A Memorandum of
The Ministry of Urban Development, Government of India
to
THE XIII FINANCE COMMISSION

Reference: Para 4 (iii) of the Presidential Order dated November 14, 2007 regarding the constitution of the XIII Finance Commission "*measures needed to augment the Consolidated Fund of a State to supplement the resources of the municipalities in the State on the basis of the recommendations made by the Finance Commission of the State"*

Legal Framework

There is a growing realization around the globe that decentralization of administrative, political and fiscal responsibilities to the local units of Government is one of the best ways of deepening democracy and increasing efficiency. India is also keeping pace with this trend. New systems of local and intergovernmental finance are being established as part of the evolution. The trend has been noted, particularly since early nineties with the passage of 74^{th} Constitutional Amendment that accelerated the process of decentralization with greater devolution and delegation of powers to local governments and the recognition of urban local bodies (ULBs) in the statute as institutions of self-government.

Consequently, Part IXA has been inserted to the Constitution pertaining to ULBs. The State Governments are expected to transfer functions listed in the Twelfth Schedule. The States are also expected to transfer the concomitant powers to enable them to carry out the responsibilities conferred upon them. The legislature of a State may both authorize the 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 ULBs. By the end of July 2004, the number of ULBs numbered 3723 in all States. This number consists of 109 Municipal Corporations, 1432 Municipalities and 2182 Nagar Panchayats (Table 1).

New fiscal arrangement necessitates every State under article 243Y to constitute, at regular interval of five years, a finance commission (SFC), and assign it the task of reviewing the financial position of 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 should be closely linked with the financial powers delegated to the local government. However, there is a significant mismatch between these two which leads to severe fiscal stress at the local level. Own revenues of local bodies 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. Since the cities contribute in a big way to the State and the national economy, it is considered necessary that the Union as well as the States should facilitate development and maintenance of basic urban infrastructure to promote overall economic growth of the country and improving the quality of life of citizens. Towards this end, devolution of resources from the Union to States and States to ULBs is considered a necessary requirement and clause "*measures needed to augment the Consolidated Fund of a State to supplement the resources of municipalities"* has been inserted in article 280 (3) of the Constitution on the recommendations of the Joint Parliamentary Committee, which went into the Constitution (Seventy-third Amendment) Bill, 1991. Para 4(iii) of the Presidential Order dated November 14, 2007 regarding the constitution of the XIII Finance Commission reiterates sub-clause 280(3) (bb & c).

Article 280 (3) (c)

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 A of the Constitution. The fact that the article 280 was amended to add clause (3)(c) explains that just as the State government has the responsibility under article 243 (Y) to devolve resources to 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 wide scope for intervention by the Union Finance Commission (CFC). "Measures" obviously include legislative, administrative and financial one – and "financial measures" obviously mean direct flow of additional resources from the Union.

The article also lays down that the suggested measures 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 Central Finance Commissions (CFCs) for the reasons stated by the earlier CFCs and experts. Therefore, the Thirteenth Finance Commission has to make its own assessment to quantify the resource requirements of the ULBs taking into account recommendations of SFCs for trends and some data. The Commission could also rely on SFCs for the horizontal distribution of the devolved funds amongst the ULBs within a State.

Earlier Finance Commissions and ULBs

It would be useful to see how the previous three Commissions approached the issue. The Tenth 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 decentralization 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. 1000 crore for municipalities to be distributed amongst the states on the basis of slum population. The Tenth Finance Commission set an important precedent by recommending fiscal transfers from the Union government to local governments through State governments.

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 Eleventh Finance Commission. It recommended Rs 2000 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. Promotion of municipalities as institutions of self-governments was the thrust of the grant. The Government of India accepted the recommendations with a caveat that required ULBs to raise suitable matching resources. The money could not be utilized and the Twelfth Finance Commission had to emphasize this point, *"…The central government should not impose any condition other than those prescribed by us, for release or utilization of these grants."* In its recommendations, the Twelfth Finance Commission attempted to adopt the equalization principle for the general transfer, but provided only a grant of Rs 5,000 crore to improve the service delivery by the ULBs in respect of solid waste management. The Twelfth Finance Commission estimated the amount recommended for both the panchayats and ULBs was *"equivalent to 1.24 per cent of the sharable tax revenue receipts of the centre …during the period 2005-10."*

TABLE 1: NUMBER OF URBAN LOCAL BODIES BY STATE
as on December 2004

SL. No.	State	Municipal Corporations	Municipal Councils	Nagar Panchyat	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 : Report of the Twelfth Finance Commission and Census of India, 2001
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.

