs!** Mimeo, Department of Economics, University of Mumbai.

Pethe, Abhay (2008b) Financing the Panchayat Raj Institutions: Flagging Some Issues for 13th Finance Commission, Invited Paper presented at the NIPFP conference, May 23-24, to be published in a book.

Pethe, Abhay and Mala Lalvani (2004) **A Fair Plan Approach For Devolution Under The Twelfth Central Finance Commission: Some Suggestions,** in Alagh, Y.K et al. **Strategic Policy and Economic Reform**, ORF New Delhi.

Pethe, Abhay and Mala Lalvani (2005) **Comparative Study of Municipal Finances in Maharashtra: Patterns, Problems and Prospects**, Urban India, Vol. XXV, No. 1.

Pethe, Abhay and Mala Lalvani (2006) **Towards Economic Empowerment of ULBs in Maharashtra,** Economic and Political Weekly of India (EPW), Vol. XLI no. 7 Feb. 18-24.

Pethe, Abhay and Mala Lalvani (2007) **Report on Finances of the MMR Region,** Study conducted for MTSU on advice of the World Bank. Unpublished Report.

Pethe, Abhay and Mala Lalvani (2008) **Finances of Panchayati Raj Institutions: A simple Story but a Messy Plot**, Study commissioned by IRMA for MoPR, Vibhooti Shukla Working Paper Series No. 28.

Pethe, Abhay, Ajit Karnik and Dilip Karmarkar (2002), "**An Approach to Designing Inter-Governmental Transfers" a study dealing with "Evolving Criteria For Allocation Of Funds As Per The State Finance Commission Recommendations From The State To Urban Local Bodies To Strengthen Decentralisation Efforts By Urban Local Bodies**", unpublished report submitted to *United Nations Development Programme (UNDP) and United Nations Centre For Human Settlements (UNCHS/UN-Habitat,* May.

Pethe, Abhay, Ajit Karnik and Dilip Karmarkar (2006) **Developing A Quantitative Framework for Determining Devolution of Funds from the State Government to Local Bodies** in **Local Governments in India: Decentralisation and Beyond** (eds) Niraja Jayal et. al., OUP.

Prud'homme, Remy (1995) **The Dangers of Decentralisation**, World Bank Research Observer, Vol.10 No(2) August.

R.B.I. (2007) **State Finances: A Study of Budgets 2007-08**, Reserve Bank of India, November.

Raghuram, G., et al (1999) **Infrastructure Development Financing: Towards a Public-Private Partnership**, Macmillan India Limited.

Rajaraman, Indira (2003) **A Fiscal Domain for Panchayats,** OUP**.**

Rajaraman, Indira (2006) **Fiscal Features of Local Governments in India** in J.J. Dethier (ed) **Governance, Decentralisation and Reform in India, China and Russia**, Kluwer.

Rajaraman, Indira (2007) **The Political Economy of Indian Fiscal Federation**, Brookings-NCAER Policy Forum.

Rao, Govinda and Tapas Sen (1996) **Fiscal Federalism in India: Theory and Practice,** Macmillan India Limited.

Rao, PSN (ed) (2006) **Urban Governance and Management: India Initiatives**, Kanishka Publishers, Distributors, New Delhi.

Rodden, T, G. Eskeland and J. Litvak (eds) (2003) **Fiscal Decentralisation and the Challenge of Hard Budget Constraints**, Cambridge Mass: MIT Press.

Roy, Ash Narain (2007) **Cajoling and Compromise Drive India's Multi-Party System**, Federations, Forum of Federations, Canada October-November.

Roy, Bahl (1999) **The Rules of Fiscal Decentralisation**, Georgia State University, Georgia.

Rural Development Department (2007) **Annual Report 2007**, RDD, GoI.

Sen, Amartya Kumar (1999), "**Development as freedom**", OUP, New Delhi.

Sethi, Geeta (2004) **Fiscal Decentralisation to Rural Governments in India,** The World Bank**,** OUP, New Delhi.

