

## CHAPTER - 3

### BASIC APPROACH

**1.3.1.** The Main objective of the State Finance Commission is to review the existing financial conditions of the Local Bodies and suggest improvements in the augmentation of resources to match their responsibilities and to improve the delivery system to the public. The Terms of Reference issued by the Government as well as the objectives of the State Finance Commissions envisaged in the Constitutional amendments indicate that State Finance Commission is distinct from the Central Finance Commission. The latter has only to suggest distribution of the funds between the Centre and the States while the former has to recommend the taxes of the State which could be assigned to the Local Bodies and also to indicate the principles of distribution of funds by the State Government to the Local Bodies and in the distribution of funds among the different tiers of Local Bodies besides inter se distribution. The Terms of Reference also indicate that the State Finance Commission has to ensure a sound financial management besides suggestions for avoiding unproductive expenditure. It also envisages the measures needed for upkeep of the assets created and maintained by the Local Bodies to ensure public utility.

**1.3.2.** The above objectives will definitely require the State Finance Commission to study the existing financial conditions and suggest improvements of the Local resource generation besides the revised distribution system and the taxes to be assigned by the State Government to ensure proper maintenance of services.

**1.3.3.** This will involve an in-depth study, not only on the Financial Resources, but also on the deficiencies in the delivery mechanism, and financial management for improvement of the levels of service. Introducing economy or possible privatisation of services which will reduce the burden of the Local Bodies will also have to be examined.

**1.3.4.** The efficiency in delivery system will also involve study of the manpower now available and redeployment if necessary, aiming at the same time, a better delivery mechanism. Similarly, for improvement of resources, if any deployment of man power is necessary commensurate with the additional resource generation, that also will form part of the recommendations. The level of Operation and Maintenance (O & M) of existing assets and services compared to the required normative level and the additional resources needed to achieve that level will also be a subject-matter to be examined.

**1.3.5.** The Government have required the projection of funds needed for a period of five years commencing from 1997-98 to 2002. This will necessitate the State Finance Commission to assess the funds needed for O & M during these years. This cannot exclude O & M needed for the possible improvements in the level of services based on standard norms. In that context, it will be necessary to assume the possible additional

O & M needs and the investments likely to be made to better the normative level of services during the next five years. In this context, the State Finance Commission will have to visualise also the investment needs. Such investments will depend upon the project financing by the Government over and above the surplus to be created by the Local Bodies from their revenue accounts. The investment need for improvement of the services at a minimum level during the next five years in a phased manner has been assumed for providing funds for O & M during the next five years.

**1.3.6.** In various National workshops in which the role of State Finance Commission was discussed, it was stressed that "Plan and Non-Plan" has no relevance to the local public with regard to the betterment of the services. The National Workshop initiated by NIPFP on various issues involved, suggested that the State Finance Commission will have to take into account the impact of the plan expenditure for the non-plan provision to be made for O & M during the next five years. In this context, the State Finance Commission has decided to adopt an integrated approach of all the issues vital for better "Financial Management".

**1.3.7.** State Finance Commission accordingly has suggested the tax reforms needed for improvement of the local resources. While recommending reforms, the methods adopted in the neighbouring States, the suggestions made by the TIME Research Foundation Calcutta on property tax reforms, besides the reforms introduced in States like West Bengal, Bihar, Karnataka, Andhra Pradesh, Gujarat and Maharashtra, have been studied. Similarly, in the case of assignment of taxes, various types of assignment prevailing in other States have also been studied before making suitable recommendations.

**1.3.8.** On the sharing of the Government revenue, the principles adopted by some of the State Finance Commissions which have submitted their Reports have also been taken into consideration. Some have adopted the principles of general sharing out of the total tax revenue of the State and some have adopted the existing procedure of sharing individual taxes earmarked for the Local Bodies.

