

# **Fiscal Decentralisation in Kerala**

**B. A. Prakash**

**Chairman, Fifth State Finance Commission**

This presentation is available in  
[www.keralaeconomy.com](http://www.keralaeconomy.com)

**November 2022**

# Objectives

- Examine the fiscal decentralisation in Kerala (With reference to mobilisation of own resource and intergovernmental fiscal transfers).
- Present recommendations of 5<sup>th</sup> State Finance Commission's (SFC) and status of implementation (2016-17 to 2020-21).
- Evaluate the fiscal decentralisation experiences, political declarations and actual results.

# Data Sources

- Fifth State Finance Commission (SFC) Report, Vol I (December 2015) and Vol II (March 2016).
- Government of Kerala, Action Taken Report on Part I and Part II of the reports of the fifth SFC (February 7, 2018).
- Other reports of SFCs, Kerala and Action Taken Report of SFCs, Kerala.
- B. A. Prakash, 2020, Local Finance, Fiscal Decentralisation and Decentralised Planning: A Kerala Experience, Sage Publications, New Delhi.

# Concept of decentralisation

- Decentralization can be classified into three types: deconcentration, delegation and devolution.
- In deconcentration, the decision-making power is with higher-level government, and the lower level is only implementing agency.
- In delegation, the higher-level government delegates decision-making power to the lower level for specified functions.
- Only in devolution is decision-making power shared between the higher and lower levels of government.
- Decentralisation is devolution of power to subnational governments or lower tier of government

# Concept of fiscal decentralisation

- “Fiscal decentralization is primarily concerned with implementing an effective intergovernmental fiscal system.
- Fiscal decentralisation is based on four pillars: expenditure assignment, revenue assignment, intergovernmental transfers/grants, and subnational debt/borrowing.
- The intergovernmental fiscal transfers refer to the transfer of finances from the higher level of government to lower government levels.
- According to Indian Constitution, the inter-government fiscal transfers are effected through the institutions viz. Union Finance Commission and State Finance Commission.

# **Pre-conditions for sound fiscal decentralisation**

- Clear assignment of functions and expenditure responsibilities.
- Allocation of own source revenue and powers to levy collect and revise taxes, fees, user charges etc. assigned to LGs.
- Unconditional and formula driven inter-governmental transfers to cover the gap in resources between own resources and expenditure.
- Powers to borrow funds for meeting current and capital items of expenditure.

- Powers to prepare budgets and conduct fiscal operations based on it.
- Powers to appoint staff, initiate disciplinary actions and terminate services.
- Public accountability mechanisms such as audit of accounts by public authority to safeguard against misuse and abuse of local discretion.
- Social accountability mechanisms where the citizens or civil society organizations can demand accountability of the LGs and better service delivery.

# Hypotheses

- The successive state governments in Kerala have been following policies which are not helpful for fiscal decentralisation, better or optimum mobilisation of own tax or non-tax revenue of LGs, strengthening the finances of LGs and compel them to rely heavily on transferred funds.
- Though Kerala has been constituting state finance commissions in time, the fiscal devolution process is subverted through delayed implementation of SFC reports, rejection of core devolution recommendations, rejection of most of other recommendations and non-implementation of accepted recommendations.

# Decentralisation of powers and functions of Local Governments in Kerala

- Kerala implemented decentralization of powers and functions to Local Governments (LGs) following 73<sup>rd</sup> and 74<sup>th</sup> amendments to the constitution of India.
  
- The amendments gave the following
  - 1) Constitutional status to LGs
  - 2) Established a system of uniform structure
  - 3) Formation of village assemblies or grama sabhas
  - 4) Transfer of 29 subjects to LGs
  - 5) Entrusted responsibility of preparing local area development plans

- 6) Constitution of district planning committees
- 7) Transfer of funds from State government based on the recommendations of State Finance Commissions (SFCs).
- 8) Constitution of State Election Commission to conduct elections to LGs every five years
- 9) Reservation of one third of total seats and Chairperson's offices for women (later increased to 50%)
- 10) Seat reservation for scheduled caste (SC) and scheduled tribe (ST) population

- The United Democratic Front (UDF) government enacted Kerala Panchayat Raj Act (KPRA) 1994 and the Kerala Municipality Act (KMA) 1994 to enable the LGs to function as third tier of government.
- The State legislature also amended other related laws to empower LGs.
- The Acts also envisaged to transfer functions of various departments of the government to LGs.
- The KPRA 1994 and KMA 1994 retained the traditional civic functions of local bodies such as grama panchayats, municipalities and municipal corporations as core functions.

