

CHAPTER 6

RESOURCE ALLOCATION MECHANISM (RAM)

5.6.1. Allocation of shared taxes and grants by the State to Local Bodies plays a crucial role in the functioning of Local Governments, and constitute an important component of the total revenues of the Local Bodies. The available data reveals that Village Panchayats depend almost to the extent of 43% of their expenditure needs on grants from Government. In the case of Panchayat Unions, the dependency on the Government is 85%. While examining the Urban Local Bodies, it is seen that the dependency of Town Panchayats, Municipalities and Municipal Corporations, though shared taxes and grants is 38%, 33% and 50% respectively. In general, shared taxes fail to take into account the needs of Local Bodies. Grants seem to be too unsystematic to bring about fiscal corrections needed for a strong local finance base.

5.6.2. The purpose of transfers from State to Local Bodies is to permit them to provide a satisfactory level of service to the community. However, the evidence points to the inability of Local Bodies to meet this objective. Further, the system of transfers in its present form, is said to have undermined the initiative of the Local Bodies. This has also created a situation of dependency of Local Bodies on State Government as there is no provision of automatic transfer of resources. Several recent studies point out the fact that there is no coherent system of state transfer to Local Bodies. There is confusion of responsibility and lack of accountability. In concluding, it is fair to say that the present system of transfers has contributed little towards solving the fiscal problems of the distressed Local Bodies and is no longer in tune with the evolving needs of Local Governments.

5.6.3. In this light, it is felt that as a general principle, transfers must be governed by the twin objectives of efficiency and equity. Further, the system of State transfer, be it the sharing of State taxes or the grants, should be designed in such a way that they lead to a transparent and predictable system of inter governmental finance in which all levels of government understand the rules of revenue sharing and grants and the entitlements under the system.

5.6.4. The existing fiscal gap on normative levels of services in Local Bodies is large enough to warrant either additional tax assignments or a revised system of transfers which will make available more resources to the Local Bodies. The objective of a new transfer mechanism should include among other things:

- (i) Closing the vertical and horizontal gaps in the finances of Local Bodies
- (ii) Provision for some upgradation of services in the existing levels of Local Bodies; and
- (iii) Provision for some additional services to be performed by the Local Bodies.

5.6.5. The transfer of functions and responsibilities as listed in 11th and 12th schedules of the 73rd and 74th Constitutional Amendments, would have to be accompanied by appropriate matching funds to the Local Bodies. This would also imply that the state will have to make adjustments so as to bring about a balance in the existing fiscal powers by providing greater flexibility to Local Bodies in matters of determining the tax rates, user charges and fees. The State Finance Commission considers it necessary to lay down principles that should enable the Local Bodies to perform at least the obligatory functions of providing the basic civic needs of the people in their areas at a satisfactory level. This objective should be taken as the starting point for determining transfers from the state to the Local Bodies. The sharing of tax revenues should play a dominant role in the transfer schemes to Local Bodies, while grants in any form should have only a secondary role and be designed to equalise the imbalances in the finances of Local Bodies.

5.6.6. The terms of reference for the State Finance Commission include the need to recommend the principles which should govern the distribution of resources between the State and the Local Bodies. While doing so, the following aspects are to be borne in mind:

- (i) the transfer of resources is on revenue account only i.e. for operation and maintenance (O & M),
- (ii) the resources should be utilised for core civic services by the Local Bodies.
- (iii) the financial position of the Local Bodies should be assessed upto 31.3.94 and the allocation is to be recommended for application for a period of 5 years commencing from April 1997 onwards.

Vertical and Horizontal Distribution

5.6.7. Considering the various aspects covered by the above terms of reference, the State Finance Commission has considered and recommended a regular devolution from the State net tax revenue to Local Bodies.

5.6.8. This allocation of resources from state to Local Bodies involves the following two vertical levels and the third, horizontal level of distribution and they are recommended as below.

LEVEL I: (Vertical)	Allocation of funds earmarked by the State for transfer to Local Bodies, between the
	(i) Rural Local Bodies and
	(ii) Urban Local Bodies
LEVEL II (Vertical)	Distribution of allocations earmarked to Rural/Urban Local Bodies in Level I to the respective tiers of District Panchayats, Panchayat Unions, Village Panchayats under Rural and Town Panchayats, Municipalities and Municipal Corporations under Urban.
LEVEL III: (Horizontal)	Inter se distribution allocated in Level II to the respective tiers viz. allocation among Village Panchayats/Panchayat Unions/District Panchayats and Town Panchayats/Municipalities/Municipal Corporations.

