SHARE OF LOCAL GOVERNMENTS IN THE UNION DIVISIBLE POOL: AN OPTION BEFORE THE 13TH FINANCE COMMISSION

V N ALOK[1]

The task of restructuring public finance substantially depends on streamlining the multiple channels of resource flow from the Union to the local governments through the states. In the legal framework the processes of fiscal devolution from States to the Panchayat Raj Institutions (PRIs) and Urban Local Bodies (ULBs) are taking place through State Finance Commissions. Assets are being either created or transferred to these bodies. The role now for the 13th Finance Commission is to act as the path breaker in creating an enabling environment for fiscal decentralisation at the sub-state level. Since it is not mandatory that the transfer of funds to the PRIs and ULBs should only be in the form of grants, this article suggests, that local governments should be considered to get the share from the central divisible pool along with the states. This would be over and above the fiscal devolution recommended to the states to correct vertical imbalance.

INTRODUCTION

LIKE MANY other federations, local governments, in India, are supposedly responsible for rendering essential services including sanitation, drinking water supply, street lighting and roads. They are also empowered to collect certain tax and non-tax revenues. However, in most cases, considerable gap between own resources and

[1]An earlier version of the paper was presented in the seminar sponsored by the XIII Finance Commission on “Issues before the Finance Commission: Empowering the Panchayati Raj Institutions” held at Institute of Rural Management, Anand during December 22-23, 2008.

requirements can easily be seen. The gap is more noticeable in the case of rural local governments than their counterparts in urban areas due to narrow resource base. However, both these local governments largely depend upon the financial support from their respective state Governments. In this paper an attempt is made to objectively assess the potential of the corrective measures that the Union Finance Commission (UFC) could take for the fiscal capacity of local governments in India. In section I, the legal framework of the local governments is presented. Section II analyses the finances of local governments and the treatments of the state governments. Section III briefly reviews the recommendations of the earlier commissions and its utilisation. In this context, section IV suggests an option to the XIII Finance Commission by tracing the genesis and rationale of article 280 (3)(bb & C). A few concluding comments are offered in the last section.

I
THE LEGAL FRAMEWORK

With the passage of the 73rd and 74th Constitutional Amendments the Panchayati Raj Institutions (PRIs) and urban local bodies (ULBs) got recognition in the book of statute as institutions of self-government. This accelerated the process of decentralisation with greater devolution and delegation of powers to local governments. Consequently, Part IX and IXA have been inserted to the Constitution for PRIs and ULBs respectively and state legislature has been made responsible to transfer functions, listed in the Eleventh and Twelfth Schedule. The state is also expected to transfer the concomitant powers to enable them to carry out the responsibilities conferred upon them.

Under the Constitution Amendment Act (CAA), the state legislature is expected to devolve responsibilities, powers and authorities to the PRIs and ULBs to enable them to function as institutions of self-government. The legislature of a state may authorize the PRIs and ULBs to levy, collect and appropriate certain taxes, duties, tolls and fees, etc, and also assign to them the revenues of certain state level taxes subject to such conditions as are imposed by the state government. Further, grants-in-aid may also be provided to the PRIs and ULBs. Resulting from the CAA, the number of PRIs stands at 2,48,968, of which 2,42,328 are village panchayats, 6,097 are intermediate panchayats, and 543 are district panchayats (Table 1).

Similarly, ULBs by the end of July 2004 numbered 3,723 in all States. This consists of 109 Municipal Corporations, 1,432 Municipalities and 2,182 Nagar Panchayats (Table 2).

TABLE 1: NUMBER OF PRIS IN EACH STATE/UT AS ON 1 APRIL 2005

Sl. No.	*Name of State/UT*	*Panchayats by tier*				*Average Rural Population Per VP*
		Village[2]	*Inter-mediate*[3]	*District*[4]	*Total*	
	State					
1	Andhra Pradesh	21913	1095	22	23030	2663
2	Arunachal Pradesh	1747	150	15	1912	527
3	Assam	2489	203	20	2712	9911
4	Bihar	8471	531	38	9040	9654
5	Chhattisgarh	9139	146	16	9301	1959
6	Goa	190	0	2	192	3537
7	Gujarat	13819	225	25	14069	2447
8	Haryana	6034	114	19	6167	2687
9	Himachal Pradesh	3037	75	12	3124	1915
10	Jharkhand	3746	211	22	3979	2256
11	Jammu & Kashmir	2683	0	0	2683	8593
12	Karnataka	5659	175	27	5861	6456
13	Kerala	991	152	14	1157	24714
14	Madhya Pradesh	22029	313	45	22387	2167
15	Maharashtra	28553	349	33	28935	2067
16	Manipur	166	0	4	170	10284
17	Meghalaya	5629	0	3	5632	366
18	Mizoram	737	0	3	740	654
19	Nagaland	1286	0	0	1286	1556
20	Orissa	6234	314	30	6578	5289
21	Punjab	12445	140	17	12602	1356
22	Rajasthan	9189	237	32	9458	5187
23	Sikkim	159	0	4	163	3357
24	Tamil Nadu	12618	385	29	13032	2711
25	Tripura	537	23	4	564	5198
26	Uttar Pradesh	52028	813	71	52912	2757
27	Uttarakhand	7227	95	13	7335	924
28	West Bengal	3360	333	18	3711	18290
	Union Territory					
29	A&N Islands	67	7	1	75	3807
30	Chandigarh	17	1	1	19	6172
31	Dadra & Nagar Haveli	11	0	1	12	17355
32	Daman & Diu	10	0	1	11	12848
33	NCT of Delhi	0	0	0	0	NA
34	Lakshadweep	10	0	1	11	3939
35	Puducherry	98	10	0	108	3477
	All India	242328	6097	543	248968	3278

SOURCE: Alok (2006)

[2]In almost all states it is known as Gram Panchayat.

[3]The nomenclature of intermediate rung differs from one state to another. It is known as Mandal Parishad in AP, Anchal Samiti in Arunachal Pradesh, Anchalic Panchayat in Assam, Janpad Panchayat in Chhattisgarh & MP, Taluka Panchayat in Gujarat, Taluk Panchayat in Karnataka, Panchayat Union in TN, Kshetra Panchayat in UP and Uttaranchal and Panchayat Samiti in many States, i.e. Bihar, Haryana, Himachal Pradesh, Jharkhand, Maharastra, Orissa, Punjab and Rajasthan.

[4]It is also known as Zilla Panchayat/Parishad in many states.

