Fiscal Decentralisation and Finances of Gram Panchayats and Municipalities
A Kerala Experience

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Based on a sample of 56 gram panchayats and 14 municipalities, it is concluded that the fiscal decentralisation implemented in Kerala is partial. In the case of intergovernmental fiscal transfers through state finance commissions, there has been delayed implementation of SFC reports, rejection of devolution recommendations, implementation of very few recommendations and non-implementation of accepted recommendations indicating a distorted implementation of fiscal decentralisation.

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Kerala implemented decentralisation of powers and functions to local governments following the 73rd and 74th amendments to the Constitution of India. Since 1994, in some aspects of decentralisation, Kerala has made substantial progress in comparison to other states in India. The state government transferred a number of functions, institutions and staff to the rural and urban local governments, conducted elections once in five years, constituted state finance commissions (SFCs) to devolve funds, strengthened local governments in several ways, entrusted additional functions and implemented decentralised planning through local governments. However, the fiscal decentralisation implemented in Kerala is partial and distorted. This is because of the non-transfer of adequate powers and resources to meet additional functions, non-transfer of financial powers to revise the rate of tax and non-tax items of local governments, distorted implementation of the SFCs recommendations and restrictive policy pursued by state government with respect to borrowing by local governments. This paper examines the implementation of fiscal decentralisation and its effects on the finances of gram panchayats and municipalities in Kerala.

Review of Literature

The Left Democratic Front (LDF) government which assumed power in 1996 wanted to implement decentralisation as a mass movement and a campaign was started to achieve rapid local-level development through decentralised planning (Thomas Isaac and Harilal 1997; Thomas Isaac and Franke 2000). Like a literacy movement, the campaign was aimed to educate about the benefits of decentralised planning to various sections, such as elected representatives of local governments, officials, retired officials interested in local governments, members of gram sabhas, and people's organisation. The measures taken for the promotion of decentralised planning during the second half of 1990s are discussed in other studies (Thomas Isaac and Franke 2000; Thomas Isaac and Heller 2003). The decentralised planning experience in Kerala was widely discussed in the country during the first decade of the 20th century and a number of scholars have examined different aspects of it (Charvak 2000; Shobha 2000; Mohanakumar 2002, 2003; Jos and John 2002; Sharma 2003; Narayana 2005). These studies have overemphasised the merits of decentralised planning, which was at the infant stage and projected as an institutional change required to solve the economic backwardness of rural areas in the Indian context. However, they failed to provide an analysis of the demerits, limitations and problems created due to the transformations.

Another study on plan campaigns came to the conclusion that campaigns devolved new authority and resources to panchayats and mandated structures and processes designed to maximise the direct involvement of citizens in planning and budgeting (Patrick Heller et al 2007). The merits and demerits of decentralised planning are pointed out in the official evaluation studies (GoK 2009; Planning Commission 2006). A study on the effectiveness of service delivery of gram panchayats in Kerala came to the conclusion that the majority failed to provide satisfactory civic services, such as disposal of solid waste, maintaining burial ground or cemetery, maintaining comfort stations, and slaughter houses (Prakash et al 2013).

Attempts were made to examine the fiscal decentralisation in Kerala and other states (Oommen 2004, 2006). These studies emphasised the need for substantial restructuring of fiscal decentralisation. A recent study on the finances of gram panchayats in Kerala came to the conclusion that the pressure to spend on welfare and development activities has outstripped the growth in revenue, and the local governments have not utilised the revenue potentials (Oommen et al 2017).

The institution mandated to effect devolution of resources to local governments is the SFC. Five SFCs were constituted to devolve state taxes and other funds to local governments and have used different approaches on fiscal devolution (SFC 1996, 2001, 2005, 2011, 2015, 2016). The fifth SFC has deviated from the earlier norms of devolution and recommended a share of state own tax revenue (SOTR) for general purposes, maintenance and development on the basis of the SOTR received on the year of devolution and changed the norms of allocation of maintenance fund and union finance commission (UFC) grant (SFC 2015, 2016).

From the above review, we can conclude that a major gap in literature is on topics such as the fiscal decentralisation process and its impacts, finances of different categories of rural and urban local governments, performance of civic functions and delivery of civic services of gram panchayats, municipalities, and municipal corporations.