Tanzi, Vito (1995) **Fiscal Federalism and Decentralisation: A Review of Some Efficiency and Macroeconomic Aspects**, Annual Bank Conference in Development Economics, Washington: World Bank.

Teresa, Ter-Minassian (ed) (1997) **Fiscal Federalism in Theory and Practice**, International Monetary Fund, Washington.

Three-i Network (2007) **India Infrastructure Report: Rural Infrastructure**, OUP.

Tiebout, C. (1961) **An Economic Theory of Fiscal Decentralisation in Public Finance: Need, Sources and Utilisation**, Princeton, New Jersey, Princeton University Press.

Tony, Travers (2007) **International Comparisons of Local Government Finance: Propositions and Analysis**, Downloaded from the internet on 16/02/08.

Vaidyanathan, A. (2003) **Rural Infrastructure** in 3i Network (ed) **India Infrastructure Report 2003: Public Expenditure Allocation and Accountability**, OUP, New Delhi.

Appendix

Appendix I(a): First SFC Reports: Dates of Constitution, Report Submission & Action Taken

State	Date of Constitution of SFC	Date of Submission of SFC report	Date of Submission of ATR	Period covered By SFC
Andhra Pradesh	22.6.1994	31.5.1997	29.11.1997	1997-98 to 1999-2000
Arunachal Pradesh	21.5.2003	6.6.2003	3.7.2003	2003-04 to 2005-06
Assam	23.6.1995	29.2.1996	18.3.1996	1996-97 to 2000-01
Bihar	23.4.1994/ 2.6.1999 *	Not submitted	Not submitted	-
Chattisgarh	22.8.2003	Not submitted	-	-
Goa	1.4.1999	5.6.1999	12.11.2001	2000-01 to 2004-05
Gujarat	15.9.1994	RLBs-13.7.1998,	Submitted	1996-97 to 2000-01
		ULBs Oct., 1998		
Haryana	31.5.1994	31.3.1997	1.9.2000	1997-98 to 2000-01
Himachal Pradesh	23.4.1994	30.11.96	5.2.1997	1996-97 to 2000-01
Jammu & Kashmir	24.4.2001	May, 2003	Not submitted	2004-2005 (Interim)
Jharkhand	28.01.2004	Not submitted		Not specified
Karnataka	10.6.1994	RLBs-5.8.1996,	31.3.1997	1997 -98 to 2001-02
		ULBs 30.1.1996		
Kerala	23.4.1994	29.2.1996	13.3.1997	1996-97 to 2000-01
Madhya Pradesh	17.8.1994	20.7.1996	20 7. 1996	1996-97 to 2000-01
Maharashtra	23.4.1994	31.1.1997	5.3.1999	1996-97 to 2000-01 #
Manipur	22.4.1994/ 31.5.1996	December, 1996	28.7.1997	1996-97 to 2000-01
Meghalaya	SFC not yet constituted	73rd Amendment not applicable as traditional Local Institution of Self Government exists in these States		

(Contd...)

Appendix I(a):
First SFC Reports: Dates of Constitution, Report Submission & Action Taken *(Concld.)*

State	Date of Constitution of SFC	Date of Submission of SFC report	Date of Submission of ATR	Period covered By SFC
Mizoram	SFC not yet constituted			
Nagaland	SFC not yet constituted			
Orissa	21.11.1996/ 24.8.1998 *	30.12.1998	9.7.1999	1998-99 to 2004-05 $
Punjab	July, 1994	31.12.1995	13.9.1996	1996-97 to 2000-01
Rajasthan	23.4.1994	31.12.1995	16.3.1996	1995-96 to 1999-2000
Sikkim	23.4.1997/ 22.7.1998 *	16.08.1999	June, 2000	2000-01 to 2004-05
Tamil Nadu	23.4.1994	29.11.1996	28.4.1997	1997-98 to 2001-02
Tripura	RLBs- 23.4.1994,	RLBs- 12.1.1996,	RLBs-O 1.04.1997	RLBs-Jan.1996. Jan.2001
	ULBs-19.8.1996	ULBs-17.9.1999	ULBs-27.11.2000	ULBs-1999-00 to 2003-04
Uttar Pradesh	22.10.1994	26.12.1996	20.1.1998	1996-97 to 2000-01
Uttaranchal	31.1.2001	2002	3.7.2004	2001-02 to 2005-06
West Bengal	30.5.1994	27.11.1995	22.7.1996	1996-97 to 2000-01