# **Mandatory Functions of Municipalities as per The Kerala Municipality Act, 1994 (KMA); Major items**

- Regulating building construction
- Maintenance of waterways and canals
- Collection and disposal of solid waste, disposal of liquid waste
- Maintenance of environmental hygiene
- Management of public markets
- Vector control
- Regulation of slaughtering of animals
- Maintenance of roads and other public properties
- Street lighting and its maintenance

- Adopt immunization measures
- Programmes for prevention and control of diseases
- Maintenance of burial and burning grounds
- Issue of licences to trades and industries
- Registration of births and deaths
- Providing parking spaces for vehicles
- Construction of waiting sheds
- Providing toilet facilities at public places
- Providing basic facilities in slum areas
- Foot path and road crossing facilities for pedestrians
- Preparation of detailed town planning

# Decentralised Planning in 1996

- The Left Democratic front (LDF) government which came into power in 1996 has given a new thrust to decentralisation.
- More emphasis was given to decentralised planning and named it as Peoples Plan Campaign
- The main objectives of the decentralised planning were
  - 1) Transferring 35 to 40 percent of the total state plan outlay to the local bodies and giving full powers to prepare plan in the 9<sup>th</sup> Five Year Plan

- 2) Ensure people's participation in plan formulation, implementation and mobilisation of local resources both manpower and physical resources for local investment
- 3) Strengthening the local bodies through decentralisation of administrative and financial powers
- 4) Expand the plan outlay and activities through resources of local bodies, mobilisation of public contributions, voluntary contribution of manpower for executing public works, beneficiary contributions etc.
- 5) The focus shifted from the traditional administrative and civic functions to local level development planning and agency functions such as distribution of social welfare pensions, implementations of Centrally Sponsored Schemes (CSS) etc.

# Profile of local governments in Kerala (Tables 1-3)

- Kerala has 1200 LGs in 2015
- There has been a decrease in number of GPs since 2005
- But the number of municipalities and municipal corporations increased since 2005
- A grama panchayat had an average population of 26,674 in 2011
- A municipality had an average population 51,664 persons and MCs 4.91 lakh in 2011
- LG wise population, SC and ST population, BPL households, area in sq.km, average resources of 1200 LGS are given in appendix A, Report of the 5<sup>th</sup> SFC, Part II.

**Table 1**  
**Number of rural and urban LGs in Kerala from 1995 to 2015**

LG	1995	2000	2005	2010	2015
<b>Rural</b>					
Grama Panchayath (GP)	990	991	999	978	941
Block Panchayath (BP)	152	152	152	152	152
District Panchayath (DP)	14	14	14	14	14
<b>Urban</b>					
Municipality	55	53	53	60	87
Municipal Corporation (MC)	3	5	5	5	6
<b>Total</b>	<b>1214</b>	<b>1215</b>	<b>1223</b>	<b>1209</b>	<b>1200</b>

*Source: GoK (2015) Report of 5<sup>th</sup> SFC, Part I, GoK (2016) Report of 5<sup>th</sup> SFC, Part II*

**Table 2**  
**Average area and population of LGs in 2011**

<b>LG</b>	<b>Number</b>	<b>Average area (Sq.km.)</b>	<b>Average population (2011 Census)</b>
DPs	14	2651.7	1903357
BPs	152	244.24	175309
GPs	978	37.16	26674
MCs	5	95.6	491240
Municipalities	60	23.65	51664
<b>Total</b>	1209	-	-

*Source: GoK (2015) Report of 5<sup>th</sup> SFC, Part I, GoK (2016) Report of 5<sup>th</sup> SFC, Part II*