5.6.9. To decide these transfers to appropriate levels as explained above, the principles should be:

- (i) Simple and clear
- (ii) Based on data which are available and authentic:
- (iii) Just and equitable

5.6.10. While the principles for transfers to Rural and Urban Local Bodies were evolved by the State Finance Commission, the views of the concerned Secretaries to Government in Rural Development Department and Municipal Administration and Water Supply Department and the respective Heads of Departments were also ascertained.

5.6.11. The Principles so formulated for the transfer of funds from State to Rural and Urban Local Bodies are given below:

Level-I: From State to Rural and Urban Local Bodies: (Vertical)

5.6.12. The population formula is generally accepted as a good basis for allocation of funds to Local Bodies both from the point of view of volume of services to be delivered and from the point of equity. The transfer of funds from State to Rural and Urban Local Bodies will therefore be based on population as per the last census. The ratio for the distribution of funds between the Rural and the Urban Local Bodies would be 60:40.

Level-II: Rural (Vertical)

5.6.13. Distribution from out of the funds allotted to the Rural Local Bodies to different tiers viz.:

- (i) District Panchayats,
- (ii) Panchayat Unions and
- (iii) Village Panchayats

will be as below:

- (i) **District Panchayats:** The District Panchayat is a new phenomenon and its structure and functions are yet to be spelt out clearly. Hence, only a lumpsum grant (Block grant) is now suggested to meet its actual needs out of the total allocation for the Rural Pool. This is fixed tentatively at 14% out of the total Rural allocation.
- (ii) **Panchayat Unions/Village Panchayats:** Considering the number of Institutions involved, their respective sphere of activities, nature and level of civic services and the staff deployed to carry out such services, the ratio between the Panchayat Unions and Village Panchayats has been suggested on 50:50 basis, of the balance remaining after distribution to District Panchayats.

Leve III: (A) Interse Distribution - Panchayat Unions:

(i)	Weightage on total population (last census) of the Panchayat Union	50%
(ii)	Weightage on SC/ST Population	25%
(iii)	Weightage for financial viability of Panchayat Unions (based on average Per Capita Land Revenue)	25%
	Total	100%

5.6.14. In view of the fact, that the population in the Panchayat Unions is the dominant factor that derives benefits from the expenditure of the unions, a larger weightage in the allocation process is given to the above factor. The weightage suggested is 50%. The balance of 50% is assigned to the other base, viz. 25% on SC/ST Population and the remaining 25% allocated for financial viability which can be based on the average per capita land revenue of the Panchayat Unions concerned. The distribution on financial viability means an inverse proportion for weightage viz. the higher the per capita land revenue the lesser the weightage to be given and lower the per capita, higher the weightage. (The formula for sample Panchayat Unions has been demonstrated in Appendix No.124

5.6.15. Since the categorisation of the Panchayat Unions has been done on the basis of their average per capita land revenue earnings, this financial parameter acts as a proxy for the financial strength of the local bodies. The lower category can be assigned a higher weight, so that the local bodies under this category can be compensated for their lower earnings, while the higher category of Panchayat Unions can get relatively lower weights, with the highest category getting the least weight.

5.6.16. The horizontal distribution of funds allotted to Village Panchayats will be as below:

Level III (B): Inter se Distribution - Village Panchayats

(i)	Weightage on Total population (last census)	-	50%
(ii)	Weightage on SC/ST population (last census)	-	15%
	Sub Total		65%
(iii)	Per capita House Tax Collection	-	15%
(iv)	Core Civic Services infrastructure maintenance deficiency (with reference to physical assets available in the Village Panchayat area)	-	20%
	Total		100

NB: For sample Village Panchayats, the formula has been demonstrated in Appendix No.123.

5.6.17. The principles of distribution of URBAN allocations are as below:

Urban Local Bodies (Vertical)

Level I Distribution of funds from the state to the Rural and Urban Local Bodies based on ratio of population of Rural and Urban Local Bodies i.e. 60:40 basis. (As already indicated under Rural)

Level II (Vertical) Distribution of funds from the Urban allocation to different tiers

- (i) Town Panchayats
- (ii) Municipalities. and
- (iii) Corporations

5.6.18. The above distribution is based on the ratio of the total population of respective tiers viz. Town Panchayats, Municipalities and Municipal Corporations based on last census figures (1991).

The current ratio will be:

	Percentage
(i) Town Panchayats	38
(ii) Municipalities.	31
(iii) Municipal Corporations	31

Level III (Horizontal) Distribution of funds inter se the institutions viz. Town Panchayats, Municipalities and Municipal Corporations.