* : Date of reconstitution. In case of Gujarat, the SFC report on RLBs was submitted prior to the reconstitution of the SFC.

: As per the ATR, the SFC recommendations shall be effective from 1.4.1999.

$: Though SFC was asked to submit the report covering a period of five years w.e.f. 1.4.1998, its report covers the period from 1998-99 to 2004-05.

Source: Report of the Twelfth Finance Commission, Government of India, 2004.

Appendix I(b):
Second SFC Reports: Details of Constitution, Report Submission & Action Taken

Sr. No.	State	Date of Constitution of SFC	Date of Submission of SFC report	Date of Submission of ATR	Period covered By SFC
1.	Andhra Pradesh	8.12.1998	19.08.2002	31.3.2003	2000-01 to 2004-05
2.	Arunachal Pradesh	Not constituted			
3.	Assam	18.4.2001	18.08.2003	Not submitted	2001-02 to 2005-06
4.	Bihar	June,1999	RLB-September, 2001	Not submitted	
			ULB- January, 2003	Not submitted	
5.	Chattisgarh	Not constituted			
6.	Goa	Not constituted			
7.	Gujarat	19.11.2003	Not submitted		2005-06 to 2009-10
8.	Haryana	6.9.2000	Not submitted		2001-02 to 2005-06
9.	Himachal Pradesh	25.5.1998	24.10.2002	24.06.2003	2002-03 to 2006-07
10.	Jammu & Kashmir	Not constituted			
11.	Jharkhand	Not constituted			
12.	Karnataka	October, 2000	December, 2002	Not submitted	2003-04 to 2007-08
13.	Kerala	23.06.1999	January, 2001	Not submitted	2000-01 to 2005-06
14.	Madhya Pradesh	17.06.1999	July, 2003	Not submitted	2001-02 to 2005-06
15.	Maharashtra	22.06.1999	30.3.2002	Not submitted	2001-02 to 2005-06
16.	Manipur	03.01.2003	Submitted	Not submitted	2001-02 to 2005-06
17.	Meghalaya				
18.	Mizoram				
19.	Nagaland				
20.	Orissa	5.6.2003	25.10.2003	Not submitted	2005-06 to 2009-10

(Contd...)

Appendix I(b):

Second SFC Reports: Details of Constitution, Report Submission & Action Taken *(Concld.)*

Sr. No.	State	Date of Constitution of SFC	Date of Submission of SFC report	Date of Submission of ATR	Period covered By SFC
21.	Punjab	Sep., 2000	15.2.2002	08.06.2002	2001-02 to 2005-06
22.	Rajasthan	07.05.1999	30.08.200 I	26.03.2002	2000-01 to 2004-05
23.	Sikkim	July, 2003	Not submitted		*
24.	Tamil Nadu	2.12.1999	21.5.2001	8.5.2002	2002-03 to 2006-07
25.	Tripura	29.10.1999	10.4.2003	Not submitted	2003-04 to 2007-08
26.	Uttar Pradesh	February, 2000	June, 2002	30.04.2004	2001-02 to 2005-06
27.	Uttaranchal	Not constituted			
28.	West Bengal	14.7.2000	6.2.2002	Not submitted	2001-02 to 2005-06
	Constitution of Third SFCs				
3.	Rajasthan	15-09-2005	February, 2008		2005-06 to 2009-10
4.	Tamil Nadu	14-12-2004	September, 2006	May, 2007	2007-08 to 2011-12

* No specific period of coverage has been prescribed.

