Fifth State Finance Commission : Recommendations on Devolution and Status of Implementation

I. Introduction

In this Paper we examine, the approach of the Fifth State Finance Commission (5th SFC) on fiscal devolution, recommendations on vertical and horizontal devolution, distribution of funds for general purpose, maintenance of assets and development, total funds recommended for transfer and status of implementation of recommendations.

Terms of Reference

The 5th SFC was constituted by the Government of Kerala with Prof. B A Prakash as Chairman and Shri. James Varghese IAS and Shri. Rabindrakumar Agarwal IAS as members on 17th December 2014. Dr. V K Baby IAS was appointed as member from 29th October 2015 in the place of Shri. Rabindra Kumar Agarwal.

The terms of reference (ToR) of the commission was as follows. The Finance Commission shall review the financial position of the Panchayats and the Municipalities and make recommendations as to – (a) The principles which should govern- (i) The distribution between the State, Panchayats and Municipalities of the net proceeds of the taxes, duties, tolls and fees leviable by the State, and the allocation between the Panchayats at all levels and the Municipalities of their respective shares of such proceeds; (ii) The determination of the taxes, duties, tolls and fees which may be assigned to or appropriated by the Panchayats and the Municipalities; (iii) The grants-in-aid to the Panchayats and the Municipalities from the Consolidated Fund of the State.

(b) The measures needed to strengthen the financial position of Panchayats and Municipalities with special reference to – the potential for Local Governments (LGs) to raise funds from borrowing, Improving the quality of upkeep of own assets and assets of transferred institutions, rationalizing of taxes and revenues, achieving economy and efficiency in expenditure, providing incentives for higher own resource mobilization etc. (c) The measures needed for the proper institutionalisation of the decentralisation initiatives in the State. (d) To revisit the recommendations of first four SFCs, which were accepted but not operationalized and require changes.

Data Sources

The commission conducted elaborate exercise to collect data and information relating to all aspects of working of LGs and suggestions on devolution of resources improving finances and other aspects related to ToR. In the sitting, conducted by the commission in all districts, 139 LGs belonging to Grama Panchayats (GPs), Block Panchayats (BPs), District Panchayats (DPs), municipalities, Municipal Corporations (MCs) attended and presented their financial issues, problems and requirments and suggestions for devolution. The commission has collected detailed financial data through online based on a detailed questionnaire from all the 1200 LGs. Discussions were conducted with the heads of 15 government departments and institutions which are connected with the Functioning of LGs. The commission also held discussions with economist, policy experts and social scientist, office bearers of GP, BP and DP association, chamber of Mayors and political parties. The commission made an assessment of finances of the State government and projected the State Own Tax Revenue (SOTR) available for devolution during 5th SFC period. Two research studies were also sponsored. Gulati Institute of Finance and Taxation (GIFT) was entrusted with the study on own resource mobilization of LGs and Kerala Institute of Local Administration (KILA) on functional, financial and administrative devolution of LGs.

Approach on fiscal devolution

Let us start with a discussion of the overall approach of the 5th SFC. Though the local bodies with limited functions have been transformed into LGs exercising a large number of administrative, civic, maintenance and development functions, corresponding changes have not been made with regard to transfer of powers and resources. Regarding mobilisation of own resources, adequate powers were not given to levy and collect new taxes and non-tax items, effect periodical revision of them and initiate revenue recovery proceedings to collect arrears, taxes, fees, etc.

The devolution method followed by previous SFC's are irrational and devolution is given based on SOTR received two to three years back. The commission wanted to move to a better method. The commission wanted to change the method of distribution of maintenance fund based on inadequate and unreliable data of assets. The commission was of the view that the distribution of plan funds based on State plan outlay is not the mandate of the commission. In the context of very poor plan performance, the commission wanted to make a radical restructuring in the formulation and execution of annual plans of LGs to improve its performance.

Regarding devolution of State Own Tax Revenue (SOTR), transfer of funds, resource mobilisation and annual plans, the LGs had raised a number of issues and demands to the commission. The commission had taken into consideration of these demands in formulating recommendations. In the devolution of SOTR and other items, the commission strictly followed the provisions of Indian Constitution, Kerala Panchayat Raj Act (KPRA) 1994, Kerala Municipality Act (KMA) 1994 and ToR.

II. Recommendations on Devolution

The commission felt that the approach of devolution followed by the previous SFCs require radical change due to following reasons. First, the previous SFCs had used devolution of funds based on (t-2) or (t-3) method. Here t represents current year or year of devolution and t-2 indicates a year preceding two years. This means that the devolution of resources for the year 2018-19 is done based on the proceeds of SOTR received during the year 2016-17. Due to this practice, the LGs are denied their rightful share due to them based on SOTR of the year of devolution. Second, Union Finance Commission (UFC) is devolving resources from Centre to States based on the estimated tax receipts of the year of devolution (t) and subsequently adjusting the amount with the actual receipts.

Third, the 3rd SFC had projected the resource availability of the State and the expenditure requirements of the LGs and recommended an annual devolution of resources for a period of five years for all LGs as well as for each LGs in advance. This recommendation was implemented successfully. Fourth, Majority of the LGs attended in the sittings of the commission demanded that the SFC should give a recommendation specifying the amount of money to be given to each LG for each year of the award period of five years as in the case of 3rd SFC. Fifth, in order to have a realistic projection of SOTR, the commission attempted projection using ‘Baseline Scenario’, ‘Long Term Trend based method’ and ‘Minimum Buoyancy in SOTR’ and compared them with the projection of the Finance Department of State government. And based on this exercise the commission adopted ‘Minimum Buoyancy in SOTR’ method for projecting SOTR.