**Table 3**  
**District wise distribution of LGs (as on 1st**  
**November 2015) (in number)**

<b>District</b>	<b>GPs</b>	<b>BPs</b>	<b>DPs</b>	<b>Municipalities</b>	<b>MCs</b>
Thiruvananthapuram	73	11	1	4	1
Kollam	68	11	1	4	1
Pathanamthitta	53	8	1	4	0
Alappuzha	72	12	1	6	0
Kottayam	71	11	1	6	0
Idukki	52	8	1	2	0
Ernakulam	82	14	1	13	1
Thrissur	86	16	1	7	1
Palakkad	88	13	1	7	0
Malappuram	94	15	1	12	0
Kozhikode	70	12	1	7	1
Wayanad	23	4	1	3	0
Kannur	71	11	1	9	1
Kasargod	38	6	1	3	0
<b>Total</b>	<b>941</b>	<b>152</b>	<b>14</b>	<b>87</b>	<b>6</b>

*Source: GoK (2015) Report of 5<sup>th</sup> SFC, Part I, GoK (2016) Report of 5<sup>th</sup> SFC, Part II*

## **Number of wards (Table 4)**

- Average number of wards per GP 17
- Average number of Wards per DP 24
- Average number of ward per municipality 36
- Average number of wards per MC 69
- Total number of wards in GP 15,962
- Total number of wards in Municipalities 3,122
- Total number of wards (panchayats, municipalities and MCs) 21,905
- Half of the wards are reserved for women

**Table 4**  
**Number of wards of LGs in Kerala, 2015**

LG	2015 (as on November)		
	Number of LGs	Number of Wards	Average Number
<b>Rural</b>			
<b>GP</b>	941	15962	17
<b>BP</b>	152	2076	14
<b>DP</b>	14	331	24
<b>Urban</b>			
<b>Municipalities</b>	87	3122	36
<b>MCs</b>	6	414	69
<b>Total</b>	1200	21905	-

*Source: GoK (2015) Report of 5<sup>th</sup> SFC, Part I, GoK (2016) Report of 5<sup>th</sup> SFC, Part II*

## Monthly honorarium (Table 5)

- The monthly Honorarium of elected representatives of LGs was very meagre till July 2016
- Amount for a member of DP was ₹4400
- Amount for a member of BP was ₹3800
- Amount for a member of GP was ₹3500
- The LGs demanded a rise in amount in the sittings of 5<sup>th</sup> SFC
- 5<sup>th</sup> SFC recommended increase at the rate of 100% for members and 200% for presidents, municipal chairman etc.
- But state government enhanced at the rate of 100% for all elected representatives

**Table 5**  
**Monthly honorarium of elected representatives of LGs**

<b>Name of LG</b>	<b>Elected Representatives</b>	<b>Rate of Honorarium (wef. 01/04/2013)</b>	<b>Enhanced rate * (wef. 01/07/2016)</b>
<b>District Panchayat</b>	President	7900	15800
	Vice President	6600	13200
	Standing Committee Chairman	4700	9400
	Members	4400	8800
<b>Block Panchayat</b>	President	7300	14600
	Vice President	6000	12000
	Standing Committee Chairman	4400	8800
	Members	3800	7600
<b>Grama Panchayat</b>	President	6600	13200
	Vice President	5300	10600
	Standing Committee Chairman	4100	8200
	Members	3500	7000
<b>Municipal Corporation</b>	Mayor	7900	13800
	Deputy Mayor	6600	13200
	Standing Committee Chairman	4700	9400
	Members	4100	8200
<b>Municipality</b>	President	7300	14600
	Vice President	6000	12000
	Standing Committee Chairman	4400	8800
	Members	3800	7600

\*Enhanced as per the recommendations of 5<sup>th</sup> SFC

# **Fiscal decentralisation and mobilisation of own tax and non-tax revenue**

- The state government had not transferred any new tax or non-tax items to LGs after the implementation of decentralized governance, in spite of assignment of a number of additional functions and expenditure responsibilities.
- The LGs were not given powers to revise rate of taxes and non-tax items assigned to them.
- Though the state government retained powers to revise rate of taxes and non-tax items, the government had not taken steps to effect periodical revision for about two decades.
- Efforts were not taken to change provisions of acts, rules and procedures for revision of rates.