All the three Commissions so far have recommended grants-in-aid of an *ad hoc* nature. Considering the task of building ULBs as "institutions of self government", the yearly allocations and releases are negligible. Moreover, Finance Commission transfers are mainly for supporting revenue expenditure and operation & maintenance and usually do not cover 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 current scenario, they need to be supported to enable them to evolve as vibrant entities capable of performing their due role.

Finances of the ULBs

Shrinking fiscal space for the ULBs can be noticed easily. Table 2 reveals that the total expenditure of the ULBs as a proportion of the combined expenditure of Union, State and local governments declined from 2.54 per cent in 1998-99, to 2.01 per cent in 2002-03. Table 3 presents a comparative picture in this regard. This needs to be addressed immediately

TABLE 2: 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
ULBs' Expenditure as % of GDP	0.69	0.57
Local Government Share of Consolidated Public Expenditure	6.41	5.51
ULBs' Share of Consolidated Public Expenditure	2.54	2.01

Sources: (Basic data) Report of the Twelfth Finance Commission and Indian Public Finance Statistics, 2006-07.

Despite the addition of a third tier in Indian federal polity; federal finance in India is still tailored to suit a two-tier model. For inclusive growth there is a need to restructure the fiscal assignment of the ULBs in a more equitable and efficient manner. The hallmark of any self-government is the degree of financial autonomy it enjoys in formulating and implementing public policies in regard to those functional responsibilities assigned to it. 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 ULBs' finances even in progressive States. 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. In other words, some of the States, despite the constraints on their resources, do reduce the fiscal imbalance of the ULBs, though partly, through a share in Union taxes. It can be observed that that the fiscal capacity of the ULBs, in general, is not very strong. It is evident from table 4 that proceeds from internal sources contribute only about half to the corresponding expenditure requirements of the 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 ULBs' own-source revenue.

TABLE 3: 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), "The New Vision of Local Governance and the Evolving Roles of Local Governments" in Local Governance in Developing Countries edited by Anwar Shah, The World Bank and * table 2.*

It may be argued that States could reduce the vertical fiscal imbalance by assigning a few buoyant revenues to the ULBs. But, the limited financial space open to the States and the low organizational and administrative capacity of the 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 ULBs to allocate resources according to their own priorities. It is critical to enable and empower the ULBs to generate and enhance their own-source revenue. In order to make this happen, a mechanism of untied transfer of funds to the ULBs is essential for enhancing their fiscal and functional autonomy.

TABLE 4: 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 2.

*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 is stated in the subsequent sections of the memorandum, that the resources transferred to the ULBs from other channels are tied and hardly assist in the requirements of the fiscal capacity building of the ULBs. Hence, a great responsibility lies with the Thirteenth Finance Commission to devolve adequate funds for this purpose to the ULBs under article 280 (3) (c).

TABLE 5: 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 decentralization 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 maintaenance, 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: Updated from V N Alok (2006), in Anwar Shah (ed.) *op cit*.

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 cognizance 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.

The resource requirement of urban local bodies is huge no matter what methods are adopted for its assessment. On the basis of City Development Plans (CDPs) submitted by the Mission cities under Jawaharlal Nehru Urban Renewal Mission (JNNURM), the projected requirement of funds for investment in the Urban Transport, Water Supply, Sewerage and Sanitation, Drainage /Storm Water Drainage, MRTS, Solid Waste Management etc. has been worked out at Rs. 2,76, 822 crore for the Mission period (2005-12). Of this Urban Transport alone accounts for 51% followed by Water Supply which accounts for 14% and Sewerage and Sanitation which accounts for 13%. A projection of these figures to 5161 towns as per the 2001 Census leads us to a figure of Rs. 7,91,080 crore.

The scale of urbanization in India can be gauged by the fact that the urban population of India is likely to increase by 249 million between 2001 and 2026, which accounts for two-thirds of total population increase. Using the data from CDPs, it is estimated that this additional population would require nearly seven lakh crore of additional investment. Meeting the requirements of space and service delivery of urban India is likely to be one of the most critical challenges that the country would face in times to come.