Source: (1) Report of the Twelfth Finance Commission, Government of India, 2004.
(2) Report of the Third Finance Commissions of Rajasthan and Tamil Nadu.

Appendix II:

Functions of Urban Local Bodies – Twelfth Schedule of Constitution of India

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 and playgrounds.
13.	Promotion of cultural, educational and aesthetic aspects.
14.	Burials and burial grounds; cremations, cremation grounds and electric crematoriums
15.	Cattle pounds; prevention of cruelty to animals.
16.	Vital statistics, including registration of births and deaths.
17.	Public amenities, including street lighting, parking lots, bus stops and public conveniences.
18.	Regulation of slaughter houses and tanneries.

Appendix III: Functions of Panchayat Raj Institutions – Eleventh Schedule of the Constitution of India

No.	Description	Category
1.	Agriculture including agricultural extension	Agriculture and allied
2.	Land improvement, land reforms, land consolidation, soil conservation	Agriculture and allied
3.	Minor irrigation, water management, watershed development	Agriculture and allied
4.	Animal husbandry, dairy, poultry	Agriculture and allied
5.	Fisheries	Agriculture and allied
6.	Social forestry, farm forestry	Agriculture and allied
7.	Minor forest produce	Agriculture and allied
8.	Small scale industries	Industries
9.	Khadi, village, cottage industries	Industries
10.	Rural housing	Welfare
11.	Drinking water	Core
12.	Fuel and fodder	Agriculture and allied
13.	Roads, culverts, bridges, ferries, waterways	Core
14.	Rural electrification, electricity distribution	Core
15.	Non-conventional energy sources	Welfare
16.	Poverty alleviation programs	Welfare
17.	Education, including primary and secondary schools	Welfare
18.	Technical training and vocational education	Welfare
19.	Adult and non-formal education	Welfare
20.	Libraries	Welfare
21.	Cultural activities	Welfare

(Contd...)

Appendix III:
Functions of Panchayat Raj Institutions – Eleventh Schedule of the Constitution of India *(Concld.)*

No.	Description	Category
22.	Markets and fairs	Agriculture and allied
23.	Health and sanitation, hospitals, primary health centres, dispensaries	Core
24.	Family welfare	Welfare
25.	Women and child development	Welfare
26.	Social welfare, welfare of handicapped and mentally retarded	Welfare
27.	Welfare of weaker sections, Scheduled Castes and Tribes	Welfare
28.	Public distribution system	Welfare
29.	Maintenance of community assets	Core

Appendix IV:
Limitations of the Data

We have collated the State-wise data on number of primary schools, secondary schools, municipal roads (surfaced and unsurfaced), major district roads, village roads, number of minor irrigation projects and wells from the website indiastat.com. Data on primary and secondary schools are as per the year 2004-05. We have taken the number of schools categorised as 'middle senior basic schools' in the website indiastat.com as the secondary schools in our study. Similarly, we have taken the number of schools categorised as 'primary junior basic school' as the primary schools in our study. Data for all the States including the three newly created States were available on the web site.

The data on major district roads as well as on village roads are as on February 2002. It is mentioned that data on major district roads and village roads for the three newly created States such as Chhattisgarh, Jharkhand and Uttarakhand are included under the respective parent States such as Madhya Pradesh, Bihar and Uttar Pradesh, respectively. We have used the population ratios of 73.3797 and 26.6203 for Madhya Pradesh and Chhattisgarh, 74.71 and 25.29 for Bihar and Jharkhand, and 94.9676 and 5.0324 for Uttar Pradesh and Uttarakhand, respectively to arrive at the length of major district roads in each of the States. The data on village roads were included under the major district roads for some States such as Andhra Pradesh, Bihar and Mizoram. Data on village roads were not available for a number of States such as Gujarat, Haryana, Maharashtra, Punjab, Sikkim and West Bengal. The data on municipal roads were not available for a number of States such as Arunachal Pradesh, Chhattisgarh, Jharkhand, Mizoram, Nagaland, Sikkim and Uttarakhand.