Hypothesis and Data Sources

Kerala's fiscal decentralisation is partial and distorted due to factors such as non-transfer of adequate powers and resources to meet the additional functions transferred to local governments; non-transfer of financial powers to revise the rate of tax and non-tax items assigned to local governments; distorted implementation of SFCs such as delayed implementation, rejection of devolution recommendations, implementing very few recommendations, non-implementation of accepted recommendations etc; and restrictive policy pursued by state government with respect to borrowing by local governments.

Factors such as non-transfer of financial powers to revise rates or effect periodical revision of tax and non-tax items of local governments; non-transfer of new tax and non-tax items to meet additional expenditure responsibilities; failure of successive state/central governments to effect periodical revision of rates for about two decades and low priority given by local governments for own resource mobilisation have led to poor own resource mobilisation and heavy reliance on transferred funds for execution of their functions.

The data for the study was collected from a sample of 56 gram panchayats belonging to all districts of Kerala using a structured schedule (Table 1). A multistage random sampling method was used to select the samples. The gram panchayats were classified into three geographic regions, such as coastal, midland, and highland or hilly regions and the samples were selected. Similarly, one sample municipality each from all districts of Kerala was selected (Nedumangad, Karunagappally, Thiruvalla, Alappuzha, Kottayam, Thodupuzha, North Paravoor, Kunnamkulam, Shornur, Manjeri, Vadakara, Kalpetta, Payyannur, and Kasaragod).

Table 1: Distribution of Sample Gram Panchayats and Municipalities

Sl No	Name of District	Total Number of Gram Panchayats	Number of Sample Gram Panchayats	Total Number of Municipalities	Number of Sample Municipalities
1	Thiruvananthapuram	73	4	4	1
2	Kollam	68	4	4	1
3	Pathanamthitta	53	4	4	1
4	Alappuzha	72	4	6	1
5	Kottayam	71	4	6	1
6	Idukki	52	4	2	1
7	Ernakulam	82	3	13	1
8	Thrissur	86	4	7	1
9	Palakkad	88	4	7	1
10	Malappuram	94	5	12	1
11	Kozhikode	70	4	7	1
12	Wayanad	23	4	3	1
13	Kannur	71	4	9	1
14	Kasaragod	38	4	3	1
	Total	941	56	87	14
Sample size (%)		100	5.95	100	16.1

Analytical Framework of Fiscal Decentralisation

According to Richard M Bird (2000),

> Fiscal decentralisation is primarily concerned with implementing an effective intergovernmental fiscal system. Intergovernmental fiscal rules determine expenditure responsibilities and revenue resources of local governments as well as the design of intergovernmental transfers system and local governments' access to capital markets.

For Bird, fiscal decentralisation is based on four pillars: expenditure assignment, revenue assignment, intergovernmental transfers/grants, and subnational debt/borrowing. Assignment of expenditure responsibilities refers to the distribution of functions among the different government levels. It improves the responsiveness of the local governments to the local preferences, enhances accountability, avoids unproductive overlap, duplication of authority and legal challenges. Allocating own source revenue refers to the distribution of financial resources among the different levels of government. It ensures subnational autonomy, promotes accountability and ownership, realises decentralisation efficiency gains and facilitates cash flow management. The intergovernmental fiscal transfers refer to the transfer of finances from the central government to lower government levels. In general, the revenue assignment never matches the expenditure needs. Thus, intergovernmental fiscal transfers are often necessary to assure revenue adequacy. It ensures bridging the vertical fiscal gap, improves horizontal fiscal balance, funds national priorities, compensates for spillovers or externalities, etc. Local borrowing for subnational governments stands as the fourth pillar of fiscal decentralisation and can act as a major source of revenue for the local government, especially in countries where their own source revenue and intergovernmental transfers are deficient with respect to local investment requirements. For the analysis of fiscal decentralisation, we use this analytical framework.

Category-wise Local Governments in Kerala

Kerala has two categories of local governments. First category is rural, having three-tier panchayats consisting of gram panchayats, block panchayats, and district panchayats. Second category is urban, consisting of municipalities and municipal corporations. Table 2 gives growth in the number of local governments between 1995 and 2015. A noticeable change that has been occurring in the state is the decline in the number of gram panchayats and increase in the number of urban local governments since 2010. The number of municipalities has increased from 53 in 2005 to 87 in 2015. This is largely due to the rapid urbanisation that has been taking place in the state.