Sixth, the SFC has radically changed the norm of devolution to distribute development fund meant to finance annual plans. The approaches of the previous SFCs except the first and third SFC were to fix a share of annual plan size of Kerala as the share of the resources earmarked for development purposes of LGs. The commission is of the view that the approach has serious problems. (1) The Constitutional articles, provisions in the KPRA, 1994 and the KMA, 1994 and the ToR of the commission have not mandated the commission to devolve the State resources based on the annual plan outlay of the State. (2) The estimated resources for State plan are not usually realised. (3) SFC has no authority to fix the plan outlay of the State, which consists of a number of items or components. (4) The mandate given by the above Acts and ToR is to share the net proceeds of tax resources of the State. In this context the commission recommended a share of the net proceeds of SOTR as calculated on (t) basis as the development fund.

Taking into consideration the above aspects, the commission presented the following recommendations on the devolution of the SOTR to LGs: (i) The commission recommended following the UFC's approach, and that devolved funds are based on the estimate made for the year of devolution *t*. (ii) It was recommended that appropriate changes may be effected in projected gross and the net SOTR, based on actual tax realisation, and any excess or shortfall may be adjusted in devolution to LGs in subsequent years. (iii) It was recommended that the award be given specifying the amount of money to be devolved to each LG for each year of the award period based on the *t* method. (iv) Rejecting the practice of giving a share of annual plan size of Kerala as development fund, the commission recommended to give a share of net proceeds of SOTR as calculated on t basis. (v) The commission has decided to distribute the maintenance fund to each LG on the basis of the actual road and non-road assets based on commission's assessments.

Vertical Devolution

The commission recommended that 20 percent of the net proceeds of annual SOTR should be devolved to LGs as total devolution on (t) basis in the year 2016-17. For the subsequent years, an annual increase of 1 percent is recommended as shown in Table 9.1.

Table 9.1

Total Devolution : Net SOTR on (t) basis (%)

Year	Net SOTR on (t) basis (share) (%)	General Purpose Fund (%)	Maintenance Fund (%)	Development Fund (%)
2016-17	20	3.5	5.5	11.0
2017-18	21	3.5	6.0	11.5
2018-19	22	3.5	6.0	12.5
2019-20	23	3.5	6.0	13.5
2020-21	24	3.5	6.0	14.5

Source: Fifth SFC (2015), Report of the 5th SFC, Part I.

And the commission recommended an award of ₹ 8599.48 crore for the year 2016-17. The recommendation for the subsequent years of the period are ₹ 10105.94 crore for 2017-18, ₹ 11850.44 crore for 2018-19, ₹ 13868.59 crore for 2019-20 and ₹ 16201.19 crore for 2020-21. This devolution excludes the grant given by 14th UFC for civic services to LGs. The component wise recommendations are shown in Table 9.2.

Table 9.2

Funds to be devolved during 5th SFC period *(₹ in crore)*					
	2016-17	**2017-18**	**2018-19**	**2019-20**	**2020-21**
General Purpose Fund	1504.91	1684.33	1885.30	2110.44	2362.68
Maintenance Fund	2364.86	2887.41	3231.94	3617.89	4050.30
Development Fund	4729.71	5534.20	6733.20	8140.26	9788.21
Total	***8599.48***	***10105.94***	***11850.44***	***13868.59***	***16201.19***
SOTR	44382.32	49709.34	55681.39	62377.26	69885.47
Net SOTR	42997.28	48123.47	53865.57	60298.15	67504.89

Source: Fifth SFC (2015), Report of the 5th SFC, Part I.

The commission recommended devolution of funds for three purposes viz. general purpose, maintenance of assets and development.

General Purpose Fund (GPF)

The commission recommended 3.5 percent of the net SOTR on t basis per year as GPF (Table 9.1). The amount of funds recommended for GPF ranged between ₹ 1504.91 crore and ₹ 2362.68 crore between 2016-17 and 2020-21 (Table 9.2). GPF is primarily meant for meeting expenditure for the execution of the mandatory functions of GPs, municipalities and MCs as stipulated in the KPRA, 1994 and the KMA, 1994 and other basic functions. Most of the mandatory functions are the traditional civic functions. However, the fund shall be used for the following purposes also. (a) To cover the deficit in own funds (tax and non-tax sources) for meeting administrative, establishment, operating and other items of expenditure of LGs. (b) To meet the items of recurring expenditure of the transferred institutions which were met from the non-road maintenance fund up to the 4th SFC period. Items like electricity charges, water charges, fuel charges, purchase of furniture in Government schools/hospitals, purchase of consumables in school labs, renewal of AMC of computers and purchase of medicines including veterinary medicines in emergency situations.

Maintenance Fund

The commission recommended 5.5 percent of net SOTR as maintenance fund for the year 2016-17 and 6 percent per year for the subsequent four years (Table 9.1). The amount of maintenance fund recommended ranged between ₹ 2364.86 crore and ₹ 4050.30 crore between 2016-17 and 2020-21 (Table 9.2). Maintenance fund is meant for meeting the maintenance expenditure of the assets of transferred institutions and LG's own institutions. Maintenance comprises of the repairs and replacements of spare items plus other requirements needed to retain an asset in working condition. The fund shall be used only for maintenance purposes. Two categories of maintenance funds are recommended viz. (i) for road and (ii) for non-road assets. (a) Repair and maintenance of all types of roads of the LGs including roads constructed under MPLADs, MLA Fund, PMGSY, Flood Relief etc., maintenance of culverts, bridges etc., resurfacing/retaring of existing roads, construction of drainage system, filling up of potholes, strengthening of embankments. Maintenance fund (Road) should not be used for creation/ construction of new roads and also for upgradation of existing roads. (b) Repair and maintenance of all non-road assets including assets of transferred institutions, hospital buildings, furniture, machineries and equipment, toilets, computers and allied equipment including AMC, all other non-road assets including own assets.