TABLE 2: NUMBER OF URBAN LOCAL BODIES BY STATE
AS ON DECEMBER 2004

SL. No.	*State*	*Municipal Corporations*	*Municipal Councils*	*Nagar Panchayat*	*Total*	*Urban Population (in crore)*
1	Andhra Pradesh	7	109	1	117	2.08
2	Arunachal Pradesh		ULBs do not exist.			
3	Assam	1	28	54	83	0.34
4	Bihar	5	37	117	159	0.87
5	Chattisgarh	10	28	71	109	0.42
6	Goa	Na	13	Na	13	0.07
7	Gujarat	7	142	Na	149	1.89
8	Haryana	1	21	46	68	0.61
9	Himachal Pradesh	1	20	28	49	0.06
10	Jammu and Kashmir	2	6	61	69	0.25
11	Jharkhand	1	20	22	43	0.60
12	Karnataka	6	41	175	222	1.80
13	Kerala	5	53	Na	58	0.83
14	Madhya Pradesh	14	86	236	336	1.60
15	Maharashtra	16	228	Na	244	4.11
16	Manipur	9	9	19	28	0.06
17	Meghalaya	Na	6	Na	6	0.05
18	Mizoram	Na	ULBs do not exist			0.04
19	Nagaland	Na	Na	9	9	0.03
20	Orissa	2	33	68	103	0.55
21	Punjab	4	98	32	134	0.83
22	Rajasthan	3	11	169	183	1.32
23	Sikkim		ULBs do not exist.			
24	Tamil Nadu	6	102	611	719	2.75
25	Tripura	Na	1	12	13	0.05
26	Uttar Pradesh	11	195	417	623	3.45
27	Uttarakhand	1	31	31	63	0.22
28	West Bengal	6	114	3	123	2.24
	Total	109	1432	2182	3723	28.61

SOURCE: Alok (2007)

NOTES: Na means not applicable: As per the CAA there are three types of ULBs. These are (a) Nagar panchayat in areas which are in transition from rural to urban. In many States, nomenclature is different and terms like ‘Notified Area Committees’, Municipal Committees’, ‘Town Area Committees’ ‘Urban Station Committees’, ‘Notified Area Committees’ are used. (b) Municipal Councils in smaller urban settlements; it is also called ‘Nagar Palika Parishad’ and ‘Municipality’ in some States (c) Municipal Corporations in larger urban areas. In some States, it is called as ‘Nagar Nigam’, ‘City Corporation’ and ‘Nagar Palikhe’. It is the discretion of the State Governments to identify and define the term of “transitional”, “smaller” and “larger” urban areas.

New fiscal arrangement necessitates every state under articles 243 (I&Y) to constitute, at regular interval of five years, a finance commission (SFC), and assign it the task of reviewing the financial position of PRIs and ULBs and making recommendations on the sharing and assignment of various taxes, duties, tolls, fees etc and grants-in-aid to be given to the local bodies from the Consolidated Fund of a state. The conformity Acts of the CAA provide for the composition of the commission, the qualifications for its members and the manner of their selection. Every recommendation of the commission together with an explanatory memorandum is to be laid before the legislature of the state.

Generally the functional responsibilities are closely linked with the financial powers delegated to the local government, in practice huge mismatch between these two leads to a severe fiscal stress at the local level. Own revenues of local governments are good enough to meet only a part of their operation & maintenance requirements; therefore they are dependent on the higher level of governments to finance even their recurring expenditure. Towards this end, devolution of resources from the Union to States and States to PRIs and ULBs was considered a necessary requirement and clause "measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Mmunicipalities" was inserted in article 280 (3) of the Constitution on the recommendations of the Joint Parliamentary Committee headed by K P Singh Deo, which went into the Constitution (Seventy-third Amendment) Bill, 1991. Later, it was inserted in the Seventy-second Amendment Bill also. Para 4(iii) of the Presidential Order dated November 14, 2007 regarding the constitution of the XIII Finance Commission is the verbatim reproduction of the sub-clause 280(3) (bb & c).

II
FINANCES OF THE LOCAL GOVERNMENTS

Shrinking fiscal space for the PRIs and ULBs can be noticed easily. Table 3 reveals that the total expenditure of the local governments as a proportion of the combined expenditure of Union, state and local governments declined from 6.41 per cent in 1998-99, to 5.51 per cent in 2002-03. In a comparative perspective, India's place and record can be seen in Table 4. Many feel that this situation needs to be radically improved.

Finance Statistics, 2006-07.

For inclusive growth there is a need to have inclusive governance by restructuring the fiscal architecture for the PRIs and ULBs in a more equitable and efficient manner. The hallmark of any self-government is the

TABLE 3: LOCAL EXPENDITURES AS A SHARE OF INDIA'S GDP

Public Expenditure	*1998-99*	*2002-03*
Local Government Expenditure as % of GDP	1.74	1.56
Panchayats' Expenditure as % of GDP	1.05	0.99
ULBs' Expenditure as % of GDP	0.69	0.57
Local Government Share of Consolidated Public Expenditure	6.41	5.51
Panchayats' Share of Consolidated Public Expenditure	3.87	3.50
ULBs' Share of Consolidated Public Expenditure	2.54	2.01

SOURCES: (Basic data) Report of the Twelfth Finance Commission and Indian Public

degree of financial autonomy it enjoys in formulating and implementing public policies in regard to those functional responsibilities assigned to it. The amendments to 280(3)(bb&c) is a firm affirmation of the organic link between the UFC and the state - sub-state public finance. The task of restructuring public finance substantially depends on streamlining the multiple channels of resource flow from the Union to the local governments through the States.

Fiscal transfers in the form of shared revenue and grants are the mainstay of the local governments' finances even in progressive States[5]. Revenue is shared from the divisible pool of the state following the recommendations of the respective SFC. However, wide variations are seen across States in defining the divisible pool. A few SFCs form the divisible pool by including the share of Union taxes in the state tax and non-tax revenues, e.g. SFCs of Andhra Pradesh, Assam and Goa (table 8). In other words, some of the States, despite the constraints on their resources, do reduce the fiscal imbalance of the local governments, though partly, through a share in Union taxes. It can be observed that the fiscal capacity of the local governments, both PRIs and ULBs, in general, is not very strong. It is evident from table 5 and 6 that proceeds from internal sources contribute little to the corresponding expenditure requirements of the PRIs and ULBs. Property tax, octroi, advertisement tax, professional tax, taxes on vehicles & animals, theatre tax, user charges on services, rental income from properties, developmental charges, fees and fines, and the like contribute the maximum to the kitty of the local governments' own-source revenue.

[5] In contrast to the general belief that PRIs are not empowered to raise loans (Gulati 1994; (Oommen 1995; Jha 2000; Rajaraman 2003, Local Authorities Loans Act, 1914, a Central Act, does exist enabling the grant of loans to local authorities including PRIs.

TABLE 4: A COMPARATIVE PERSPECTIVE ON LOCAL GOVERNMENT SHARE OF GDP AND CONSOLIDATED PUBLIC EXPENDITURES

Country/ Reference Year	*Share of Local Expenditure in GDP (%)*	*Share of Local Expenditure in Consolidated Public Expenditure (%)*
Argentina, 2003	3	13
Brazil, 2003	7	20
Chile, 2001	3.5	10
China, 2003	11	51
India, 2002*	1.6	5.5
Indonesia, 2001	6.5	25
Poland, 1997	11	37
South Africa, 2001	6.5	27
Average - Select Developing Countries	5.8	not available
Average- OECD Countries	13	27

SOURCES: Anwar Shah with Sana Shah (2006), and * Table 3.