Table 2: Number of Rural and Urban Local Governments in Kerala from 1995 to 2015

Local Government	1995	2000	2005	2010	2015
Rural					
Grama panchayats	990	991	999	978	941
Block panchayats	152	152	152	152	152
District panchayats	14	14	14	14	14
Urban					
Municipality	55	53	53	60	87
Municipal corporation	3	5	5	5	6
Total	1,214	1,215	1,223	1,209	1,200

Source: SFC (2015).

Fiscal Decentralisation Implemented in Kerala

Assignment of functions and expenditure responsibilities: Prior to the enactment of the Kerala Panchayat Raj Act (KPRA), 1994 and Kerala Municipality Act (KMA), 1994, the gram panchayats, municipalities, and municipal corporations were assigned traditional civic functions. The major functions were construction and repair of public roads, street lighting, drainage, cleaning of streets, disposal of solid and liquid waste, maintenance of public toilets, burial grounds and bathing ghats, preventive measures to check the spread of epidemics, maintenance of ponds and waterbodies, registration of births and deaths, etc. With the enactment of the above-mentioned acts, in addition to the traditional civic functions, more functions were transferred to them. Currently, the above local governments have to execute six major functions, namely mandatory and general functions, sector-wise responsibilities, coordination of the administration of transferred institutions, maintenance of own assets and assets of transferred institutions, annual plan formulation and implementation and collection of tax and non-tax revenue.

The transfer of the additional functions without providing adequate additional funds has crippled the functioning of local governments. Though a number of new functions are assigned to gram panchayats, municipalities, and municipal corporations, no corresponding expansion by incurring additional expenditure was made to the administrative machinery, staff strength, facilities, capital stock, etc. The transfer of agency functions such as distribution of welfare pension schemes of the state government and implementation of centrally sponsored schemes (CSSs) without providing adequate additional staff and expansion of administrative machinery have created severe problems. The diversion of staff to execute agency functions has adversely affected the basic functions of the local governments. A mismatch between the transfer of a lot of functions and a slow growth in staff strength emerged as a serious problem paralysing local government activities at multiple fronts. According to a study covering 50 sample gram panchayats in Kerala, the average number of staff per gram panchayat increased from 12.5% in 1995 to 13.2% in 2000 and to 14.9% in 2005 (Prakash 2005). There has been a shift in the focus of the local governments from civic functions to newly assigned functions. This resulted in the neglect of civic functions and steady deterioration of civic services provided.

The lack of role clarity in the powers and functions of local governments with regard to the transferred institutions and the dual control exercised by government and local governments have created a lot of confusion in all categories of local governments. In all the transferred institutions, the staff is under the administrative control of the parent department and are appointed, transferred and paid salaries by the government. The only major role assigned to local governments is maintenance of assets of the transferred institutions.

Instead of giving more autonomy for fund utilisation, the state government has compelled the local governments to divert their funds for various state schemes. Some examples are the EMS housing scheme, enhancement of the share of Indira Awas Yojana, Sarva Shiksha Abhiyan, Asraya, etc. Shifting financial burden of new and upgraded transferred institutions to local governments is yet another issue. For example, the upgradation of high school to plus two or taluk-level hospitals to district level and the force on local governments to bear the capital expenditure. Thus, assignment of additional functions without providing adequate resources to meet the cost and forcing them to divert their funds for state schemes have crippled the functioning of the local governments.

Mobilisation of own source of revenue: Since the implementation of decentralisation, the state government has assigned a few taxes and non-tax items to the local governments as per KPRA, 1994 and KMA, 1994. The acts empower the gram panchayats, municipalities, and municipal corporations to levy taxes like property, profession, advertisement, entertainment, show, service, etc. Both the gram panchayats and the urban local governments can also levy a surcharge on property tax and service tax/cess on sanitation, water supply, street light and drainage. Besides the taxes, they can also levy and collect non-tax revenue, for example, trade licence fee, building permit fee, registration fee, fines, rent, etc.