Development Fund

The commission recommended 11 percent of Net SOTR as development fund for 2016-17 (Table

9.1) for the subsequent years, it ranged between 11.5 percent to 14.5 percent. The amount of funds recommended as development fund ranged between ₹ 4729.71 crore and 9788.21 crore between 2016-17 and 2020-21 (Table 9.2). Development fund is meant to finance the decentralised plans of the LGs for local level development. The individual LGs will have freedom to prepare and execute annual plans consisting of a number of individual projects and schemes for local level development, subject to the overall plan guideline of the State Government.

Other Major Recommendations

The 14th UFC recommended grants to LGs for improving the delivery of basic services. The practice followed in Kerala is to transfer this as part of development fund. The commission disagreed the practice. The commission recommended that the grants given by the 14th UFC for civic services should be treated as a separate grant and it should be transferred in addition to the devolution of the commission.

The commission recommended that a gap fund shall be distributed to the financially weak GPs and set apart ₹ 50 crore from the share of GPF available to the GPs for the purpose. Gap is calculated as follows: Own fund plus GPF minus Total of establishment, administrative, operations and other recurring expenses.

III. Horizontal Devolution

General Purpose Fund (GPF)

The Commission recommended that horizontal devolution of GPF should be effected as per the following criteria. For distributing share of various categories of LGs (GPs, BPs, DPs, municipalities and MCs) as well as individual LG's belonging to each category, the sharing criteria mentioned is as follows.

Share of DP and BP

a) First we are earmarking the share of GPF of DPs and BPs.
b) The total amount of DPs and BPs are calculated in the following manner.

Amount given in the year 2015-16 + annual incremental increase of 12 percent for the 5th SFC period.

c) For inter se distribution of GPF to the DPs, weightage shall be given to population (50 percent), area (10 percent), number of Government High Schools (10 percent), Higher Secondary Schools (10 percent), and number of district level Government hospitals coming under the DPs (20 percent).

d) For inter se distribution of GPF to BPs, weightage shall be given to population (70 percent), area (10 percent) number of Government hospitals coming under the BPs (20 percent).

Share of GPs, Municipalities and MCs

After deducting the total share of DPs and BPs, the rest of the amount will be distributed among GPs, municipalities and MCs on the basis of 2011 population as detailed below: GPs (77.24 percent), municipalities (13.43 percent) and MCs (9.33 percent). Thereafter the Commission decided to give Special Grants, One Time Grants and Revenue Collection Incentive Bonus, which will be deducted from the share of respective type of LGs.

The special grants are recommended at the rate of ₹ 15 lakhs per annum for six GPs coming under the surrounding area of Sabarimala and ₹ 25 lakh per annum to Guruvayoor Municipality. Onetime grant or ₹ 10 lakh per municipality is recommended for 28 newly created municipalities and ₹ 20 lakh to Kannur MC. An amount of ₹ 5 crore is set apart as revenue collection incentive bonus for GPs; ₹ 1 crore for municipalities and ₹ 50 lakh for MCs.

Share of GPs

Share to be distributed to GPs = Total share of GPF – (A gap fund (GF) of ₹ 50 crore per annum + special grant (SG) @ ₹ 15 lakh per annum given to six GPs + Revenue Collection Incentive Bonus of ₹ 5 crore per annum).

This share of GPs shall be distributed among GPs based on weightage (Population 80 percent, area 10 percent, inverse of income 10 percent)

Share of municipalities

Share to be distributed to municipalities = Total Share of Municipalities – (Special Grant (SG) of ₹ 25 lakh per annum to Guruvayoor Municipality + one time grant of ₹ 10 lakh per municipality to 28 new municipalities + Revenue Collection Incentive Bonus of ₹ 1 crore per annum).

The share of municipalities shall be distributed among municipalities based on the weightage (population 80 percent, area 10 percent, inverse of income 10 percent)

Share of MCs

Share to be distributed to MCs = Total share of MCs – (one time grant of ₹ 25 lakh to newly created Kannur Corporation for 2016-17 + Revenue Collection Incentives Bonus of ₹ 50 lakh per annum).

The share of MCs shall be distributed among MCs based on the weightage (Population 80 percent, area 10 percent, Inverse of Income 10 percent).

Maintenance Fund

The Commission recommended the horizontal devolution of maintenance fund as follows. For distributing share of various categories of LGs as well as individual LG's belonging to each category, the following sharing criteria (a) to (c) shall be followed.

a) The total maintenance fund of the LGs shall be divided into maintenance for road assets and non-road assets in the proportion of 78.1 : 21.9.

b) The LG wise sharing of the maintenance fund for each item of road and non-road will be on the basis of the following share. The share is worked out on the basis of the asset position of various categories of LGs as on 30.09.2015.

   The road and non-road assets were verified and corrected by the Commission and found that the total Black Topped (BT) road length under the custody of LGs was 64984.87 Kilometers and total plinth area of buildings owned by LGs was 9063108.84 Sq.M (Table 9.3).