TABLE 5: CONTRIBUTION OF OWN- SOURCE REVENUE IN TOTAL EXPENDITURE OF PRIS, ALL TIERS

Revenue	*1990-91*	*2000-01*	*2001-02*	*2002-03*
Own Revenue (%)	4.5	5.9	6.0	6.8
Others* (%)	87.9	90.7	87.9	92.1

SOURCE: Alok (2006),

NOTE: * Others includes devolution and grants. The figures do not add up to 100% due to persistent gap between total (revenue + capital) expenditure and total revenue.

It may be argued that States could reduce the vertical fiscal imbalance by assigning a few buoyant revenues to the PRIs and ULBs. But, the limited financial space open to the States and the perceived low organisational and administrative capacity of the PRIs and ULBs has prevented the States from exercising this option. The dependence on fiscal transfers, particularly conditional and purpose specific ones, is reducing the autonomy of the PRIs and ULBs to allocate resources according to their own priorities. It is critical to enable and empower the local governments to generate and enhance their own-source revenue. In order to make this happen, a mechanism of untied transfer of funds to the local governments is essential for enhancing their fiscal and functional autonomy.

TABLE 6: CONTRIBUTION OF OWN- SOURCE REVENUE IN TOTAL EXPENDITURE OF ULBS

Revenue	*1998-99*	*1999-00*	*2000-01*	*2001-02*	*2002-03*
Own Revenue (%)	57.11	51.07	52.47	55.05	52.58
Others* (%)	38.56	40.09	40.15	40.15	37.41

SOURCE: same as table 3.
Note: *Others includes devolution and grants. The figures do not add up to 100% due to persistent gap between total (revenue + capital) expenditure and total revenue.

Table 7 presents the state wise trend in the share of fiscal transfers to local government in state's revenue. In the analysis the fiscal transfers under major head 3604 (Compensation and assignment to local bodies & PRIs) of the Finance Accounts have been taken into account. It may be noted that the transfers to local governments as a percentage to total revenue have declined in most states in recent years. Oommen (2006) also made the same assertion by analysing different set of data.

TABLE 7: SHARE OF FISCAL TRANSFERS TO LOCAL GOVERNMENTS (MAJOR HEAD 3604) IN TOTAL REVENUE OF STATE GOVERNMENTS (PER CENT)

	States	*1986-87*	*1990-91*	*1995-96*	*2000-01*	*2004-05*	*2006-07*	*(g) – (f)*
	(a)	*(b)*	*(c)*	*(d)*	*(e)*	*(f)*	*(g)*	*(h)*
1	Andhra Pardesh	1.24	0.90	0.79	0.84	0.79	0.63	-0.16
2	Assam	0.50	0.45	0.30	0.16	0.13	0.10	-0.04
3	Bihar	0.27	0.25	0.03	0.02	0.03	0.02	-0.01
4	Chhattisgarh	na	na	na	2.50	3.48	3.00	-0.48
5	Gujarat	0.69	0.56	0.47	0.32	0.71	0.38	-0.33
6	Haryana	0.00	0.52	0.18	0.23	0.83	2.00	1.18
7	Himachal Pradesh	0.37	0.25	0.23	0.66	0.06	0.05	-0.02
8	Jammu & Kashmir	0.00	0.00	0.00	0.00	0.00	0.00	0.00
9	Jharkhand	na	na	na	na	na	0.03	na
10	Karnataka	2.63	2.52	1.35	3.58	3.00	4.26	1.26
11	Kerala	0.13	1.33	1.38	0.63	-0.02	9.98	10.01
12	Madhaya Pradesh	2.03	2.66	3.06	3.86	4.64	4.99	0.34
13	Maharashtra	0.88	0.37	0.28	2.34	2.06	1.48	-0.58
14	Orissa	0.49	0.83	0.33	2.16	1.22	1.86	0.65
15	Punjab	0.77	1.42	1.23	0.95	0.54	0.88	0.34
16	Rajasthan	0.55	0.33	0.24	0.14	0.01	0.00	-0.01
17	Tamil Nadu	2.57	2.12	2.00	5.34	6.89	6.30	-0.59
18	Uttar Pradesh	0.65	1.28	1.80	4.39	4.74	4.80	0.06
19	Uttarakhand	na	na	na	4.44	3.45	2.86	-0.59
20	West Bengal	3.43	3.07	2.51	1.51	1.27	1.27	0.00

SOURCE: (Basic data), Office of the Comptroller and Auditor General of India and CMIE.

It could be argued, that the resources are also transferred to the PRIs and ULBs from other channels but those are tied and hardly assist in the

TABLE 8: SFC RECOMMENDATIONS FOR SHARE IN STATE RESOURCES

State	%	Share of PRIs and Urban Bodies	Basis of distribution
Total Revenue of State:			
Andhra Pradesh (I)	39.24	70%and 30%	Development criteria
Assam(I)	2.0	Not mentioned	Population
Goa (I)	36.0	75% and 25%	Population, geographical area, performance.
Own Revenue of State:			
Andhra Pradesh (II)*	10.39*	65%and35%	Development criteria
J & K (I)	13.5	67% and 33%	Not mentioned
Kerala (I)	1.0	not mentioned	Population
Madhya Pradesh (I)	11.579	25.13% and 74.87%	Population, area, tax efforts
Orissa (II)	10.0	80% and 20%	Population, density, number of holdings, revenue efforts
Sikkim (I)	1.0	100% and 0%	ULB does not exist in the state
Uttarakhand (II)	10.0	60% and 40%	Population, area, deprivation index, remoteness index, tax efforts
Uttar Pradesh(I)	10.0	30% and 70%	Population (80%); area (20%)
Uttar Pradesh(II)	12.5	40% and 60%	Population and area
Non-loan gross own revenue:			
Karnataka(I)	36.0	85% and 15%	For panchayats-population, area, index of decentralisation and for ULBs population 67% and illiteracy rate 33% [Kar II has followed it]
Karnataka(II)	40.0	80% and 20%	
State Own Taxes			
Assam (II)	3.5	Based on 1991 census	Pop, Area, Net Distt Domestic product
Kerala (II)	9.0	78.5% and 21.5%	Population
Kerala (III)	25.0#	Not mentioned	Not mentioned
Madhya Pradesh (II)	4.0	77.33% and 26.67%	Population
Punjab (II)	4.00	67.50% and 32.50%	Population, per capita, revenue, SCs
Rajasthan(I)	2.18	77.3% and 22.7%	Population
Rajasthan(II)	2.25	76.6% and 23.4%	Population
Tamil Nadu(I)$	8.0	60% and 40%	Population
Tamil Nadu(II)	10.0	58% and 42%	Population, SCs and STs, per capita own revenue, area, asset maintenance, resource gap
Tamil Nadu(III)	10.0	58% and 42%	Population, resource potential, needs
Uttarakhand (I)	11.0	42.23 and 57.77	Population and Distance from Rail Head
West Bengal(I)	16.0	Breakup as per population. district wise	Population and % of SC/ST, non literates
West Bengal(II)	16.0	Breakup as per population. district wise	Population 50% and 7% to other variables, population density, SC/ST, non-literates, IMR, rural population, per capita income.