Property tax: Though property tax was assigned to gram panchayats, municipalities, and municipal corporations, they were not given powers to revise the rates of taxes or effect periodical revision of the tax. These powers were vested with the state government. Due to the inaction of successive state governments to revise the rate of property tax, the rate remained unchanged for 17 years in gram panchayats and 20 years in municipalities and municipal corporations. Though, the government has affected an increase in tax rates through changing the norm of taxation from annual rental value basis to plinth area basis in 2013, the enhanced rate was substantially reduced in April 2015. The reductions affected gave tax exemption to all houses with a plinth area up to 660 sq ft, limiting tax hike up to 25% for houses with a plinth area up to 2,000 sq ft and adjustment of the excess tax collected in the enhanced rate during the subsequent years. The gram panchayats which implemented the tax revision from 2013 began to face a situation of refunding the tax collected. The municipalities and municipal corporations which have been preparing to switch over to plinth area basis after a long gap of 20 years have stopped the implementation of revision of property tax.

Though the KPRA, 1994 and KMA, 1994 stipulates that the state government should revise property tax once every five years, the government failed to implement it for about two decades.

Profession tax: Profession tax is the second major item of tax collected by gram panchayats, municipalities, and municipal corporations. It is levied and collected twice a year. In India, profession tax is collected by the state government in all the states, except Kerala and Tamil Nadu. A serious problem faced by the local governments in Kerala is the non-revision of the ceiling of the tax which was fixed at ₹2,500 per year per person in 1988. As per the Constitution, Parliament has the authority to change the ceiling of profession tax. Though the successive UFCs had recommended a revision of the ceiling of the tax, no action has been taken so far. The long delay in the revision of the ceiling of the tax has resulted in enormous loss in revenue of the local governments and severely affected their finances. The poor collection of tax, due to incomplete data on tax payers and low priority given to the collection of taxes by local governments is yet another problem.

Entertainment, advertisement, and service taxes: Entertainment tax collected from cinema halls was the third major source of revenue of gram panchayats, municipalities, and municipal corporations. However, the local governments lost their power to collect this tax with the inclusion of entertainment tax in the goods and services tax (GST) from July 2017.

The KPRA, 1994 and KMA, 1994 empower the gram panchayats, municipalities, and municipal corporations to levy and collect the advertisement tax. However, complex and impracticable procedures such as preparation of by-laws, local governments approval by director of panchayat/urban affairs and notification by local self-government department (LSGD) prescribed a revision of rates. Due to these irrational and time consuming procedures, only 15% of the local governments are levying the advertisement tax.

The KPRA, 1994 and KMA, 1994 empower the gram panchayats, municipalities, and municipal corporations to levy service tax/cess on sanitation, water supply, street lighting and drainage, wherever these services are provided at the rate fixed by the local governments subject to a minimum rate. Though all the gram panchayats, municipalities, and municipal corporations have the option to levy service tax, only a small number of local governments levy the tax. This is because of the ambiguous wording of the acts and the rules relating to compulsory collection of the tax by gram panchayats.

Non-tax revenue: The items of non-tax revenue collected by gram panchayats, municipalities, and municipal corporations are trade licence fee (dangerous and offensive [D&O]), building permit fee, registration fee, fee for certificates, cinematograph licence fee, market fee, fines and penalties, rent on buildings, income from river sand, etc. Among them, the major items are building permit fee, D&O licence fee, fines and penalties, and rent on buildings. Though the local governments can collect non-tax revenue, they do not have powers to revise rates and the rate has remained unchanged since 2011.

Local governments own and collect rent on different types of buildings, such as shopping complexes, commercial buildings, community halls, and auditoriums. The fifth SFC which examined the rate of rent charged by local governments found that the rates were very low compared to the open market rates. In some cases of community halls and auditoriums, the rent charged was insufficient to cover even the electricity, water and cleaning charges. The fees charged for the certificates, licences, services, etc, are also very low and were fixed long back.

We can conclude that the fiscal decentralisation implemented in Kerala with regard to the mobilisation of its own source of revenue is a distorted one. In spite of assignment of a number of additional functions, no new tax or non-tax item was transferred to local governments. They were not given powers to effect periodical revision of rates of tax and non-tax items assigned to them, and the state government failed to effect revision of property tax once in five years as per the KPRA, 1994 and KMA, 1994.

Intergovernmental fiscal transfers: An unconditional and formula-driven intergovernmental transfer is an important precondition for a sound fiscal decentralisation system of local governments. It covers the gap in resources between own resources and expenditure. In India, intergovernmental fiscal transfers from state to local governments are done through SFCs.