Table 9.3

Assets of LGs

Category of LGs	Plinth Area of Building (in Sq M)	BT Road Length (in KM)

District Panchayat	2143088.31	3132.39
Municipality	1314693.90	10751.51
Block Panchayat	762903.36	0.00
Grama Panchayat	3874188.88	47184.71
Municipal Corporation	968234.39	3916.27
	9063108.84	**64984.87**

Source: Fifth SFC (2015), Report of the 5th SFC, Part I.

c) The *inter se* share among the LG's shall be based on their respective share in road and non-road assets. LG wise distribution of assets (road and non-road) is given in the report of the commission (Appendix B, part II of the report).

Development Fund

The Commission recommended the horizontal devolution and distribution of development fund into Special Component Plan (SCP) fund, Tribal Sub Plan (TSP) fund and General Sector fund as per sharing criteria prescribed below.

(a) SCP Fund based on the share of Schedule Caste (SC) population to total population of 2011 Census

(b) TSP Fund based on the share of Schedule Tribe (ST) population to total population of 2011 Census

(c) General Sector Fund which is the difference between total development fund and SCP and TSP Fund

Thus Total Development Fund = SCP Fund + TSP Fund + General Sector Fund

SCP Portion of Development Fund

The Commission recommended the horizontal devolution and distribution of SCP portion of development fund as per the sharing criteria prescribed below.

a) Total Fund will be divided between rural and urban in the ratio of SC population of 2011 Census

b) The SCP Fund available for rural LGs will be divided among GP, BP and DP on the ratio of 60:20:20

c) The *inter se* share among rural LG's shall be based on SC population

d) The SCP Fund available to urban LGs will be divided among municipalities and MCs on the basis of SC population.

TSP Portion of Development Fund

The Commission recommended the horizontal devolution and distribution of TSP portion of development fund as per the sharing criteria prescribed below.

a) Total Fund will be divided between rural and urban in the ratio of ST population of 2011 Census

b) The TSP Fund available for rural LGs will be divided among GP, BP and DP on the ratio of 60:20:20

c) The *inter se* share among rural LG's shall be based on ST population.

d) The TSP Fund available to urban LGs will be divided among municipalities and MCs in the ratio of share of ST population.

General Sector Portion of Development Fund

The Commission recommended the horizontal devolution and distribution of general sector portion of development fund on criteria of distribution mentioned in Table 9.4.

A figure showing the criteria used for overall horizontal devolution of GPF, maintenance fund and development fund and its inter se share is given in figure 9.1.