- This has increased the dependence of LGs on transferred funds.
- Though KPRA, 1994 and KMA, 1994 authorise the State government to revise the rate of property tax of the LGs once in five years, the successive governments in Kerala have not revised the rate accordingly.
- A revision of property tax effected after a gap of 17 years was practically withdrawn.
- The upper ceiling of the profession tax, the second major item of tax of LGs which was fixed in 1988 was not revised due to indifferent attitude of the successive governments at the centre.

- The inclusion of entertainment tax, the third major item of tax of LGs in the GST has resulted in considerable revenue loss to the LGs.
- The outdated bye-law system followed with regard to advertisement tax stands as an obstacle to introduce or revise the rate of tax in the LGs.
- Though all the GPs, municipalities and MCs can levy advertisement tax, only 15 percent of the LGs collect it due to the practical problems associated with the introduction of the tax.
- Due to the lack of clarity in KPRA, 1994, KMA, 1994 and the rules framed relating to compulsory collection of service tax, majority of the LGs are not collecting the tax.

- The situation is not different with respect to non-tax items. The rate of fees levied for licenses, permits, certificates, rents collected for the buildings owned by LGs etc. are very low, fixed several years ago and not revised periodically.
- The 5<sup>th</sup> SFC has recommended the transfer of one time building tax, now collected by the revenue department to GPs, Municipalities and MCs. But State government has rejected it.
- The unwillingness of successive state governments to transfer powers and make necessary changes in Acts and rules relating to taxes and non-tax items assigned to LGs have stood an obstacle to increase revenue mobilisation of LGs

- The average total receipts per GP in 2014-15 was 8.06 crore
- In 2014-15, the average share of receipts of GP – tax and non-tax 9%, transferred funds 47%, CSS 24% and welfare pension 20%.
- The average total receipts per Municipality in 2014-15 was 21.70 crore
- In 2014-15, average share of receipts of municipality – tax and non-tax 26%, transferred funds 52%, welfare pension 14%, CSS 7% and borrowing 1%.
- Thus the fiscal decentralisation policies of the state government are not helpful for better or optimum mobilisation of own resources of LGs.
- And the LGs are forced to rely heavily on transferred funds

# Intergovernmental fiscal transfers through SFCs

- Government of Kerala had constituted six state finance commission since 1994, which submitted reports (Table 6)
- The award period of the commission were between 1996-97 to 2020-21
- The award period of the 5<sup>th</sup> SFC was 2016-17 to 2020-21
- The 5<sup>th</sup> SFC comprises of, Prof. B A Prakash, Chairman; Sri. James Varghese, Principal Secretary LSG Department, Member; and Dr. V. K. Baby, Special Secretary, Finances (Resources), as Member.
- The 6<sup>th</sup> SFC is constituted with Sri. S. M. Vijayanand, a former Chief Secretary to Government of Kerala, as Chairman on October 31, 2019.

**Table 6**  
**Chairman and members of SFCs in Kerala**

<b>Name of the Commission</b>	<b>Date of Constitution of the Commission</b>	<b>Chairman of the Commissions</b>	<b>Members of the Commission</b>
First SFC	April 23, 1994	Shri. P.M. Abraham	Shri. K. Mohandas Shri. K. A. Ommer
Second SFC	June 23, 1999	Dr. Prabhat Patnaik	Dr. K. M. Abraham Shri. S. M. Vijayanand
Third SFC	September 20, 2004	Shri. K. V. Rabindran Nair	Shri. V. S. Senthil Shri. P. Kamalkutty
Fourth SFC	September 19, 2009	Prof. M. A. Oommen	Shri. S. M. Vijayanand Smt. Ishita Roy
Fifth SFC	December 17, 2014	Prof. B. A. Prakash	Shri. James Varghese Dr. V. K. Baby

*Source: GoK (2015) Report of 5<sup>th</sup> SFC, Part I, GoK (2016) Report of 5<sup>th</sup> SFC, Part II*

## **Terms of references of 5<sup>th</sup> SFC**

- 1) Review the financial position of Local Governments (LGs) and make recommendations on the following:
  - a) the principles which should govern the distribution between the state, LGs, the net proceeds of state taxes, duties, fees etc,
  - b) allocate between different categories of LGs and their respective share of proceeds,
  - c) assignment of taxes, duties to LGs, and
  - d) allocation of grants-in-aid to LGs.