SOURCE: Alok (2008)

Notes: # Not confirmed as the Report of the III SFC of Kerala has mentioned it at one place in uncertain term and the State Government gas not taken any cognisance of this number in its ATR.

$In Tamil Nadu, the divisible pool called pool B consists of sales tax, motor vehicle tax, state excise revenue and other state taxes. The other pool A consists of levies which rightly belong to local bodies i.e. surcharge on stamp duties, local cess and local cess surcharge and entertainment tax. The entire proceeds of pool A taxes are recommended to be distributed to the local bodies.

*Second SFC of Andhra Pradesh recommended 10.39% share as additional devolution over and above the existing annual devolution.

TABLE 9: ALLOCATION OF GRANTS TO PRIS AS RECOMMENDED BY THE XII FC AND ITS UTILISATION (RS IN CRORE)

	State	12th FC Allocation of PRIs for 2005 -10	Amount Released upto Dec 17, 2008	Last Half yearly Instalment released for the fiscal year	Utilisation reported by State Govt	% age utilised	Utilised under Water Supply and sanitation	
							Amount	%age
	Non-special category States							
1	Andhra Pradesh.	1587	952	07-08 (II)	654	69	573	88
2	Bihar	1624	974	07-08 (II)	650	67	292	45
3	Chhattisgarh	615	431	08-09 (I)	369	86	2	50
4	Goa	18	3	06-07 (II)	0	0		
5	Gujarat	931	652	08-09 (I)	452	69	126	28
6	Haryana	388	272	08-09 (I)	214	79	214	100
7	Jharkhand	482	0		0	0		0
8	Karnataka	888	622	08-09 (I)	444	71	117	26
9	Kerala	985	591	08-09 (I)	315	53	164	52
10	Madhya Pr.	1663	1164	08-09 (I)	991	85	481	49
11	Maharashtra	1983	1190	07-08 (II)	893	75	586	66
12	Orissa	803	562	08-09 (I)	403	72	397	99
13	Punjab	324	130	06-07 (II)	65	50		0
14	Rajasthan	1230	861	08-09 (I)	519	60	500	96
15	Tamil Nadu	870	609	08-09 (I)	522	86	498	95
16	Uttar Pradesh	2928	1757	07-08 (II)	950	65	819	86
17	West Bengal	1271	890	08-09 (I)	573	64	75	13
	Special category States							
18	Arunachal Pradesh	68	7	05-06 (I)	0	0		0
19	Assam	526	158	06-07 (I)	36	23		0
20	Himachal Pradesh	147	103	08-09 (I)	88	83	88	100
21	J & K	281	53	06-07 (I)	0	0		0
22	Manipur	46	13	07-08 (II)	8	67	7	84
23	Meghalaya	50	20	06-07 (II)	15	75	9	61
24	Mizoram	20	10	07-08 (I)	8	80	7	88
25	Nagaland	40	20	07-08 (I)	16	80	16	100
26	Sikkim	13	5	06-07 (II)	3	50	3	98
27	Tripura	57	17	06-07 (I)	0	0		0
28	Uttaranchal	162	65	06-07 (II)	49	75	22	45
	Total	20000	12128		8236	68	4993	61

Source: (Basic data) Finance Commission Division, Ministry of Finance, GoI

requirements of the fiscal capacity building of the PRIs and ULBs. Hence, a responsibility lies with the XIII Finance Commission to devolve adequate funds for this purpose to the PRIs and ULBs under article 280 (3) (bb & c). Substantial tied funds are being transferred to the PRIs and ULBs through the centrally sponsored schemes (CSSs). For long, the CSS transfers were administered and utilised mainly by the line departments. In recent years, the local governments are being increasingly recognised as implementing institutions for the plan schemes of line ministries.

TABLE 10:ALLOCATION OF GRANTS TO ULBS AS RECOMMENDED BY THE XII FC AND ITS UTILISATION (RS IN CRORE)

	State	12th FC Allocation of ULBs for 2005-10	Amount Released upto Dec. 17, 2008	Half yearly Instalment released upto	Utilization reported by State Govt.	%age utilised	Utilised for Solid Waste Mgt Amount	Utilised for Solid Waste Mgt %age
	Non-special category States							
1	Andhra Pradesh	374	187	07-08 (I).	150	80	150	100
2	Bihar	142	85	07-08 (II).	57	67	28	50
3	Chhattisgarh	88	35	07-08 (I).	26	75	18	69
4	Goa	12	2	05-06 (II)	1	52	0	0
5	Gujarat	414	290	08-09 (I)	248	86	135	54
6	Haryana	91	64	08-09 (I)	36	57	18	50
7	Jharkhand	98	0		0		0	
8	Karnataka	323	194	07-08 (II).	162	83	81	50
9	Kerala	149	104	08-09 (I)	75	71	44	59
10	Madhya Pradesh	361	253	08-09 (I)	181	71	90	50
11	Maharashtra	791	396	07-08 (I).	230	58	123	54
12	Orissa	104	42	06-07 (II)	0	0	0	0
13	Punjab	171	120	08-09 (I)	103	86	51	50
14	Rajasthan	220	154	08-09 (I)	100	65	61	61
15	Tamil Nadu	572	400	08-09 (I)	343	86	172	50
16	Uttar Pradesh	517	362	08-09 (I)	310	86	155	50
17	West Bengal	393	275	08-09 (I)	177	65	81	46
	Special Category States							
18	Arunachal Pradesh	3	1	05-06 (II)	0	0	0	
19	Assam	55	17	06-07 (I)	6	33	5	85
20	Himachal Pradesh	8	6	08-09 (I)	5	86	4	87
21	J & K	38	11	06-07 (I)	0	0	0	
22	Manipur	9	5	07-08 (I).	4	80	2	50
23	Meghalaya	8	3	06-07 (II)	2	75	2	63
24	Mizoram	10	5	07-08 (I).	4	80	2	50
25	Nagaland	6	3	07-08 (I).	2	80	1	57
26	Sikkim	1	0		0	0	0	0
27	Tripura	8	1	05-06 (I)	0	0	0	0
28	Uttaranchal	34	10	06-07 (I)	0	0	0	0
	Total	5000	3023		2220	73	1223	55

SOURCE: Finance Commission Division, Ministry of Finance, Government of India

Recently, the schemes have started assigning a range of responsibilities to the PRIs and ULBs and depend upon them for grassroots implementation. In addition, there are several important flagship programmes of the Union, which aim at provisioning basic essential services across the country through the local governments. The allocations to the programmes, entailing the involvement of the local governments, have shown a substantial growth. It is a good augury that the institutional mechanisms tend to provide centrality to the PRIs and ULBs in their planning and implementation. It is observed that today, the physical and social infrastructure is growing gradually in all rural and urban areas. Tomorrow, the emphasis will shift to the operation and maintenance of the assets created, the cost of which would have to be met largely through devolution and grants recommended by the UFC and SFCs.