**1.3.9.** In Tamil Nadu also, both the options have been considered by State Finance Commission. Some of the taxes now levied by the State and passed on to the Local Bodies are found among the list of taxes earmarked for Local Bodies by the Local Taxation Inquiry Commission (1953). State Finance Commission is of the view that any sharing of revenue from the State should exclude these items which are already earmarked for Local Bodies but are collected by the State and passed on to the Local Bodies to have an efficient and better management of collection system. These revenues depend on local potential and yield will be substantial where better potential is available. The inclusion of these taxes in general sharing will be objected to by Local Bodies since it will lead to distribution by diverting the income from higher potential areas to lesser ones.

**1.3.10.** Accordingly, State Finance Commission has proposed to retain the existing method of devolution of revenues out of the taxes already earmarked for Local Bodies, either collected by them or by the Government. In some cases the State

Government have made additional levy on the same taxes for the benefit of the State Government. State Finance Commission has taken the view that the entire levy on these basic taxes should go to the Local Bodies in full. For instance in northern States, octroi is a major resource. But there is no octroi levied in Tamil Nadu. The Santhanam Committee which went into the working of Panchayat Raj Finance in 1963 suggested that the Local Bodies should be allowed to levy octroi. However, the National Level Taxation Committees indicated that the octroi should be abolished in stages and in lieu thereof, the States could permit the Local Bodies to levy Surcharge on Sales Tax. Similarly, the Local Bodies were levying tolls on the vehicles plying through their areas, before the enactment of the Motor Vehicles Taxation Act. But now the toll tax has been abolished and is substituted by Motor Vehicles Tax.

**1.3.11.** State Finance Commission has therefore recommended for sharing of this revenue of the State in which the Local Bodies have a legitimate claim, by taking it to a divisible pool and distributing it to all the Local Bodies on an equitable principle to be evolved by them. State Finance Commission has also studied the various other taxes levied by Tamil Nadu Government and have suggested for sharing of the taxes which have specific relevance to local bodies by taking them to the divisible pool.

**1.3.12.** Similarly, in the case of core civic services, the State Finance Commission has tried to assess the need for increasing the level of service and work out the cost involved for such improvements by way of capital investment. It has also tried to suggest methods for project financing for achieving the capital investments through pooling of surplus funds from Local Bodies, utilising Tenth Finance Commission award as a corpus fund, obtaining institutional finance, and creation of a financial institution exclusively for the Local Bodies for upgrading their level of services. Certain amount has been set-apart from the distribution for the post devolution inequality and to provide incentive for performance. Efforts have also been taken to identify the services which could be privatised or executed through BOT (Build, Operate and Transfer) by involving financial institutions, non-governmental organisations and also industries, wherever possible.

**1.3.13.** There have also been studies on enforcing economy, redeployment of existing man-power, liberalisation of powers to avoid delays, better control and accountability mechanism needed and organisational re-structuring to ensure viability. Similarly, avoidance of duplicity of institutions has also been looked into wherever necessary and feasible. State Finance Commission has also given due consideration to the financial constraints of the State in their resources position and has ascertained the projection of revenues as well as expenditure commitments of the State for the five-year period covered by State Finance Commission.

**1.3.14.** The devolution of functions indicated in Schedules 11 and 12 of 73rd and 74th Amendments to the Constitution has got a vital bearing on the functioning of the Local Bodies in the socio-economic field. State Finance Commission has tried to find out the nature of devolution likely to be made for making suitable recommendations for devolution of finance and functionaries needed for implementing such functions by the

various tiers of Local Bodies. Though a model package has been drafted by State Finance Commission in consultation with various departmental representatives of the State Government, the final decision of the Government has not been made available to State Finance Commission. Hence this aspect has not been fully gone into by the Commission for making suitable recommendations. It is hoped that when the Government issues necessary orders for the devolution of functions, it will also correspondingly provide necessary devolution of funds already earmarked and functionaries who are already attending to such functions in the line departments.

**1.3.15.** To facilitate the process of decision making, various methodologies have been adopted by State Finance Commission in gathering data and views from various levels as discussed in the ensuing chapter.