The data on wells were as on November 2000. The data on wells were not available for Jharkhand and Uttarakhand. Data on minor irrigation were not available for Chhattisgarh, Gujarat, Karnataka, Maharashtra, Jharkhand, Uttarakhand and Tamil Nadu.

All possible efforts have been made to trace the required data for the Study. Non-availability of data in respect of a few States in certain sectors, however, would have implications for the findings of the Study. The raw data on all the above-mentioned assets are given in the table.

State-wise Data on Assets

State	Primary schools	Secondary schools	Wells	Minor irrigation	District roads	Village roads	Municipal roads
Andhra Pradesh	61680	16667	837	4641	141079	N.A.	9024.7
Arunachal Pradesh	1371	495	22	50	12169	4657	N.A.
Assam	30068	8143	214	419	26416	44135	1017
Bihar	39347	10963	354	4147	45541	N.A.	2011.1

(Contd....)

State-wise Data on Assets *(Concld.)*							
State	**Primary schools**	**Secondary schools**	**Wells**	**Minor irrigation**	**District roads**	**Village roads**	**Municipal roads**
Chhattisgarh	33595	10799	303	N.A.	225152	12556	N.A.
Goa	1003	73	58	18	4462	3974	426
Gujarat	16385	22623	579	N.A.	51555	N.A.	10723.6
Haryana	11800	2269	352	2274	19651	N.A.	2926.9
Himachal Pradesh	11178	2210	84	193	20772	560	903.5
Jammu and Kashmir	12049	4239	201	356	7671	3372	441
Jharkhand	16572	4933	N.A.	N.A.	15416	N.A.	N.A.
Karnataka	26645	26816	857	N.A.	108506	4665	6854.9
Kerala	6827	3049	210	424	18504	107988	10217.6
Madhya Pradesh	96737	34641	549	5129	620640	34610	9368.2
Maharashtra	41669	26295	693	N.A.	299608	N.A.	13304.1
Manipur	2552	831	25	31	6638	2172	73.4
Meghalaya	5851	1759	52	77	5416	604	26.4
Mizoram	1481	939	3	8	3518	N.A.	N.A.
Nagaland	1520	480	11	66	13754	5137	N.A.
Orissa	45700	15893	626	1401	38542	189445	9763.2
Punjab	13352	2503	117	6777	42757	N.A.	3974.4
Rajasthan	55942	26201	761	4133	72078	44287	3190.6
Sikkim	684	185	31	20	1502	N.A.	N.A.
Tamil Nadu	33470	7111	579	N.A.	51010	72470	10451.3
Tripura	1776	1001	48	41	5569	7912	160.7
Uttar Pradesh	129976	36874	526	12357	114841	30383	39554
Uttarakhand	14663	3861	N.A.	N.A.	6086	1610	N.A.
West Bengal	50397	1929	212	2797	44864	N.A.	15756.1

Appendix V:
Estimation of O & M requirements of the Local Bodies for one year

(Amount in Rs. crore)

State	Education	Water	Roads	O&M requirements
Andhra Pradesh	2300	9.4	300	2610
Arunachal Pradesh	78	0.1	34	112
Assam	1186	0.9	143	1330
Bihar	1183	8.4	95	1286
Chhattisgarh	605	0.1	475	1080
Goa	28	0.0	18	45
Gujarat	1174	0.1	125	1299
Haryana	517	4.6	45	567
Himachal Pradesh	344	0.4	44	389
Jammu and Kashmir	633	0.8	23	657
Jharkhand	199	0.0	31	230
Karnataka	2024	0.2	240	2264
Kerala	1055	0.9	273	1329
Madhya Pradesh	3238	10.4	1329	4577
Maharashtra	3461	0.1	626	4087
Manipur	157	0.1	18	175
Meghalaya	184	0.2	12	196
Mizoram	90	0.0	7	97
Nagaland	111	0.1	38	149
Orissa	1738	2.9	476	2216
Punjab	573	13.6	93	680

(Contd...)