- 2) The measures needed to strengthen the financial position of LGs (Both own resources and borrowing)
- 3) Measures needed for the proper institutionalisation of the decentralisation initiatives in the state.
- 4) Revisit the recommendation of the first Four SFCs which were accepted but not implemented.

## **Data sources of 5<sup>th</sup> SFC**

- Commissions approach was to meet the LGs and discuss with them to get an idea of ground realities and problems.
- Commission held sittings in 14 districts to discuss fiscal issues with 104 sample LGs (GPs, BPs, DPs, Municipalities and MCs)
- Another sittings in five districts was held to examine plan performance and plan expenditure of 33 sample LGs covering all categories.
- Collected financial data from all LGs (1200) through online using a detailed questionnaire.

- Discussions with Department of Finance, State Planning Board and all the departments related to LGs.
- Discussion with LG Associations, political parties, economists and experts etc.
- Entrusting two studies to GIFT and KILA
- Estimation of assets of all 1200 LGs (length of road in kms and area of non-road assets in sq. m.)
- Among the reports published on LGs in Kerala so far, the 5<sup>th</sup> SFC report gives comprehensive and authentic data on finances, maintenance assets, devolution, other fiscal issues and decentralised planning.

## **5<sup>th</sup> SFC's approach and recommendations**

- Recommended devolution of funds based on the estimate made for the year of devolution  $t$ .
- Previous SFC's 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.
- Similar to UFC, the 5<sup>th</sup> SFC assessed the finances of the state and projected the gross and net SOTR. Based on it, resources are devolved for 5 years.

- Recommended that the award be given specifying the amount of money to be devolved to each LG for each year of the award period.
- The practice followed was SFCs used to give the recommendations and actual allocation of funds was done by the Finance Department.
- Rejecting the practice of fixing a share of annual plan size of the State as development fund to LGs Fifth SFC recommended to give a share of net proceeds of SOTR as development fund.

- Recommended to distribute the maintenance fund to each LG on the basis of the actual road and non-road assets based on commission's assessments.
- The earlier practice was to distribute the funds based on incorrect or unreliable data of LGs by finance department.
- Recommended that the grants given by the 14<sup>th</sup> UFC for civic services should be treated as a separate grant and it should be transferred in addition to the devolution of 5<sup>th</sup> SFC.
- The 5<sup>th</sup> SFC rejected the earlier practice of transferring this as part of development fund.

## **Funds devolved**

- The SFC recommended devolution for three purposes :  
General Purpose, Maintenance and Development.

### **General Purpose Fund (GPF)**

- GPF is primarily meant for meeting expenditure for the execution of the mandatory and civic functions of LGs.
- The fund is meant for covering the deficit in own funds (tax and non-tax sources) for meeting administrative, establishment, operating and other items of expenditure of LGs.
- To meet the items of recurring expenditure of the transferred institutions which were met from the non-road maintenance fund up to the 4<sup>th</sup> SFC period.

## **Maintenance Fund**

- Maintenance fund is meant for meeting the maintenance expenditure of the assets of transferred institutions and LG's own institutions.
- 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.
- Repair and maintenance of all types of roads coming under LGs.
- Repair and maintenance of all non-road assets including the assets of transferred institutions.

## **Development Fund**

- Development fund is meant to finance the decentralised plans of the LGs for local level development.

## **Recommendations on devolution**

- Recommended that 20 percent of the net proceeds of annual SOTR be devolved to LGs as total devolution on (t) basis for the first year.
- For the subsequent years, an annual increase of one percent is recommended (Table 7).
- The amount of funds devolved for five years is given in Table 8.
- Formula for Distribution of General sector Portion of Development Fund is given in Table 9
- The total transfer of funds for GP, municipality, DP, MC and BP are given in Table 10

**Table 7**  
**Total devolution : Net SOTR on (t) basis (%)**

<b>Year</b>	<b>Net SOTR on (t) basis (share) (%)</b>	<b>General Purpose Fund (%)</b>	<b>Maintenance Fund (%)</b>	<b>Development Fund (%)</b>
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 5<sup>th</sup> SFC, Part I.