Octroi- major revenue source for municipalities – has been abolished without substitution by any other local source. Urban Local Bodies should be encouraged to augment their own sources of revenue especially property tax. In this context, they should be encouraged to carry out reforms which has been mandated under JNNURM i.e. arrangements for 90% coverage and 85% collection efficiency within the next seven years. All local bodies should switch over to the 'unit area method' or 'capital value method' for assessment of property tax in a time-bound manner. The categories of exemptions from property tax need to be reviewed and minimized. Tax details for all properties should be placed in the public domain to avoid collusion between the assessing authority and the property owner. A computerized data base of all properties using GIS mapping need to be prepared for all municipal areas.

A major proportion of the funds which will flow to the States and ULBs should be linked to the implementation of reforms in various areas such as governance, land and property reforms, financial sustainability and responsiveness to citizens. Some of the important areas are constitution of District Planning Committees and Metropolitan Planning Committees, institutionalization of citizens' participation in planning and integration of district and metro Plans with the State Plans. In the water supply sector, priority areas should be increasing operational efficiency, metering of water connections, minimization of leakage and Unaccounted for water (UFW). In the long term, the efforts should be made to generate adequate revenue through water charges, at least, to meet the O&M expenses in the initial years and gradually increased to recover the capital, to make the systems financially viable and self supporting. In the sewerage sector, ULBs should be encouraged to adopt cost effective and less power consuming technologies. They can be encouraged in adopting these technologies through incentives such as tax concessions. In the area of Solid Waste Management, compulsory production of compost exploring the possibility of energy recovery and earmarking adequate land for sanitary landfills, compost plants and other processing units should be given priority.

Municipal bodies should also be encouraged to leverage the land resources available with them and adopt other innovative means of financing for generating resources for infrastructure and capital expenditure. While the above areas cover the overall agenda for reform, specific reforms mandated under the JNNURM could be considered for framing a reform agenda for all the ULBs. The details of these reforms are as given below:

Sectors	Reforms
Governance Reforms	• Implementation of decentralization measures as envisaged in 74th Constitution Amendment Act • Transfer to activities under the 12th Schedule • Administrative reforms • Structural reforms • Provision of basic services to urban poor etc.
Land and Property Reforms	• Reform of property tax (arrangements for 90 % coverage and 85% collection efficiency within next seven years) • Earmarking at least 20-25% of developed land in all housing projects for EWS/LIG • Introduction of computerized process of registration of land and property. • Repeal of Urban Land Ceiling and Regulation Act • Introduction of Property Title Certification System in ULBs etc.
Financial Sustainability	• Levy of reasonable user charges by ULBs states • Internal earmarking within local body, budgets for basic services to the urban poor etc
Process Oriented /Citizen Responsive Reforms	• Adoption of modern, accrual-based double entry system of accounting, • Introduction of system of e-governance • Reform of Rent Control Laws balancing the interests of landlords and tenants. • Rationalisation of Stamp Duty (no more than 5%) • Enactment of Public Disclosure Law • Enactment of Community Participation Law to institutionalize citizen participation etc

Requirement of Funds Raised by the State Departments

In order to estimate the resource gap and the requirements of funds by ULBs for core services for the 5 year period commencing from 1st April, 2010 to 2015, the Ministry of Urban Development issued a questionnaire to the States seeking information such as sources of income and revenue, total income /revenue generated, expenditure incurred, resources likely to be raised by the ULBs for the 5 year period commencing form 1st April, 2010 to 2015 (along with year-wise break up), the gap in requirement of funds and resource generation for 5 years commencing from 1st April, 2010 to 2015 (along with year-wise break up), status of implementation of recommendations of SFCs etc. Replies received from nine States- Gujarat, Himachal Pradesh, Jharkhand, Karnataka, Orissa, Puducherry, Tripura, Uttarakhand, West Bengal – have been used for projecting the requirement on per capita basis for the total urban population of the country which works out to 1,28,660 crore.