In addition, Disaster Management Act, 2005 has also identified the role for the PRIs and ULBs at the local level.

III
RECOMMENDATIONS OF EARLIER FINANCE COMMISSIONS AND THEIR UTILISATION

So far three Union Finance Commissions have approached the issue and made their recommendations The X Finance Commission took a suo moto cognisance in this regard as article 280 had just been amended when the Commission was in office. As the contours of decentralisation were not very clear at the time, the Commission had to adopt an ad hoc approach of a token nature and made a provision of Rs 4,381 crore @ Rs 100 per capita for passing on to PRIs between 1996 and 2000. In the absence of formal disbursement certificates by the state governments, the Government of India, it is learned, could release only Rs 3,567 crore. On the other hand, the Commission recommended Rs. 1,000 crore for municipalities to be distributed amongst the states on the basis of slum population.

The TOR to augment the Consolidated Fund of a state to enable them to supplement the resources of the local governments was, for the first time made to the XI Finance Commission. It recommended Rs 10,000 crore for PRIs and Rs 2,000 crore for municipal institutions. Certain institution building activities such as maintenance of accounts, creation of database and audit were made the first charge of the fund. Inducement to local governments as institutions of self-governments was the thrust of the grant. The Government of India accepted the recommendations with a caveat compelling PRIs and ULBs to raise suitable matching resources.

The money could not be utilised and the Twelfth Finance Commission had to emphasise this point, "…The central government should not impose any condition other than those prescribed by us, for release or utilisation of these grants." In its recommendations, the 12th Finance Commission attempted to adopt the equalisation principle and provided only a grant of Rs 20,000 for PRIs for drinking water suppy and sanitation and Rs 5,000 crore for ULBs to improve the service delivery in respect of solid waste management. The Twelfth Finance Commission estimated the amount recommended for both the Panchayats and ULBs "equivalent to 1.24 per cent of the sharable tax revenue receipts of the centre …during the period 2005-10[6]." The inter se allocation, release and utilisation of the grants could be seen in Tables 9 and 10 .

If fact, all the three commissions recommended grants-in-aid of an ad hoc nature. Considering the expectations of the people enveloping about 2.5 lakh Panchayats and 3.7 thousand Municipalities and the historic task to build "institutions of self government", the yearly allocations and releases are negligible. Moreover, Finance Commission transfers are for revenue support and ordained for operation & maintenance and cannot take the form of function specific grants. These are in the domain of the Planning Commission and the line ministries.

There have been frequent suggestions that local governments have to be self-sufficient financially. But it has to be admitted that in the initial stages they need to be induced and supported to act as a government at the local level to deliver local public goods.

IV
NEED TO REORIENT FISCAL TRANSFER MECHANISM FOR LOCAL GOVERNMENTS

The 13th Finance Commission has a major role to induce the institutions of governance that are closest to the people. All States except one have completed at least two rounds of elections under the supervision of respective state election commission, an autonomous constitutional entity. Similarly, processes of fiscal devolution from States to the PRIs and ULBs are taking place through SFCs. In many States, the report of third generation SFC has been submitted. Assets are being either created or transferred to the PRIs and ULBs. All of this imposes an administrative cost on the local governments and draws on scarce resources that they receive from their own sources and from the state. In this connection, fiscal transfers through UFC have to play a critical role.

[6]Report of the Twelfth Finance Commission (2005-10), 2004, p. 152.

It is to be mentioned that ad hoc grants of a token nature given by the earlier UFCs now need to be replaced by regular transfer arrangement. The role now for the Thirteenth Finance Commission is to act as the path breaker in creating an enabling environment for fiscal decentralisation at the sub-state level. This could be done through fiscal capacity equalisation, an essential condition for a controlled and gradual process of fiscal decentralisation (Bahl, 1999). This requires, at this stage, the support from the UFC as various sub national governments have different and inadequate capacities to finance the PRIs and ULBs. This is partly due to hard budget constraints imposed on them. It is expected from the Thirteenth Finance Commission to accept that fiscal decentralisation is not a zero sum game. In this context, the following points are worthy of being noted:

- Certain annual rise in the administrative cost is inherent with the increase of public employees' salaries particularly after the implementation of the recommendations of the Sixth Pay Commission. This will have effect in the establishment cost of the local governments including the salary of the staff in the account and a computer section (necessary minimum staff need to be appointed in all panchayats, municipalities and nagar panchayats).
- Due to increased activities, there would be an additional maintenance cost of office space including storage, record rooms, computer centre, libraries etc.
- In order to impose a uniform system of financial accounts, audit rules, disclosure requirements under Right to Information (RTI) Act, there would be a need for technical assistance to local governments in several areas such as computerisation, accounting, treasury, tax administration, data processing, project evaluation, audit at local fund and Comptroller and Auditor General (CAG) levels, transparent procurement procedures etc.
- Operation and maintenance costs will go up chiefly due to greater investment in the form of local infrastructure particularly for drinking water supply, irrigation and communication for the poor.
- There would be additional recurring expenditure on traditional civic services like public lighting, roads and sanitation arising out of increased people's expectations.

Genesis and Rationale of Article 280 (3) (bb&c)

The genesis of the addition of clause (3) (bb & C) to article 280 of the Constitution can be traced in the Report of the Joint Committee of Parliament (1991) that felt

"amendment should be made in article 280 relating to constitution of

Central Finance Commission so that the said Commission should make recommendations to the President.....The need for this amendment has been (was) explained further in detail in chapter II of the Report".

Chapter II of the report made inter alia the following explanation,

"Availability of resources should be both commensurate and elastic keeping pace with their growing needs. Apart from augmenting internal sources, methods need to be devised for enlarging the area of assured devolution and the quantum of assistance that will flow from the Centre to States and States to the Municipalities. The Centre -State fiscal relations are governed by constitutional provisions. Unfortunately there is no such constitutional mechanism at present which provides for a regular assessment of the fiscal resource gap that exists in municipalities on account of the increasing responsibilities thrust upon them and for putting the devolution of resources to urban local bodies on a rational and firmer footing."

It may also be recollected what the then Minister for Rural Development said while moving the Constitution (Seventy-second Amendment) Bill, 1991

"Constitution (Seventy-third) Amendment cast a duty on the centre as well as the states to establish and nourish the village panchayats so as to make them effective self-governing institutions.... We feel that unless the panchayats are provided with adequate financial strength, it will be impossible for them to grow in stature".

It is to be noted that the provision regarding "measures needed to augment the Consolidated Fund of a State" is provided in article 280 and not in Part IX and IX A of the Constitution. The fact that the article 280 was amended to add clause (3)(bb& c) explains that just as the state government has the responsibility under article 243 (I&Y) to devolve resources to PRIs and ULBs, the Union government also has a corresponding role and responsibility. The clause was inserted to enable and provide a legal basis for the pass-through of central funds to the local governments, with which the Union has no direct relationship. The term "measures needed to augment the Consolidated Fund of a State" offers a extensive scope for intervention by the Union Finance Commission (UFC). "Measures" obviously include legislative, administrative and financial one – and "financial measures" perceptibly mean direct flow of resources from the Union to local governments through States.