**Table 8**  
**Funds to be devolved during 5<sup>th</sup> SFC period**  
**(₹ in crore)**

	<b>2016-17</b>	<b>2017-18</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>
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 5<sup>th</sup> SFC, Part I.

## Table 9

### 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
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

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

**Table 10**

**Total transfer of funds during the 5<sup>th</sup> SFC period : LG category wise (₹ in crore)\***

<b>Name</b>	<b>2016-17</b>	<b>2017-18</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>
	<b>Amount (₹ in crore)</b>				
Grama Panchayat	5562.56	6523.62	7590.48	8976.80	9164.23
Municipality	1446.45	1697.50	1977.40	2382.75	2108.01
District Panchayat	1015.77	1197.52	1427.93	1696.43	2008.86
Municipal Corporation	799.25	934.42	1090.81	1315.95	1175.00
Block Panchayat	862.99	1009.44	1217.42	1460.79	1745.07
<b>Grand Total</b>	<b>9687.02</b>	<b>11362.50</b>	<b>13304.04</b>	<b>15832.72</b>	<b>16201.17</b>
	<b>Composition (%)</b>				
Grama Panchayat	57.42	57.41	57.05	56.70	56.57
Municipality	14.93	14.94	14.86	15.05	13.01
District Panchayat	10.49	10.54	10.73	10.71	12.40
Municipal Corporation	8.25	8.23	8.20	8.31	7.25
Block Panchayat	8.91	8.88	9.16	9.23	10.77
<b>Grand Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

**\*Devolution of 5<sup>th</sup> SFC and UFC grants**

## **Major recommendations of 5<sup>th</sup> SFC on mobilisation of tax and non-tax revenue**

- The property tax should be revised at the expiry of every five years as envisaged in the Kerala Panchayat Raj Act and the Kerala Municipality Act. The rules in this regard shall be framed/amended promptly.
- Loss of revenue, if any, incurred by Local Governments due to lack of timely revision of property tax (once in five years) has to be compensated by the State Government.
- A proper database on all categories of workers in the unorganized sector and self-employed sector should be prepared by LGs for assessment of profession tax.

- The Advocates should voluntarily disclose their income and the profession tax be levied based on the self-disclosed income which is subject to verification.
- Raise the ceiling limit of profession tax as recommended by 14<sup>th</sup> UFC. Take up the matter with the union government.
- State Government should not give any exemption to entertainment tax
- The Acts shall be suitably amended so as to do away with the system of making bye-laws for regulating advertisement.
- Increase of building permit fee collected by LGs by 50 percent.

- Rationalise and enhance rent rates on shops and buildings rented out by the LGs including community halls and auditoriums.
- The rates of all other non-tax items (except fee for marriage certificate) shall be raised at least by 50%.
- All items of tax and non-tax revenue collected by LGs mandatorily be revised at the expiry of every five years as in the case of property tax.
- The building tax now collected by Revenue Department should be transferred to LGs. Necessary legislation in this regard shall be made.

# Status of implementation of 5<sup>th</sup> SFC

- The 5<sup>th</sup> SFC submitted the first part of the report containing devolution recommendations, in December 2015.
- But the action taken report was placed in Kerala State Legislature on February 7, 2018.
- And state government has not implemented the 5<sup>th</sup> SFC report for two years (2016-17 and 2017-18)
- The State Government has not prepared to devolve funds to LGs based on SFC recommendations for five years (2016-17 to 2020-21)
- As a result the LGs got only a lower amount than the amount recommended by the 5<sup>th</sup> SFC.
- And the 1200 LGs in Kerala were denied their legitimate right to receive their due share of taxes recommended by 5<sup>th</sup> SFC

# **Implementation of 5<sup>th</sup> SFC recommendations (Tables 11 and 12)**

- Among the total 103 recommendations, 51 were accepted and 10 accepted with modifications (Total 61). But only 28 were implemented
- Of the 21 recommendations on devolution of SOTR, only five were accepted and implemented
- This means that the state government rejected most of the devolution recommendations
- Most of the 5<sup>th</sup> SFC's recommendations on own resources were accepted (23 items). But only 10 were implemented.
- This indicates the indifference of state government towards own resource mobilisation

- Regarding the recommendations of fiscal issues, only a few were implemented.
- Though 13 recommendations were given for restructuring plan formulation, only one was implemented
- Regarding change in law, rules and procedures only one recommendation was implemented
- On the whole, it gives a dismal picture of implementation
- 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.