ESTIMATION OF STATES OF THE RESOURCE GAP FOR ULBs DURING 2010-15

(Rs in crores)

S. No	State	Requirement of Funds	Resource Generation	Gap
1	Gujarat	10000	4625	5375
2	Himachal Pradesh	646	301	345
3	Jharkhand	3724	194	3530
4	Karnataka	38312	22129	16183
5	Orissa	4724	1629	3095
6	Puducherry	301	192	109
7	Tripura	259	72	187
8	Uttarakhand	3104	460	2644
9	West Bengal	4872	2705	2167
	Total	**65942**	**32307**	**33635**

Role of the Thirteenth Finance Commission

The Thirteenth Finance Commission has a major role to empower 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 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 ULBs. All of this imposes an administrative cost on the ULBs and draws on scarce resources that they receive from their own sources and from the State. In this connection, fiscal transfers through CFC have to play a critical role.

It is to be mentioned that *ad hoc* grants of a token nature given by the earlier CFCs now need to be replaced by regular transfer arrangement. The challenge before the Thirteenth Finance Commission is to act as the path breaker in creating an enabling environment for fiscal decentralization at the sub-State level. This could be done through fiscal capacity equalization that is an essential condition for a gradual process of equitable decentralization. This requires, at this stage, the support from the

Finance Commission as State Governments and urban local bodies have inadequate capacities to meet the resource needs. This is partly due to hard budget constraints imposed on them. Fiscal decentralization 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 ULBs including the salary of the staff in the account and a computer section (necessary minimum staff need to be appointed in all 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, sanitation and urban transport.

- There would be additional recurring expenditure on traditional civic services like public lighting, roads and sanitation arising out of increased people's expectations.

It is , therefore, requested to the Thirteenth Finance Commission to realistically assess the cost of the creation of third tier and compensate it adequately. The time has come, to desist from the approach of *ad hoc* nature and include the ULBs in the arrangement of revenue sharing as the case with the State emanated from the 80th Amendment of the Constitution. Also, the articles 243X, 243Y, 266, 268, 269, 270, 275, 279 and 280 do not, in any way, preclude the CFC from earmarking a share of central revenues for the ULBs, suggesting that it be given into the Consolidated Fund of a State for the express purpose of supplementing the ULBs fund. Since nowhere it is stated that the transfer of funds to the ULBs should only be in the form of grants, it is urged, 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 ULBs with the Indian federal structure along with the State and Union government.

- The ULBs 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).

We may also submit that the scheme will be consistent with the practice adopted in other federations with an institution akin to the Finance Commission. For example; a) 4 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%). Moreover, the scheme is simple and does not require a constitutional amendment.

TABLE 6: PROJECTED CENTRAL GROSS TAX REVENUES

(Rs. in crore)

Revenue	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Gross Central Tax Revenues	795997	921329	1066395	1234302	1428645	1653589
Net Central Tax Revenues	668637	773916	895772	1036814	1200062	1389015
ULBs' share	20059	23217	26873	31104	36002	41670

Source: (Basic data) Central Budgets.

Considering the merits of tax sharing, the Thirteenth Finance Commission should recommend three per cent of the divisible pool of the Union. In other words, three per cent of the net proceeds of the central taxes could be devolved to the ULBs through the State governments. This would be over and above the share of the State governments from the 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 6 of the central gross tax revenue till the last year of the award period of the Thirteenth Finance Commission. It is recognised that the Thirteenth Finance Commission will be making a detailed analysis of the trend of the central tax revenues and the projections that could also be based on the likely introduction of GST. On a conservative estimate the share of the ULBs in first year of the award period would be around Rs 24,000 crore. This would increase with the increase of central tax revenues.

Inter-se Distribution of Fiscal Transfers to Municipalities

It is suggested that the horizontal distribution of the above fiscal transfer among States should be based on a few simple parameters. Any formula must assign appropriate weight to progress made in regard to functional, financial and administrative decentralisation as well as implementation of key reforms as already brought out in previous sections. 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 CFC is ordained for revenue expenditure, the Thirteenth Finance Commission could suggest the SFC or the State to make *inter se* distribution among the ULBs within the State on these lines. It is hoped that the State will adopt uniform accounting systems that follow accepted principles, prescriptions for audit procedures etc.

It is urged to the Thirteenth Finance Commission to reiterate and recommend a 'permanent SFC cell' 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. Being the line Ministry, the Ministry of Urban Development is the appropriate agency for monitoring the implementation of reforms. It is thus essential that a Cell be constituted in the Ministry of Urban Development be responsible for monitoring and implementation of the funds transferred from the Thirteenth Finance Commission.