Seemingly, there is nothing standing in the way of earmarking a certain percentage of the transfer to be passed on to local governments. The words "measures", "augment" and "supplement" are clear enough. Of course, the position can be put beyond a shadow of doubt by suggesting an amendment to article 266, defining the Consolidated Fund of a state on lines similar to the Consolidated Fund of India – that is, net of transfers of state's resources and those transferred from the Union to local governments[7].

It is also stipulated that the suggested measures of the UFC to augment the Consolidated Fund of a state have to be based on the recommendations of the SFC. This will continue to create a major difficulty in practice for the present and future UFCs for the reasons stated by the earlier UFCs and experts. Therefore, the Thirteenth Finance Commission has to make its own assessment to quantify the non-plan resource requirement of the PRIs and ULBs relying on the SFCs only for trend, knowledge and some data. The Commission could also rely on SFCs for the horizontal distribution of the devolved funds amongst the PRIs and ULBs within a State.

The 13th Finance Commission may, therefore, realistically assess the cost of the creation of third tier and compensate it adequately. The time has come, for the UFC to desist from the approach of ad hoc nature and include the local governments in the arrangement of revenue sharing as the case with the state emanated from the 80th Amendment of the Constitution. Also, the articles 243H, 243I, 243X, 243Y, 266, 268, 269, 270, 275, 279 and 280 do not, in any way, preclude the UFC from earmarking a share of central revenues for the PRIs and ULBs, suggesting that it be given into the Consolidated Fund of a state for the express purpose of supplementing the PRIs and ULBs fund. Since nowhere it is stated that the transfer of funds to the PRIs and ULBs should only be in the form of grants, it is safe to suggest, that local governments should also be considered to get the share from the central divisible pool along with the States. This would be over and above the fiscal devolution recommended to the States to correct vertical imbalance. Seemingly, the scheme has the following merits:

- This will help a great deal in linking the local governments with the Indian federal structure along with the state and Union government.
- The local governments will be able to share the aggregate buoyancy of central taxes. This is particularly important when the economy is passing through an inflationary phase.
- The Union, state and local governments would feel the impact of fluctuations in central tax revenues alike.
- The progress of tax reforms will be greatly facilitated if the scope of tax sharing arrangement is enlarged so as to give greater certainty of resource flows to local government and increased flexibility in tax reform and tax reengineering e.g. introduction of goods and service tax (GST).

[7] V Ramachandran (2008)

It may be argued that the scheme will be consistent with the practice adopted in other federations with an institution akin to the UFC. For example; a) four per cent of the commonwealth net personal income tax is shared with local governments in Australia, b) local governments are entitled to an 'equitable share' of national revenue in terms of section 214 of the constitution of South Africa, c) In Nigeria, resources are allocated among the three tiers of government, i.e., federal (49%), state (24%), local (20%), other funds and the federal capital territory (7%)[8]. Moreover, the scheme is simple and does not require a constitutional amendment.

TABLE 11: PROJECTED CENTRAL GROSS TAX REVENUES[9]

(Rs. in crore)

Revenue	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*2013-14*	*2014-15*
Gross Central Tax Revenues	789179	910307	1050026	1211190	1397091	1611525
Net Central[10] Tax Revenues	662910	764658	882022	1017400	1173556	1353681
PRIs' share (5%)	33146	38233	44101	50870	58678	67684
ULBs' share (3%)	19887	22940	26461	30522	35207	40610

SOURCE: (Basic data) Central Budgets.

Considering the merits of tax sharing, the Thirteenth Finance Commission could recommend five per cent and three per cent of the divisible pool of the Union to the PRIs and ULBs respectively. In other words, eight per cent of the net proceeds of the central taxes could be devolved to the local governments through the state governments. This would be over and above the share of the state governments from the

[8]Contribution of Abhijit Datta is gratefully acknowledged in providing these figures.

[9]The central gross tax revenue has been projected based on the buoyancy based growth rates applied on the budget-estimates of gross-central-tax-revenues for the base year 2008-09. The estimated buoyancy of gross-central-tax-revenues for the period between 1999-00 and 2007-08 (RE) is 1.41. However, this is exceptionally high and given the downward revision of aggregate growth target and uncertain global economic environment, it may be difficult to sustain an aggregate buoyancy of taxes at this level. So, for the purpose of estimation and projection of gross-tax-revenues, we have taken 1.3 as the buoyancy and projected the profile of taxes. The estimated buoyancy based growth rate of taxes for this period works out to be 15.35 per cent.

[10]Net central revenues exclude cesses, surcharges and the cost of collection from the Gross central revenues. As per our calculation, it stands a whopping 16% of the gross revenues. Since, cess and surcharge on central taxes do not form part of the divisible pool, State loses a share from a large quantum of Rs 70,000 crore in a year (1.5% of GDP). It is an irony that cess is largely levied for education, that is also in the domain of local governments.

divisible pool as would be revised and recommended by the Thirteenth Finance Commission. Considering the growth of the economy and the buoyancy of the taxes, some conservative projections have been made in table 11 of the central gross tax revenue till the last year of the award period of the Thirteenth Finance Commission. On a conservative estimate the share of the local governments in first year of the award period would be around Rs 60,000 crore. This would increase with the increase of central tax revenues.

Other Instruments

The horizontal distribution of the above fiscal transfer among States should be based on a few simple parameters. There may not be a need to have a separate formula for the inter se distribution of the PRIs and ULBs' fund among States. However, the formula must assign appropriate weight to progress made in regard to functional, financial and administrative decentralisation. In this regard, the formula could assign appropriate weight to a devolution index (Alok and Bhandari 2004). that was accepted as the resolution of the Fifth Roundtable of the State Ministers In-charge of Panchayati Raj at Srinagar in October 2004 (http://www.panchayat.gov.in). The revised version is at annex.

The complications involved in the implementation strategy are known in view of the heterogeneity and varying capabilities of the sub national governments. But the basic rule could be to protect simplicity by limiting the number of objectives to be accomplished by each policy instrument. Since, the fiscal transfer from the UFC is ordained for revenue expenditure, the Thirteenth Finance Commission could suggest the SFC or the state to make inter se distribution among the PRIs and ULBs within the state on these lines. It is expected that the state will adopt uniform accounting systems that follow accepted principles, prescriptions for audit procedures etc.

The 13th Finance Commission could reiterate and recommend a 'permanent SFC cell'[11] in each state, probably located in the Department of Finance with staff adequate to continuously monitor local government finances including development transfers from the line ministries. The unit could also develop an extensive data system in consultation with the state statistical unit so as to facilitate effective monitoring and evaluation.

---

[11] The XII Finance Commission and many State Finance Commissions have also recommended it.

CONCLUSION

The 13th Finance Commission could strike out a bold path and play a positive role in energising the local governments by strengthening their fiscal capacity not merely to satisfy its mandate but more importantly to enable the empowerment of the citizens particularly poor of the country.