Appendix V:
Estimation of O & M requirements of the Local Bodies for one year *(Concld.)*

(Amount in Rs. crore)

State	Education	Water	Roads	O&M requirements
Rajasthan	3271	8.4	239	3518
Sikkim	55	0.0	3	58
Tamil Nadu	1366	0.1	268	1634
Tripura	255	0.1	27	282
Uttar Pradesh	4994	24.8	370	5389
Uttaranchal	264	0.0	15	279
West Bengal	1115	5.6	121	1242
Total	**32,199**	**92.4**	**5,489**	**37,780**

Appendix VI:
Estimation of Population Pressure on Assets Population Pressure on Assets

State	Population	Education	Water	Roads	Index
Andhra Pradesh	75727541	927	1603	505	0.1011
Arunachal Pradesh	1091117	555	2085	65	0.0902
Assam	26638407	669	6054	372	0.2365
Bihar	82878796	1579	1981	1743	0.1767
Chhattisgarh	20795956	447	68634	87	2.3054
Goa	1343998	1232	5659	152	0.2347
Gujarat	50596992	1162	87387	812	2.9784
Haryana	21082989	1452	913	934	0.1099
Himachal Pradesh	6077248	439	3011	273	0.1241
Jammu and Kashmir	10069917	588	2679	877	0.1381
Jharkhand	26909428	1196	0	1746	0.0981
Karnataka	52733958	896	61533	439	2.0954
Kerala	31838619	3036	7155	233	0.3474
Madhya Pradesh	60385118	437	1165	91	0.0564
Maharashtra	96752247	1321	139614	309	4.7077
Manipur	2388634	673	7214	269	0.2718
Meghalaya	2306069	290	2822	381	0.1164
Mizoram	891058	342	11237	253	0.3943
Nagaland	1988636	949	2976	105	0.1343
Orissa	36706920	567	2508	154	0.1076
Punjab	24289296	1485	358	520	0.0787

(Contd...)

Appendix VI:
Estimation of Population Pressure on Assets Population Pressure on Assets *(Concld.)*

State	Population	Education	Water	Roads	Index
Rajasthan	56473122	646	1342	472	0.0820
Sikkim	540493	597	2338	360	0.1098
Tamil Nadu	62110839	1479	107273	464	3.6401
Tripura	3191168	1072	6980	234	0.2762
Uttar Pradesh	166052859	953	1338	899	0.1063
Uttarakhand	8479562	439	0	1102	0.0514
West Bengal	80221171	1522	2846	1323	0.1897

Appendix VII:
Inverse of Asset Density

	Inverse of asset density				
State	**Area**	**education**	**water**	**roads**	**Index**
Andhra Pradesh	275,068	3.4	5.8	1.8	0.0004
Arunachal Pradesh	83,743	42.6	160.1	5.0	0.0069
Assam	78,483	2.0	17.8	1.1	0.0007
Bihar	94,164	1.8	2.3	2.0	0.0002
Chhattisgarh	135,194	2.9	446.2	0.6	0.0150
Goa	3,702	3.4	15.6	0.4	0.0006
Gujarat	196,024	4.5	338.6	3.1	0.0115
Haryana	44,212	3.0	1.9	2.0	0.0002
Himachal Pradesh	55,673	4.0	27.6	2.5	0.0011
Jammu and Kashmir	222,236	13.0	59.1	19.4	0.0030
Jharkhand	79,700	3.5	0.0	5.2	0.0003
Karnataka	191791	3.3	223.8	1.6	0.0076
Kerala	38,863	3.7	8.7	0.3	0.0004
Madhya Pradesh	308,144	2.2	5.9	0.5	0.0003
Maharashtra	307,713	4.2	444.0	1.0	0.0150
Manipur	22,327	6.3	67.4	2.5	0.0025
Meghalaya	22,429	2.8	27.4	3.7	0.0011
Mizoram	21,081	8.1	265.8	6.0	0.0093
Nagaland	16,579	7.9	24.8	0.9	0.0011
Orissa	155,707	2.4	10.6	0.7	0.0005
Punjab	50,362	3.1	0.7	1.1	0.0002

(Contd...)