**Table 11**  
**5<sup>th</sup> SFC: Number of recommendations accepted**

Sl No	Item	Total Number of Recommendations	Number of Accepted	Number of Accepted with modification	Total Accepted and Accepted with modification	% of Accepted and Accepted with modification to Total
1	Devolution of SOTR	21	2	3	5	23.8
2	Maintenance of Assets	5	1	1	2	40.0
3	UFC Grants	5	3	1	4	80.0
4	Mobilisation of Own Resources of LGs	29	23	-	23	79.3
5	Finances of Rural LGs	3	3	-	3	100.0
6	Finances of Municipalities and MCs	3	1	-	1	33.4
7	Implementation of Previous SFC Recommendations	2	2	-	2	100.0
8	Fiscal Issues	12	7	2	9	75.0
9	Restructuring Plan Formulation and Execution	13	4	3	7	53.8
10	Change in Law, Rules and Procedures	10	5	-	5	50.0
	<b>Total</b>	<b>103</b>	<b>51</b>	<b>10</b>	<b>61</b>	<b>59.2</b>

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

**Table 12****Number of recommendations implemented to total accepted recommendations of Fifth SFC**

Sl No	Item	Total Accepted and Accepted with modification	Implemented recommendations	
			Number	% to total
1	Devolution of SOTR	5	5	100.0
2	Maintenance of Assets	2	0	0
3	UFC Grants	4	3	75.0
4	Mobilisation of Own Resources of LGs	23	10	43.5
5	Finances of Rural LGs	3	2	66.7
6	Finances of Municipalities and MCs	1	1	100.0
7	Implementation of Previous SFC Recommendations	2	2	100.0
8	Fiscal Issues	9	3	33.4
9	Restructuring Plan Formulation and Execution	7	1	14.3
10	Change in Law, Rules and Procedures	5	1	20.0
	<b>Total</b>	<b>61</b>	<b>28</b>	<b>45.9</b>

Source: GoK (2018) Action Taken Report on Part I and Part II of the Reports of 5<sup>th</sup> SFC : TVM, GoK;  
First report of the Sixth State Finance Commission Kerala, December 2020

## Major devolution recommendations of 5<sup>th</sup> SFC rejected by state government

1	Devolution of funds based on the estimate made for the year of devolution t following UFC approach.
2	Award recommending the amount of money to be devolved to each LG for each year of the award period based on the t method.
3	Distribute the maintenance fund to each LG on the basis of the actual road and non-road assets based on commission's assessment.
4	Maintenance fund should be used only for the purpose of maintenance of road and non-road assets.
5	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.
6	The grants given by the 14 <sup>th</sup> UFC for civic services to LGs be treated as a separate grant and transferred in addition to the devolution of the commission.
7	Transfer the devolved funds to public accounts of LGs in 12 instalments in a year.

# SFCs and devolution process

- Successive state governments have been constituting SFC's in every five years (Table 6)
- All the 5 SFC's have submitted their reports prior to the award period (Table 13)
- But as per constitution of India, state government has to place a report in legislature mentioning the action taken on each recommendations of SFC
- In the case of 2<sup>nd</sup> SFC the action taken report was submitted in the legislature after 3 years (Table 13). This means that implementation of the report was delayed by 3 years.
- In case of 5<sup>th</sup> SFC the action taken report was placed after two years. Delayed the implementations of the report by 2 years (Table 13)

- Successive governments used to say in the Action Taken Report that they accepted a large number of recommendations
- But in actual practice the number of recommendations implemented are small in number.
- The percentage of recommendations implemented in the successive SFCs are as follows, 1<sup>st</sup> SFC 36%; 2<sup>nd</sup> SFC 27%; 3<sup>rd</sup> SFC 31%; and 4<sup>th</sup> SFC 17% (Table 14)