A FURTHER READING

1. Alok, V N 2004, "State Finance Commissions in Indian: An Assessment", Indian Journal of Public Administration, Vol L, No.3, pp 716-732.
2. ————— 2006, "Local Government Organisation and Finance: Rural India" in in Anwar Shah (ed) Local Governance in Developing Countries, The World Bank
3. ———— 2008, "The Role of State Finance Commissions in Fiscal Decentralisation in India" in M A Oommen (ed) Fiscal Decentralisation to Local Governments in India, Newcastle upon Tyne, Cambridge Scholars Publishing,
4. Alok, V. N. and Laveesh Bhandari, 2004. "Rating the Policy and Functional Environment of PRIs in Different States of India – A Concept Paper". Paper presented at the Fifth Roundtable of Ministers In-charge of Panchayati Raj held on October 28-29, 2004 at Srinagar. www.panchayat.gov.in
5. Asian Development Bank 2009, Urban Poverty in India, New Delhi, B S Books
6. Bardhan, P. and D. Mookherjee 2007 'The Rise of Local Governments: An Overview' in Bardhan, P. and D. Mookherjee (eds) Decentralisation and Local Governance in Developing Countries: A Comparative Perspective, New Delhi, Oxford.
7. Bahl, Roy 1999, Implementation Rules for Fiscal Decentralization, Georgia State University, Atlanta, Georgia
8. Bird Richard and Christine Wallich 1993, Fiscal Decentralization and Intergovernmental Relations in Transition Economies, Policy Research Working Papers (Public Economics) No 1122, The World Bank.
9. Census of India, 1991. "Final Population Totals". New Delhi: Government of India.
10. Commonwealth Grants Commission 2006, Architecture of Horizontal Fiscal Equalization: Principles and Interpretation, New South Wales submission.
11. Government of India, 2008, Central Budget 2008-2009, Ministry of Finance
12. —————— 2007, "Indian Public Finance Statistics, 2006-2007". New Delhi: Ministry of Finance.
13. —————— 2007, Sixth Report of Second Administrative Reforms Commission, 'Local Governance', Oct.
14. Government of India, 2001. "Final Population Totals", New Delhi, Government of India
15. —————, 2000. "Report of the Eleventh Finance Commission for 2000-2005". New Delhi: Government of India.
16. —————, 2004. "Report of the Twelfth Finance Commission (2005-10)". New Delhi: Government of India.
17. Gulati, I S 1994. "Financial Devolution to Local Bodies: Role of State Finance Commissions" in Economic and Political Weekly, XXIX, No. 40
18. India 1914 The Local Authorities Loans Act, 1914 Act No. 9 of 1914.
19. Jha, Sikha 2000 " Fiscal Decentralization in India: Strengths, Limitations and Prospects for Panchayati Raj Institutions" Background Paper 2, Overview of Rural

Decentralization in India, vol. 3. Washington D C, World Bank.

20. Karnik, Ajit. Abhay Pethe and Dilip Karmarkar 2002, Devolution of Funds from State Government to Local Bodies: A Quantitative Approach, Working Paper UDE(CAS)2(2)/2002, University of Mumbai, Department of Economics.
21. Kelkar, Vijay 2004, Report of the Task Force on Implementation of the Fiscal Responsibility and Budgetary Management Act, 2003, Ministry of Finance, GoI.
22. Lok Sabha 1992, The Constitution (Seventy Third amendment) Bill, 1991 (Insertion of New Part IX A and addition of Twelfth Schedule) Report of the Joint Committee headed by K P Singh Deo.
23. Oommen, M.A 1995. Panchayat Finances and Issues Relating to Inter-Governmental Transfers" In Panchayat and Their Finance, ed. M.A. Oommen and Abhijit Datta, 1-54, New Delhi: Institute of Social Sciences.
24. Oommen, M.A. 2005, Twelfth Finance Commission and Local Bodies, in Economic and Political Weekly, May 14
25. Prud'homme, Remy. 1995, The Dangers of Decentralization, World Bank Research Observer, Vol.10 No(2) August.
26. ——————— 2006, Fiscal Decentralization to the Sub-State Level Governments, in Economic and Political Weekly, March 11.
27. Rajaraman, Indira 2003, A Fiscal Domain for Panchayats, Oxford.
28. ————— 2006, Fiscal Features of Local Governments in India in J.J. Dethier (ed) Governance, Decentralization and Reform in India, China and Russia, Kluwer
29. Ramachandran, V. 2008, Letter to Dr Kelkar, Chairman, 13th Finance Commission, September 16.
30. Shah, Anwar. 1989, "A Capitalization Approach to Fiscal Incidence at the Local Level". Land Economics 65 (4): 359-75.
31. Shah, Anwar and Sana Shah 2006, "The New Vision of Local Governance and the Evolving Roles of Local Governments" in Anwar Shah (ed) Local Governance in Developing Countries, The World Bank
32. Singh, Rahul 2009, "Law –and-Economics of the Third Stratum: Is it a La Meddle, Muddle but stay in the Middle?" paper presented in the conference on December 22 at IRMA sponsored by the XIII Finance Commission.
33. Tiebout, C. 1961 An Economic Theory of Fiscal Decentralization in Public Finance: Need, Sources and Utilization, Princeton, New Jersey, Princeton University Press.
34. World Bank 2007, West Bengal Fiscal Decentralization to Rural Governments: Analysis and Reform Options (unpublished)

Annexure

Devolution Index[12]

A. The Index

This article proposes a method that quantifies the current environment that PRIs function under. That is, how 'free' the PRIs are to take independent decisions and implement them. No doubt the actual performance of PRIs differs and depends upon many other factors. These factors are specific to the state, to the different level of the Panchayati Raj Institutions. The enabling environment is also determined by village level factors. To re–iterate, the method seeks to measure the environment of PRI functioning that state governments have been able to create, not for the functioning of PRIs and not the functioning of PRIs themselves.

As a consequence, the data and information are required at the state–level. An attempt is made to cover both quantitative and qualitative aspects. Qualitative issues have been categorised in a quantitative manner so that quantitative ratings can be conducted.

The methodology stresses upon the village level PRIs. These are rated on the basis of

- Functions
- Finances
- Functionaries

It is therefore named as the FFF-Index. Each of these heads has between five to nine measures. The value of each measure ranges between one and five. Equal weights are assigned. It is proposed that three indices be first prepared, one each for Functions, Finances and Functionaries by averaging the values of the measures under each head. In order to ensure clarity, efficiency and proper accountability, it is proposed to adopt the differentiation of functions into core, welfare and economic categories as done by the Eleventh Finance Commission. Whether civic amenities, primary health care, drinking water supply or sanitation or any other should be core function and to what level it should be assigned will have to be clearly spelt out by the legislature. The principle of subsidiarity, that whatever can be done best at a lower level must necessarily be done at that level unless a convincing case can be made for assigning them to higher levels of government, should be respected and adhered to.