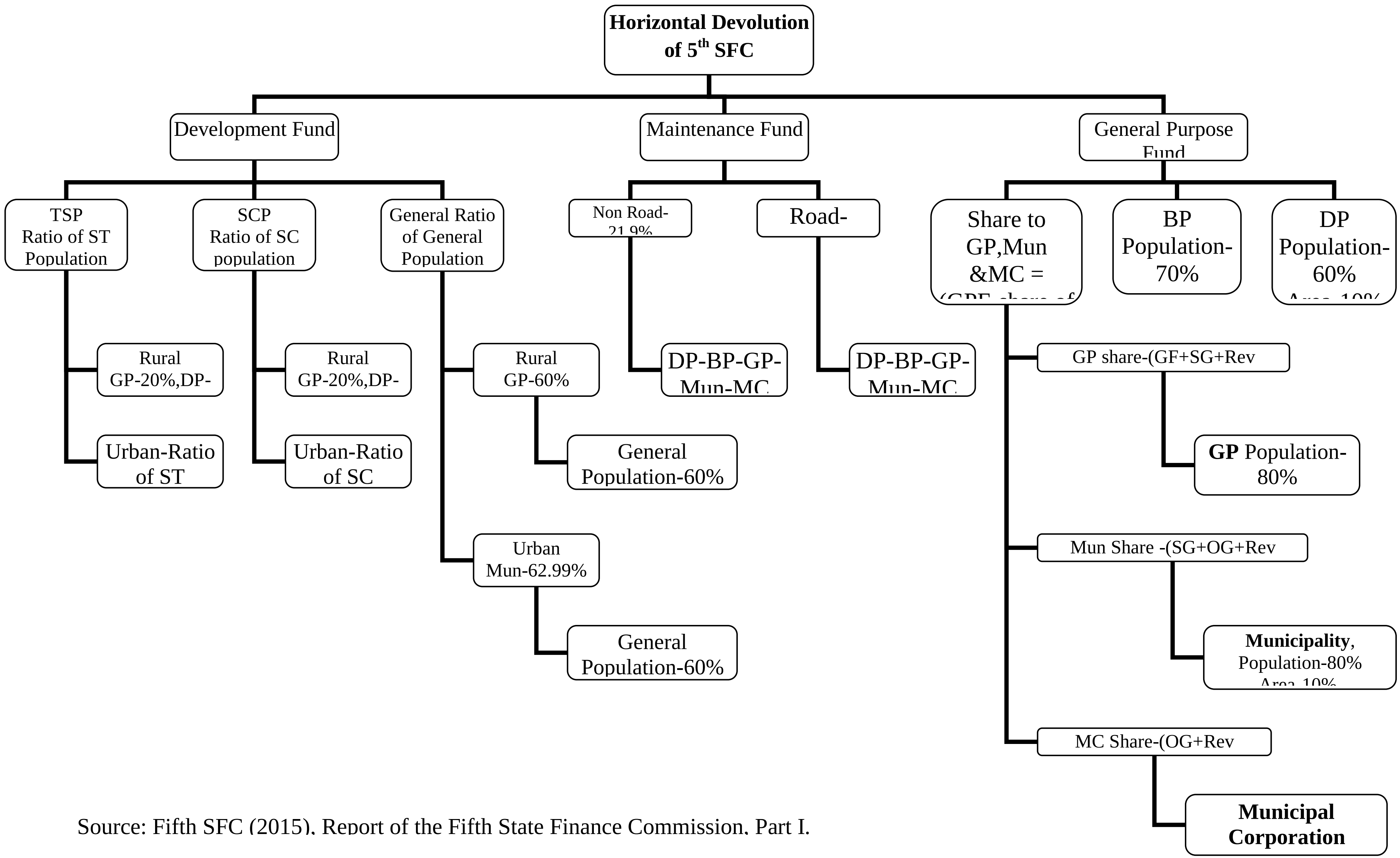
Table 9.4

Formula for Distribution of General sector Portion of Development Fund

(Weightage in percent by type of LG)					
Criteria	**GP**	**BP**	**DP**	**Municipality**	**MC**
Population	60	60	60	60	60
Percentage of BPL Households	20	20	20	20	20
Area	20	20	20	20	20
Total	**100**	**100**	**100**	**100**	**100**

Source: Fifth SFC (2015), Report of the 5th SFC, Part I.

Figure 9.1



Source: Fifth SFC (2015). Report of the Fifth State Finance Commission. Part I.

IV. Transfer of Funds Recommended by 5th SFC

This section presents the transfer of funds recommended by the 5th SFC for five years from 2016-17 to 2020-21. The funds consist of two items: a share of the SOTR devolved to LGs and UFC grant given by the Central government as per the recommendations of the 14th UFC. The UFC grant consists of two items: a basic grant and performance grant for GPs and urban LGs. In the case of GPs, 90 percent of the grant is basic grant and 10 percent performance grant. In the case of urban LGs, the respective share is 80 percent and 20 percent. As the performance grant is transferred based on certain conditions, the 5th SFC has not included it in the funds to be transferred. Though the SFC can use its own formula to distribute UFC grants, the 5th SFC used the 14th UFCs formula to distribute the grants. The 5th SFC treated UFC grants as separate grant and recommended to transfer it in addition to the share of SOTR transferred to LGs.

LG wise and Fund wise Devolution of Funds

The total amount recommended for different categories of LG from the share of SOTR (development, general purpose and maintenance fund) and UFC grant are given in Table 9.5

Table 9.5

Total transfer of funds during the 5th SFC period : LG Category wise (₹ in crore)

Name	2016-17	2017-18	2018-19	2019-20	2020-21
Grama Panchayat	**5562.56**	**6523.62**	**7590.48**	**8976.80**	**9164.23**
Development Fund	2304.83	2696.87	3281.15	3966.82	4769.89
General Purpose Fund	1094.84	1225.31	1371.46	1535.19	1718.63
Maintenance Fund	1562.27	1907.49	2135.09	2390.06	2675.71
UFC Grant	600.62	693.96	802.78	1084.73	
Municipality	**1446.45**	**1697.50**	**1977.40**	**2382.75**	**2108.01**
Development Fund	559.00	654.08	795.79	962.08	1156.85
General Purpose Fund	190.57	213.29	238.73	267.23	299.16
Maintenance Fund	380.69	464.81	520.27	582.40	652.00
UFC Grant	316.19	365.33	422.62	571.05	
District Panchayat	**1015.77**	**1197.52**	**1427.93**	**1696.43**	**2008.86**
Development Fund	768.28	898.96	1093.72	1322.27	1589.96
General Purpose Fund	35.91	40.22	45.04	50.45	56.50
Maintenance Fund	211.59	258.35	289.17	323.71	362.39
Municipal Corporation	**799.25**	**934.42**	**1090.81**	**1315.95**	**1175.00**
Development Fund	329.33	385.34	468.83	566.80	681.55
General Purpose Fund	132.52	148.31	166.00	185.82	208.02
Maintenance Fund	166.66	203.49	227.77	254.96	285.44
UFC Grant	170.75	197.28	228.22	308.37	
Block Panchayat	**862.99**	**1009.44**	**1217.42**	**1460.79**	**1745.07**
Development Fund	768.28	898.96	1093.72	1322.27	1589.96
General Purpose Fund	51.07	57.20	64.06	71.75	80.36
Maintenance Fund	43.64	53.28	59.64	66.76	74.74
Grand Total	**9687.02**	**11362.50**	**13304.04**	**15832.72**	**16201.17**

Source: Fifth SFC (2015), Report of the 5th SFC, Part I.

All the categories of LGs are entitled to get development, general purpose and maintenance fund. In the case of UFC grants, only three categories of LGs – GPs, municipalities and MCs are eligible for the grant. The total funds recommended by the 5th SFC increased from ₹ 9687.02 crore in 2016-17 to ₹ 16201.17 crore in 2020-21. An LG wise growth and composition of transfer of funds recommended by the 5th SFC is given in Table 9.6.