Kerala had constituted five SFCs to review the financial position of local governments, recommended devolution of state taxes, distributed grants-in-aid and formulated measures to strengthen the financial position of the local governments. Table 3 (p 61) presents date of submission and presentation of SFC reports along with the action taken on the reports in the Kerala legislative assembly. It also shows the award period of the SFCs. In the case of the second SFC, the report on the action taken was presented in the Kerala legislature assembly after three years and the fifth SFC after two years. This indicates that the state government had delayed the implementation of the second SFC by three years and the fifth SFC by two years. Another disturbing aspect is the implementation of a small share of recommendations (Table 4). In the case of the second SFC, the percentage of recommendations implemented was 27% and in the third SFC, it was 31%.

Fifth SFC and its implementation: The fifth SFC gave the following recommendations on the devolution of the SOTR to local governments: (i) devolution of funds should be based on the estimate made for the year of devolution *t* similar to UFC. Here, *t* represents the current year, or the year of devolution. (ii) The award should specify the amount of money to be devolved to each local government for the year of the award period based on the *t* method. (iii) Net proceeds of 20%–24% of the annual SOTR should be devolved to local governments as total devolution on the basis of *t* for general purpose, maintenance and development (Table 5). All the above recommendations were rejected.

The fifth SFC had given 133 recommendations based on the terms of reference (TOR) of the commission. Based on the actions taken on each of the recommendations, we have classified them as accepted, rejected and accepted with modifications. Of the total recommendations, 78 were accepted, 13 accepted with modification and 42 rejected. The major items of rejected recommendations are on aspects like devolution of SOTR, mobilisation of own resources, restructuring plan formulation and execution, and changes in law, rules and procedures. The delayed implementation of the fifth SFC and the rejection of most of the devolution recommendations imply subversion of fiscal decentralisation.

Table 3: 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	08–01–2001	07–01–2004	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 19–12–2015 Part - II 11–03–2016	7–02–2018 7–02–2018	2016–17 to 2020–21

Source: SFC (2015).

Table 4: Number of Recommendations Accepted and Rejected

Name of Commission	Total Number of Recommendations	Number Accepted	Number Implemented	Number Accepted (% to Total)	Number Implemented (% to Total)
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	133	78	–	58.65	–

Sources: SFC (2015); GoK (2018).

Table 5: Total Devolution of Fifth SFC (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: SFC (2015).

Borrowing to meet investment needs: In Kerala, freedom is not given to local governments to avail sufficient loans from different sources. The state government imposed a number of restrictions and cumbersome procedures to avail loans. Some of the restrictions are discussed subsequently. First, the KPRA, 1994 and KMA, 1994 permit the local governments to borrow money for remunerative development schemes on the condition that the assets of the local governments shall not be pledged for availing a loan. Second, the local governments in Kerala can borrow only from one state-financing institution, namely the Kerala Urban and Rural Development Finance Corporation (KURDFC). The KURDFC is a public limited company. Third, for the purpose of providing loans to local governments, the projects are classified into remunerative and non-remunerative schemes. Remunerative schemes include construction of commercial complexes, bus stands, lodges, etc. Non-remunerative schemes include construction of roads, small bridges, parks, stadiums, etc. Fourth, there are two stages of disbursement of loan from the KURDFC: approval of schemes and sanction of loan. Those local governments that have defaulted the payment of overdues to the company on prior loans availed are not eligible for applying for a new loan. Fifth, all loans sanctioned by the company are to be secured by deposit of title deeds of property worth at least 150% of the loan amount. Sixth, for depositing title deeds with the KURDFC, the local governments have to produce original documents, non-encumbrance certificates for the last 14 years, latest land tax receipt, valuation of the property prepared by the engineers of the local governments, etc. Lastly, the concerned local government has to produce a sanction of competent authority under Section 3 of the Local Authorities Loans Act for availing loans offered by the company.

Only a few local governments availed loans from the KURDFC due to the restrictions, cumbersome procedures and discouragement from the state government. Between 2009–10 and 2013–14, only 38 urban local governments and 50 rural local governments availed loans (Table 6). This indicates that the policy and procedures of the state government towards the

Table 6: Details of Loan Availed by Local Governments from the KURDFC

Year	Urban Local Bodies		Rural Local Bodies		Grand Total
	No	Amount (₹ lakh)	No	Amount (₹ lakh)	Amount (₹ lakh)
2009–10	7	296	7	221	517
2010–11	9	642	13	444	1,086
2011–12	9	526	12	256	782
2012–13	6	585	10	364	949
2013–14	7	1,344	8	164	1,508
Total	38	3,393	50	1,449	4,842

Source: SFC (2016).

borrowing of local governments is hostile and has an anti-fiscal decentralisation nature.