[12]Earlier version of the paper, "Rating the Policy and Functional Environment of PRIs in Different States of India– A Concept Paper' was prepared, presented and finalised by V N Alok and Laveesh Bhandari at the Srinagar Round Table in October 2004. It was a part of the resolution.

B. The Mechanics of the FFF-Index

The final index of devolution to PRIs however should be calculated as a multiple of the three sub–indices. This is based on the view that greater devolution is a product of all the three categories of devolution and not its simple aggregate. The following variables are included:

Variable	*Measure*
A: Functions: Creating and supporting conditions for assigning functions to PRIs	
1. De facto transfer of 5 Core functions to the Panchayats by way of Rules/ Notifications/ Orders of state governments	[(Number transferred/5)*4]+1
2. De facto transfer of 13 Welfare functions	[(Number transferred/13)*4]+1
3. De facto transfer of other 11 Economic functions	[(Number transferred/11)*4]+1
4. Percentage share of funds transferred to PRIs from out of 29 matters listed in the 11th Schedule based on the State Budget for the latest year	< 5% – 1 5 – 25% – 2 25 –50% – 3 50 –75% – 4 ≥75% –5
5. The state government has incorporated Citizens Charter for PRIs and implemented Right to Information Act	No to both – 1 Has done either – 3 Has done both – 5
6. Whether Detailed Activity Mapping has been conducted or not.[13]	No activity mapping has been conducted – 1 Activity mapping has been conducted for: All core functions – +2 (add 2 mark) All Welfare Functions – +1 (add 1 mark) All Economic Functions– +1(add 1 mark)
B. Finances: Creating conditions that strengthen PRIs financial abilities	
7. Authorisation to the Village Panchayats as per the Village Panchayat Act to collect and appropriate taxes, duties, tolls and fees. (See below)	[(Number assigned/6)*4]+1
8. PRIs Own Revenue as % of State's Own Revenue (based on latest data for the aggregate PRI budgets and the corresponding State Budget)	≤0.5% –1 1 – 1% – 2 2 – 2% – 3 3 – 3% – 4 ≥ 4% – 5

[13]Detailed Activity Mapping is the first step towards high 'quality' of devolution. As such this index will not be able to capture the qualitative aspects of devolution. For this purpose we propose a three-pronged approach to measuring the extent, quality of devolution and the quality of outcomes. See concluding note.

Variable	*Measure*
9. Constitution of State Finance Commission.[14] (See below)	Only 1 SFC has been constituted – 1 Second SFCs report received– 2 Third SFC has been constituted – 3 Third SFC report received - 5
10. Composition of SFC in the State Act –Qualification of Members and manner of selection	No to both – 1 Has mentioned either – 3 Has mentioned both – 5
11. Action taken on the Major Recommendations of latest State Finance Commission[15]	SFC not constituted or report not submitted or <5% of recommendations accepted –1 >5% to <25% of recommendations accepted– 2 25 to 50% of recommendations accepted – 3 50 to 75% recommendations accepted – 4 >75% of recommendations accepted – 5
12. Timely Actions on the latest SFC's recommendations	> Two years – 1 < Two years but >one year – 2 < One year but > six months – 3 < Six months – 5
13. Percentage of funds devolved to PRIs that are 'untied' to any scheme (based on the latest State Budget)	<5% are untied – 1 5–25% untied – 2 25–50% untied – 3 50–75% untied – 4 >75% untied – 5
14. PRI accounts are audited on an annual basis within 1 year of the year end (the measure here will be % of PRIs whose accounts are audited for the preceding year)	<5% – 1 5–25% of PRIs audited – 2 25–50% of PRIs audited – 3 50–75% of PRIs audited – 4 >75% of PRIs audited – 5
15. Release of TFC grants to PRIs	If 50% funds are released: By Q_4 – 1 By Q_2 – 4 By Q_3 – 3 In Q_1 –5
C: Functionaries: Powers of elected functionaries and support received by them	
16. If devolved functions are administered by	State Government employees - 1 Parallel Parastatal bodies employees - 2 Panchayats employees - 5

[14] 1. Property /House Tax; 2. Profession Tax; 3.Land Tax/Cess; 4. Taxes/Tolls on vehicles; 5. Entertainment Tax/Fees; and 6. License Fees/others

[15] Succeeding SFCs build a momentum of transparency and evaluation of the devolution process, which in turn leads to better 'quality' of devolution. This measure seeks to captures this element. Newly formed State shall assign 5 marks for the constitution of second SFC.

Variable	*Measure*
17. Gram Sabha meetings are recorded and available to all concerned	If <5% Meetings' records are available –1 If 5–25% Meetings' records are available –2 If 25–50% Meetings' records are available –3 If 50–75% Meetings' records are available –4 If >75% Meetings' records are available –5
18. Who has the power to a.) take disciplinary actions/suspend/remove elected officials; b.) suspend /dissolve the elected bodies; and d.)suspend/cancel resolutions passed	District Magistrate and below –1 State Government Administration – 2 State Government (Quasi Judicial) – 4 Standing Committee of Legislature – 5
19. General support to Panchayats: Government has specified institutions and entities to support PRIs for preparation of Annual Plans	For <5% PRI – 1 For 5–25% of PRIs – 2 For 25–50% of the PRIs – 3 For 50 to 75% of the PRIs – 4 For >75% of the PRIs – 5
20. General support to Panchayats: Government has specified institutions and entities to support PRIs for capacity building	For <5% PRI – 1 For 5–25% of PRIs – 2 For 25–50% of the PRIs – 3 For 50 to 75% of the PRIs – 4 For >75% of the PRIs – 5
21. Constitution of District Planning Committees (DPC)	If <5% DPCs constituted –1 If <25% of DPCs constituted – 2 If between 25 to 50% of DPCs constituted – 3 If between 50 to 75% of DPCs constituted – 4 If greater than 75% DPCs constituted – 5
22. Treatment to the status of Parallel bodies	No change - 1 Inducted PRIs representatives in these bodies---- 2 Modified their powers only to fund management 3 Made parallel bodies as units of PRIs 4 Merged the parallel bodies with PRIs -5

The proposed FFF-index seeks to capture the extant of devolution that the state government has achieved. As such it is transparent and objective in that any one can conduct this and judge for themselves the extent of devolution. More importantly it will allow a comparison of states not only with each other but also across time. That is, how rapidly they are moving towards greater devolution. The proposed index is therefore, simple, objective, and transparent for anyone to create independently.

The FFF-index however will not be able to capture certain qualitative elements of the devolution process. The Activity Mapping of the three Tiers of PRIs provides an excellent framework for measuring the quality of the devolution. However an index based on those specific activities will not be highly comparable across states as it will have to capture elements that are idiosyncratic to the state. Such an index will better measure the changes within the state across time. More importantly the measures will have to be based on some subjective judgments. This would also require PRI level surveys.

The proposed FFF-index will also not be able to capture outcomes, as has been mentioned in earlier sections. Measuring outcomes would also require studies and surveys at the PRI level and should be conducted at a regular basis to fine-tune the devolution process.