Table 9.6

LG Category wise transfer of funds : Growth & Composition

Sl. No	**Category of LGs**	Growth (%)				
		2016-17	2017-18	2018-19	2019-20	2020-21
1	GP	-	14.73	14.06	18.26	2.05
2	Municipality	-	14.79	14.15	20.50	-13.03
3	DP	-	15.18	16.14	15.83	15.55
4	MC	-	14.47	16.74	17.11	-12.00
5	BP	-	14.51	17.08	16.66	16.29
Total		-	14.75	14.59	15.97	2.27
		Composition (%)				
1	GP	57.42	57.41	57.05	56.70	56.57
2	Municipality	14.93	14.94	14.86	15.05	13.01
3	DP	10.49	10.54	10.73	10.71	12.40
4	MC	8.25	8.23	8.20	8.31	7.25
5	BP	8.91	8.88	9.16	9.23	10.77
Total		100	100	100	100	100

Source: Based on Table 9.5

From the Table we may draw the following inferences. (1) The annual growth of funds was more than 14 percent in all categories of LGs between 2016-17 and 2019-20. (2) The growth rate of 2.27 percent in 2020-21 is attributed to non-availability of data of UFC grant, to be recommended by the 15th UFC. (3) Of the total transferred funds, the share of funds allocated to GPs is about 57 percent, municipalities 15 percent and MCs 8 percent. These LGs are executing more functions such as mandatory, civic, maintenance of assets and development compared to other categories of LGs. (4) On the other hand, the LGs which are executing development and maintenance functions such as BPs and DPs get a lower share of the total funds.

An attempt is made to present rural, urban and LG wise distribution of funds recommended for transfer (Table 9.7).

Table 9.7
Total transfer of funds during 5th SFC period : Rural and Urban (₹ in crore)

Name	2016-17	2017-18	2018-19	2019-20	2020-21
Rural	**7441.32**	**8730.58**	**10235.84**	**12134.02**	**12918.16**
Development Fund	3841.38	4494.78	5468.58	6611.37	7949.81
General Purpose Fund	1181.81	1322.73	1480.57	1657.39	1855.50
Maintenance Fund	1817.50	2219.12	2483.90	2780.53	3112.85
UFC Grant	600.62	693.96	802.78	1084.73	NA
Urban	**2245.70**	**2631.92**	**3068.21**	**3698.71**	**3283.02**
Development Fund	888.32	1039.42	1264.61	1528.88	1838.40
General Purpose Fund	323.09	361.59	404.72	453.04	507.18
Maintenance Fund	547.35	668.29	748.03	837.36	937.44
UFC Grant	486.94	562.61	650.84	879.42	NA
Grand Total	**9687.02**	**11362.50**	**13304.05**	**15832.72**	**16201.17**

Source: Fifth SFC (2015), Report of the 5th SFC, Part I.

The rural LGs comprises of GPs, BPs and DPs are entitled for an amount ranged between ₹ 7441.32 crore to ₹ 12918.16 crore during the period of five years between 2016-17 and 2020-21. On the other hand the urban LGs comprises of municipalities and MCs get an amount ranged between ₹ 2245.70 crore and ₹ 3698.71 crore during the above five years. The rural, urban LG wise growth in the transfer of funds and its composition is given in Table 9.8.

Table 9.8
Rural Urban LG wise transfer of funds : Growth & Composition

Sl. No	Category	Growth (%)				
		2016-17	**2017-18**	**2018-19**	**2019-20**	**2020-21**
1	Rural	-	17.33	14.71	15.64	6.46
2	Urban	-	14.67	14.22	17.05	-12.66
Total		**-**	**14.75**	**14.59**	**15.97**	**2.27**
		Composition (%)				
1	Rural	76.82	76.84	76.94	76.64	79.74
2	Urban	23.18	23.16	23.04	23.36	20.26
Total		**100**	**100**	**100**	**100**	**100**

Source: Based on Table 9.7

A notable aspect is that the rural LGs account for more than 76 percent of the total amount recommended for transfer.

A fund wise analysis will give the structure of the funds recommended to the LGs. Table 9.9 gives the fund wise devolution recommended by the 5th SFC.

Table 9.9

Total transfer of funds during 5th SFC period : Fund Wise Devolution (₹ in crore)

Name	2016-17	2017-18	2018-19	2019-20	2020-21
Development Fund	**4729.70**	**5534.20**	**6733.20**	**8140.25**	**9788.21**
General Sector	4225.19	4943.88	6014.98	7271.94	8744.12
SCP	430.83	504.11	613.32	741.49	891.60
TSP	73.68	86.21	104.89	126.81	152.49
General Purpose Fund	**1504.90**	**1684.32**	**1885.29**	**2110.44**	**2362.67**
General Purpose Fund	1444.25	1626.67	1827.64	2052.79	2305.02
Gap Fund	50.00	50.00	50.00	50.00	50.00
One Time Grant	3.00	0.00	0.00	0.00	0.00
Revenue Collection Incentive Fund	6.50	6.50	6.50	6.50	6.50
Special Grant	1.15	1.15	1.15	1.15	1.15
Maintenance Fund	**2364.85**	**2887.41**	**3231.93**	**3617.89**	**4050.29**
Non Road	518.44	633.00	708.53	793.14	887.93
Road	1846.41	2254.41	2523.41	2824.75	3162.36
UFC Grant	**1087.56**	**1256.57**	**1453.62**	**1964.15**	**NA**
Basic Grant	1087.56	1256.57	1453.62	1964.15	NA
Grand Total	**9687.02**	**11362.50**	**13304.05**	**15832.72**	**16201.17**

Source: Fifth SFC (2015), Report of the 5th SFC, Part I.

Development fund accounted for the largest share of funds devolved. The amount of development fund increased from ₹ 4729.70 crore in 2016-17 to ₹ 9788.21 crore in 2020-21. Maintenance fund is the second major item and the amount ranged between ₹ 2364.85 crore and ₹ 4050.29 crore in 2020-21. The third item is GPF and the amount ranged between ₹ 1504.90 crore and ₹ 2362.67 crore during five years. The growth and composition of the item wise funds recommended are given in Table 9.10.