Appendix VII:
Inverse of Asset Density *(Concld.)*

	Inverse of asset density				
State	**Area**	**education**	**water**	**roads**	**Index**
Rajasthan	342,236	3.9	8.1	2.9	0.0005
Sikkim	7,096	7.8	30.7	4.7	0.0014
Tamil Nadu	130,058	3.1	224.6	1.0	0.0076
Tripura	10,492	3.5	22.9	0.8	0.0009
Uttar Pradesh	238,566	1.4	1.9	1.3	0.0002
Uttaranchal	53,566	2.8	0.0	7.0	0.0003
West Bengal	88,752	1.7	3.1	1.5	0.0002

Appendix VIII:
Calculation of Shares of each State in the local body grants

	Calculation of Shares of each State in Local Body Grants					
State	**Fiscal Capacity**	**Inverse of Asset Density**	**Population Pressure on Assets**	**Share of O & M Needs**	**Total**	**Shares of Each State**
Andhra Pradesh	0.2249	0.0000	0.0126	3.4540	3.6915	5.7
Arunachal Pradesh	0.7778	0.0009	0.0113	0.1481	0.9380	1.5
Assam	0.7139	0.0001	0.0296	1.7604	2.5039	3.9
Bihar	0.4757	0.0000	0.0221	1.7020	2.1998	3.4
Chhattisgarh	0.5545	0.0019	0.2882	1.4296	2.2741	3.5
Goa	0.0519	0.0001	0.0293	0.0599	0.1413	0.2
Gujarat	0.1160	0.0014	0.3723	1.7186	2.2083	3.4
Haryana	0.1034	0.0000	0.0137	0.7506	0.8677	1.3
Himachal Pradesh	0.2560	0.0001	0.0155	0.5152	0.7869	1.2
Jammu and Kashmir	0.6464	0.0004	0.0173	0.8690	1.5331	2.4
Jharkhand	0.0992	0.0000	0.0123	0.3040	0.4155	0.6
Karnataka	0.2620	0.0010	0.2619	2.9968	3.5217	5.5
Kerala	0.2157	0.0001	0.0434	1.7594	2.0186	3.1
Madhya Pradesh	0.8846	0.0000	0.0071	6.0579	6.9495	10.8
Maharashtra	0.1799	0.0019	0.5885	5.4092	6.1794	9.6
Manipur	0.8140	0.0003	0.0340	0.2314	1.0796	1.7
Meghalaya	0.8307	0.0001	0.0146	0.2600	1.1054	1.7
Mizoram	0.6342	0.0012	0.0493	0.1280	0.8126	1.3

(Contd...)

Appendix VIII:
Calculation of Shares of each State in the local body grants *(Concld.)*

State	Fiscal Capacity	Inverse of Asset Density	Population Pressure on Assets	Share of O & M Needs	Total	Shares of Each State
	Calculation of Shares of each State in Local Body Grants					
Nagaland	0.4535	0.0001	0.0168	0.1974	0.6679	1.0
Orissa	0.7838	0.0001	0.0135	2.9334	3.7306	5.8
Punjab	0.1394	0.0000	0.0098	0.8997	1.0489	1.6
Rajasthan	0.6344	0.0001	0.0103	4.6562	5.3009	8.2
Sikkim	0.7372	0.0002	0.0137	0.0773	0.8284	1.3
Tamil Nadu	0.1520	0.0010	0.4550	2.1631	2.7711	4.3
Tripura	0.6629	0.0001	0.0345	0.3734	1.0710	1.7
Uttar Pradesh	0.3897	0.0000	0.0133	7.1318	7.5348	11.7
Uttaranchal	0.0202	0.0000	0.0064	0.3697	0.3963	0.6
West Bengal	0.1098	0.0000	0.0237	1.6442	1.7777	2.8