5.6.19. The following principle of weightage will be adopted for inter se distribution from out of the urban allocation to the respective tier of Local Body.

	Town Panchayats	Municipalities	Corporations
(i) Total Population (1991)	45%	45%	40%
(ii) Total SC/ST Population (1991)	20%	10%	10%
Sub Total	65%	55%	50%
(iii) Financial indicator Per Capita receipt under own resources (Average of both Tax and Non-Tax resources for the last 3 years ending with 31.3.94)	15%	15%	15%
(iv) Service indicator (existing Per Capita expenditure on core civic services) (for the last 3 years ending with 31.3.94)	20	30	35
Total	100	100	100

5.6.20. The formula for distribution for the sample Town Panchayats and Municipalities have been worked out and given in Appendix Nos.121 and 122.

5.6.21. Operative Portion of the Report

Pool A: This contains taxes which belong to Local bodies but collected by the Government. However, this does not form part of State tax revenue except for Entertainment Tax. This is to be distributed among the Local bodies concerned.

Projection for 1997-98
(Rupees in Crores)

a) Surcharge on Stamp Duty	230.00
b) Local Cess and Local Cess Surcharge	30.00
c) Entertainment Tax	120.00
Total	380.00

Pool B: This is the divisible pool containing all State taxes excluding Entertainment Tax.

**Projection for 1997-98
(Rupees in Crores)**

a) Sales Tax	}	620
b) Motor Vehicle Tax	}	(This constitutes nearly
c) State Excise Revenue	}	8 percent of the Divisible
d) All Others	}	Pool*)

*** DIVISIBLE POOL:** Total tax revenue of the State projected for 1997-98 = Rs.7867 crores - Entertainment Tax of Rs.120 crores = Rs.7747 crores.

Progressive Devolution: Pool B

1997-98	8%	of the total tax revenue of the State
1998-99	9%	-do-
1999-2000	10%	-do-
2000-01	11%	-do-
2001-02	12%	-do-

Principles of Distribution: Only out of Pool B

Total		100%
State Reserve (15% towards Equalization Fund and Incentive Fund)		15%
Divisible Pool		85%
	<u>Out of 85</u>	<u>Out of 100</u>
Rural Local bodies	51	60
District Panchayat -	7	14
Panchayat Union -	22	43
Village Panchayat -	22	43
Urban Local bodies	34	40
Corporation -	10.5	31
Municipalities -	10.5	31
Town Panchayats -	13	38

Note: Of the 100% for devolution, 60% is earmarked to Rural Local Bodies and 40% to Urban Local Bodies. The percentage of distribution within the earmarked Pool has been indicated taking each Pool as 100%.

Mode of Release

Funds will be released by the State Government to the local bodies in three instalments as follows:

1st Instalment - April - May	-	25% of provision
2nd Instalment - August - September	-	50% of provision
3rd Instalment - January-February	-	25% of balance

The difference with actuals will be adjusted during the release of 1st Instalment of the following year

5.6.22. Additional Devolution by the State

1993-94	-	Actuals - Devolutin to Local Bodies	-	Rs.341.5 Crores	
1996-97	-	R.E. - Provision for Local Bodies	-	Rs.556.90 Crores	
1997-98	-	SFC's Recommendation for devolution	-	Rs.1000 Crores	
Percentage of increase over the previous year				-	80%

The impact of devolution proposed for the period from 1997-98 to 2001-02 is given.

Once the principles of devolution on the above basis are given effect to, the assistance to be based on individual taxes and tied and un-tied grants for maintenance purposes will not arise. However, it needs to be explained, that these recommendations are related to the existing levels of service. Any further devolutions of functions and additional infrastructure creation in future years will have to be taken care of separately outside the scope of the devolution now proposed, since the yearwise devolutions are designed to take into account of inflationary trends of existing assets only.

(Rs. in Crores)

Table 5.32 Statement Showing the Devolution to Local Bodies

Year	Own resource	Local based Taxes Pool A	Divisible Pool B (85% for Local Bodies)	Equalization & incentive Fund (15% of Pool B) State Reserve	Total	Total Expenditure Proposed	Net Position
1997-1998	518.05	380.00	527.00	93.00	1518.05	1472.50	45.55
1998-1999	556.19	410.40	655.68	115.71	1737.98	1619.74	118.24
1999-2000	655.97	448.23	805.56	142.34	2053.10	1781.34	271.76
2000-2001	723.87	478.69	931.17	164.32	2298.05	1959.92	338.13
2001-2002	800.48	516.99	1066.21	188.15	2571.77	2156.10	415.67