Table 9.10

Fund wise transfer of funds : Growth & Composition

Sl. No	Fund	Growth (%)				
		2016-17	**2017-18**	**2018-19**	**2019-20**	**2020-21**
1	Development	-	17.01	17.81	17.29	16.84
2	GPF	-	10.65	10.66	10.67	10.68
3	Maintenance	-	18.10	10.66	10.67	10.68
4	UFC	-	13.45	13.56	25.99	-
Total		**-**	**14.75**	**14.59**	**15.97**	**2.27**
		Composition (%)				
1	Development	48.83	48.71	50.61	51.41	60.42
2	GPF	15.54	14.82	14.17	13.33	14.58
3	Maintenance	24.40	25.41	24.29	22.85	25.00
4	UFC	11.23	11.06	10.93	12.41	-
Total		**100**	**100**	**100**	**100**	**100**

Source: Based on Table 9.9

A trend in change of development fund indicates an annual growth of 17 percent per annum. The annual growth of the GPF is about 11 percent. The annual growth of maintenance fund ranged between 11 and 18 percent. On the other hand, there is considerable fluctuations in the growth of UFC grants recommended. An analysis of the share of the various funds indicates that development fund has the largest share, followed by maintenance fund, GPF and UFC grants.

Total transfer of funds : 5th SFC and 14th UFC

An attempt is made to present total funds devolved to LGs as per the recommendations of 5th SFC and 14th UFC. Though 14th UFC has recommended basic grants and performance grants, we have taken only basic grants, which accounts for 90 percent of total UFC grants of GPs and 80 percent of the total UFC grants of urban LGs. As the performance grant is a conditional grant and is distributed on the basis of certain performance indicators and exist uncertainty about the number of LGs to qualify for the same, the 5th SFC has not included the item in devolution of funds.

Table 9.11 gives the total transfer of funds recommended by 5th SFC and 14th UFC for a period of four years.

Table 9.11

Total transfer of funds : Growth & Composition

Sl. No	**Item**	**Amount (₹ in crore)**			
		2016-17	**2017-18**	**2018-19**	**2019-20**
1	UFC Basic Grant	1087.56	1256.57	1453.62	1964.15
2	SFC Fund	8599.46	10105.93	11850.43	13868.57
Total		**9687.02**	**11362.50**	**13304.05**	**15832.72**
		Growth (%)			
1	UFC Basic Grant	-	13.45	13.56	25.99
2	SFC Fund	-	14.91	14.72	14.55
Total		**-**	**14.75**	**14.59**	**15.97**
		Composition (%)			
1	UFC Basic Grant	11.23	11.06	10.93	12.41
2	SFC Fund	88.77	88.94	89.07	87.59
Total		**100**	**100**	**100**	**100**

Source: Fifth SFC (2015), Report of the 5th SFC, Part I.

The total funds increased from ₹ 9687.02 crore in 2016-17 to ₹ 15832.72 crore in 2019-20. The growth rate ranged between 14.59 percent and 15.97 percent. During the first two years, growth rate of SFC funds was higher compared to UFC fund, but the third year the situation is reversed. A notable aspect is that the share of UFC grant is small compared to SFC devolved funds. The share of SFC fund ranged between 87.6 percent and 89.0 percent to the total fund during the period of four years.

V. Status of Implementation

Here we present the time taken for presentation of the Action Taken Report in Kerala legislative assembly, acceptance or rejection of recommendations on devolution and other items by State Government. The 5th SFC had submitted their first part of the report containing the recommendations on devolution on December, 2015 and second part on other subjects on March, 2016 to Governor of Kerala. The award period of commission was five years from 2016-17 to 2020-21. But the action taken report on the recommendations of the commission was placed in Kerala Legislative Assembly on February 7, 2018, after the presentation of the State budget for 2018-19. Due to this State Government delayed the presentation of the Action Taken Report to Kerala legislature by two years. State government also failed to devolve funds to 1200 LGs in Kerala based on 5th SFC recommendations in three budgets for the years 2016-17, 2017-18 and 2018-19. The Government allotted a lower amount than the amount recommended by 5th SFC for, three consecutive years. The amount allocated to LGs was 10 percent less in 2016-17, 14 percent less in 2017-18 and 19 percent less in 2018-19. And the 1200 LGs in Kerala were denied their legitimate right to receive their due share of State taxes recommended by the 5th SFC for three years.

Rejection of Devolution Recommendation

It is disturbing to note that all core devolution recommendations of the commission were rejected by the State Government. They include devolution of funds based on the year of devolution t followed by UFC, recommendations of devolved funds to each LG for the award period, distribution of maintenance fund based on actual assets of LG, unhealthy diversion of maintenance fund for non-maintenance purpose, distribution of a share of SOTR as development fund, treating 14th UFC grants as separate grant etc. Table 9.12 gives the list of core devolution recommendations of 5th SFC rejected by the State Government.

Table 9

Major Devolution Recommendations rejected by State Government

1	Devolution of funds based on the estimate made for the year of devolution t following UFC approach.
2	Any excess or shortfall may be adjusted in devolution to LGs in subsequent years based on tax realisation.
3	Award recommending the amount of money to be devolved to each LG for each year of the award period based on the t method.
4	3.5 percent of the net proceeds of the annual SOTR be devolved as GPF on t basis for five years.
5	Distribute the maintenance fund to each LG on the basis of the actual road and non-road assets based on commission's assessment.
6	5.5 to 6 percent of the net SOTR on t basis as maintenance fund.
7	Maintenance fund should be used only for the purpose of maintenance of road and non-road assets.
8	A share of the net proceeds of the SOTR – as calculated on t basis – as the development fund. The rate of devolution recommended ranged between 11 and 14.5 percent.
9	The grants given by the 14^{th} UFC for civic services to LGs be treated as a separate grant and transferred in addition to the devolution of the commission.
10	Transfer the devolved funds to public accounts of LGs in 12 instalments in a year.