## Table 13

### Date of submission and presentation of SFC reports in legislative assembly

Name of Commission	Date of submission of Report	Date of presentation in Legislative Assembly	Award Period
First SFC	29-02-1996	13-03-1997	1996-97 to 2000-01
Second SFC	<u>08-01-2001</u>	<u>07-01-2004</u>	2001-02 to 2005-06
Third SFC	23-11-2005	16-02-2006	2006-07 to 2010-11
Fourth SFC	Part - I 22-01-2011 Part - II 31-03-2011	24-02-2011 22-03-2012	2011-12 to 2015-16
Fifth SFC	Part - I <u>19-12-2015</u> Part - II <u>11-03-2016</u>	<u>7-02-2018</u> <u>7-02-2018</u>	2016-17 to 2020-21

Source: GoK (2015) Report of 5<sup>th</sup> SFC, Part I, GoK (2016) Report of 5<sup>th</sup> SFC, Part II

**Table 14**  
**Number of recommendations accepted and rejected**

<b>Name of Commission</b>	<b>Total Number of Recommendations</b>	<b>Number Accepted</b>	<b>Number Implemented</b>	<b>Number Accepted (% to total)</b>	<b>Number Implemented (% to Total)</b>
First SFC	69	63	25	91.30	36.23
Second SFC	49	43	13	87.76	26.53
Third SFC	32	30	10	93.75	31.25
Fourth SFC	Part I 46	21	18	45.65	39.13
	Part II 105	87	7	82.86	6.67
	Total 151	108	25	71.52	16.56
Fifth SFC	103	61	28	59.22	27.18

*Source: GoK (2015) Report of 5<sup>th</sup> SFC, Part I, GoK (2016) Report of 5<sup>th</sup> SFC, Part II  
GoK (2008) Action Taken Report of Part I and Part II of 5<sup>th</sup> SFC*

# Table 15

## Status of Fiscal Decentralisation

<b>Pre-conditions for sound fiscal decentralisation</b>	<b>Kerala's Situation</b>
Clear assignment of functions	Not clear in the case of transferred institutions
Allocation of own source revenue	Powers are not given to LGs revise rate of tax or non-tax
inter-governmental transfers	Not implementing SFC's devolution and other recommendations
Powers to borrow funds	Permission of government is needed
Powers to prepare budgets	Yes
Powers to appoint staff	No; Staff are appointed and transferred by state government
Public accountability mechanisms	Audit is done by audit department
Social accountability mechanisms	No mechanisms

# Conclusions

- The successive governments in Kerala have been following anti-decentralisation policies regarding own resource mobilisation of LGs
- Non-transfer of powers to revise rate of tax and non-tax items assigned to LGs, non-transfer of any new tax, failure to effect periodical change in rate of tax and non-tax items, non-implementation of required changes in Acts, rules and procedures, retaining the out of date by law system, lack of clarity in Acts on compulsory collection of service tax etc. stood as obstacles to increase own resource mobilisation.
- This has weakened the LGs own resource mobilisation, financial stability and forced them to rely heavily on transferred funds.

- Kerala has been following a dual practice with regard to SFCs
- The successive state governments constitute SFCs in time and declare that they have accepted most of the SFC's recommendations.
- But they have not implemented majority of the accepted recommendations and ask the next SFC to revisit the accepted recommendations
- There is huge difference in what government says in public about fiscal decentralisation and actual practice.

# References

- Report of the Fifth State Finance Commission, Part I (December, 2015) & II (March, 2016). <http://www.finance.kerala.gov.in/sfc.jsp>
- Action taken report on the part I & part II of the reports of the Fifth SFC (Placed in Kerala Legislative assembly on February 7, 2018). <http://www.finance.kerala.gov.in/sfc.jsp>
- B. A Prakash (2018). Rejection of Kerala's Fifth State Finance Commission Recommendations. *Economic and Political weekly*. Vol. 53. No 13. March 31.

- B. A. Prakash (2020). Local finance, fiscal decentralisation and decentralisation and decentralised planning: A Kerala Experience, Sage Publications, New Delhi.
- Economic and Political Weekly (EPW). 2022. “Fiscal Decentralisation and Finances of Gram Panchayats and Municipalities: A Kerala Experience” Vol. 57, Issue No 36
- First report of the Sixth State Finance Commission, Kerala, December 2020. <https://www.finance.kerala.gov.in/sfc.jsp>

THANK YOU