Instead of opting for a progressive criterion suggested by the 5^{th} SFC, the State government decided to continue with existing practice of devolving SOTR based on the tax receipts of two years back. The government is not prepared to change norms of distribution of maintenance fund to LGs based on reliable data of assets. This results in distorted distribution of maintenance funds such as LGs with small assets getting large amount and LGs with large assets getting small amount.

Recommendations Accepted and Rejected

The 5^{th} SFC had given 133 recommendations based on the terms of reference of the commission. Based on the action taken on each of the recommendation, we have classified them as accepted, rejected and accepted with modifications. The recommendations comes under the items such as devolution of SOTR, maintenance of assets, UFC grants, mobilisation of own resources, finances of rural and urban LGs, implementation of the previous SFC recommendations, fiscal issues, restructuring plan and changes in law, rules and procedures. Table 9.13 gives the number of recommendations accepted, accepted with modification and rejected.

Table 9.13

5th SFC: Number of Recommendations Accepted and Rejected

Sl No	Item	Total Number of Recommend-ations	Number of Accepted	Number of Accepted with modification	Number of Rejected	Percentage of Accepted to Total
1	Devolution of SOTR	21	3	4	14	14.29
2	Maintenance of Assets	5	1	1	3	20.00
3	UFC Grants	5	3	-	2	60.00
4	Mobilisation of Own Resources of LGs	29	23	1	5	79.31
5	Finances of Rural LGs	3	2	1	-	66.67
6	Finances of Municipalities and MCs	3	-	1	2	-
7	Implementation of Previous SFC Recommendations	32	30	-	2	93.75
8	Fiscal Issues	12	7	2	3	58.34
9	Restructuring Plan Formulation and Execution	13	4	3	6	30.77
10	Change in Law, Rules and Procedures	10	5	-	5	50.00
	Total	**133**	**78**	**13**	**42**	**58.65**

Source: GoK (2018) Action Taken Report on Part I and Part II of the Reports of 5th SFC : TVM, GoK.

Of the total recommendations, 59 percent were accepted by the State government. In the case of recommendations on devolution, the percentage of acceptance is very small (14 percent). The maintenance of assets and restructuring plan are the other items having poor acceptance. Of the total recommendations on change in law, rules and procedures 50 percent are accepted. The other items of recommendations, majority accepted are fiscal issues, UFC grants, finances of rural LGs and mobilisation of own resources. An interesting aspect is the acceptance of 94 percent of the recommendations of the first four SFCs which were accepted by the successive State governments but not operationalized so far. From the above we can conclude that most of the recommendations on devolution, maintenance of assets and finances of urban LGs are rejected. However, the government accepted 79 percent of the recommendations on mobilisation of own resources of LGs. Majority of the recommendations on finances of rural LGs and fiscal issues are also accepted.

Conclusion

The 5th SFC's approach on devolution is much different from the approaches followed by earlier SFCs. In place of devolution based on (t-2) or (t-3) method, the commission used t method for devolving State taxes based on year of devolution. Instead of giving maintenance fund based on unreliable data, the commission decided to distribute the maintenance fund to each LG on the basis of the actual road and non-road assets. Regarding the practice of giving a share of annual plan size of Kerala as development fund, the commission recommended to give a share of net proceeds of SOTR as development fund. The 5th SFC wanted to treat the grants of 14th UFC given to LGs as a separate grant and it should be transferred to LGs in addition to SFC's devolution. The commission also recommended that the award to be given specifying the amount of money to be devolved to each LG for each year of the award period.

Clear norms are prescribed for the horizontal devolution of GPF, maintenance fund and development fund for various categories of LGs as well as for individual LG. Based on the above devolution principles and criteria, the commission had worked out itemwise and year wise amount of devolution to 1200 LGs of Kerala for a period of five years.

However, the State Government was not prepared to take prompt action to implement the recommendations of 5th SFC. Though, the commission submitted the first part of the report containing devolution recommendations, in December 2015, the action taken report was placed in Kerala State Legislature on February 7, 2018. The State Government had not prepared to devolve funds to LGs in its three budgets for the years 2016-17, 2017-18 and 2018-19. As a result the LGs got only a lower amount than the amount recommended by the 5th SFC. Of the total recommendations of the commission only 59 percent was accepted by the State Government. It is disturbing to note that except a few (14 percent) all the recommendations on devolution were rejected.

The delayed implementation of 5^{th} SFC and rejection of most of the devolution recommendations raise many serious issues. The recommendations of 5^{th} SFC, a constitutional body was not implemented for two years. The 1200 LGs in Kerala were denied their legitimate right to receive their due share of State taxes recommended by the 5^{th} SFC for three years. The Government allotted a lower amount than the amount recommended by 5^{th} SFC for, three consecutive years. Most of the core devolution recommendations of 5th SFC which are formulated on clear norms for general purpose, maintenance of assets and development were rejected. The fiscal decentralisation system in Kerala is subverted. There is arbitrary allocation of resources, reversal of fiscal decentralisation and move towards fiscal centralisation. The subversion of the 5^{th} SFC's recommendations may be considered a most serious lapse on the part of a State government which claims the strengthening of decentralisation to be an important aspect of its development agenda.