Finances of Gram Panchayats

We have seen that the fiscal decentralisation implemented in Kerala with regard to mobilisation of taxes and non-tax revenue is a distorted one. This has resulted in heavy reliance on transferred funds from the state government for meeting expenditure needs of local governments. In this context, we examine the finances of gram panchayats.

Growth and structure of receipts: The receipts of gram panchayats can be classified into five items, namely tax and non-tax revenue; transfer of funds from the state resources; World Bank loan and Thirteenth UFC grants; CSS and welfare pension receipts and borrowings. Out of these, except CSS and welfare pension receipts, other items are used for executing the functions assigned to gram panchayats. The CSS and welfare pensions are meant for the implementation of the agency functions. The total receipts received per gram panchayat i ncreased from ₹486.15 lakh in 2011–12 to ₹806.27 lakh in 2014–15. The wide variations in yearly receipts are due to the carry-over of unspent amounts of a year to subsequent years and delayed receipts of CSS and welfare pensions (Table 7).

An analysis of the structure of receipts shows that the transfer of funds from the state, World Bank loans, and Thirteenth UFC grants accounts for the largest share. The other major items are funds received for agency functions like CSS and welfare pensions. An important feature of the finances of gram panchayats is its heavy reliance on funds transferred from the state to meet its expenditures. Based on the fourth SFC recommendations, three items of funds are transferred to the gram panchayats. These items include general purpose, development and maintenance for road and non-road assets (Table 8). Among them, development funds transferred from state resources account for the largest share. The inaction of the state government, for nearly two decades, to affect periodical revision of taxes and non-tax items levied and collected by gram panchayats has seriously affected the own revenue mobilisation of gram panchayats.

Table 7: Total Receipts per Gram Panchayat—Amount, Growth Rate, and Composition

Item	2011–12	2012–13	2013–14	2014–15
Receipts (₹ in thousands)	48,615.59	60,512.75	67,779.64	80,627.75
Growth rate (%)	–	24.5	12.0	19.0
Composition (%)				
Tax	5.9	5.7	5.5	6.6
Non-tax	5.0	3.8	2.4	2.1
Total transfer of funds	38.2	34.7	41.4	36.8
World Bank loan	2.4	3.0	2.7	2.5
Thirteenth UFC grants	5.5	6.2	6.1	7.6
CSS	25.9	28.6	24.8	23.8
Welfare pensions	14.8	17.5	16.7	20.1
Borrowing	2.2	0.5	0.4	0.6
Total receipts	100.0	100.0	100.0	100.0

Source: Sample study.

Table 8: Receipts of Devolved Funds per Gram Panchayat—Amount, Growth Rate, and Composition

Item	2011–12	2012–13	2013–14	2014–15
Receipts (₹ in thousands)	22,422.05	26,580.51	34,029.94	37,761.21
Growth rate (%)	–	18.5	28.0	11.0
Composition (%)				
General purpose fund	17.9	18.5	17.4	18.6
Development fund	47.8	42.4	43.0	39.9
Maintenance fund (road)	12.2	12.3	14.5	13.4
Maintenance fund (non-road)	5.1	5.8	7.6	6.6
World Bank loan	5.2	6.8	5.4	5.2
Thirteenth UFC grant	11.8	14.2	12.1	16.1
Total	100	100	100	100

Source: Sample study.

Growth and structure of expenditure: The category of expenditure is classified into eight subheads. These include: administration, establishment, annual plan, maintenance, operation and maintenance (O&M), miscellaneous, CSS, and welfare pension (Table 9). Among the items of expenditure, the annual plan accounts for the largest item of expenditure. The items consist of spending from the development fund, World Bank loan, and Thirteenth UFC grants. Welfare pension is the second major item of expenditure ranging between 14% and 24% of the total expenditure. Expenditure on CSS, establishment and maintenance are ranked third, fourth, and fifth positions. An important aspect of the structure of expenditure has been the spending of about 40% of the total expenditure on agency functions, namely social welfare pensions and CSS. The assignment of a heavy load of agency functions without expanding administrative machinery, staff strength, delegation of financial powers, etc, is one of the critical problems faced by the gram panchayats.

Finances of Municipalities

The urban local governments, namely municipalities and municipal corporations in Kerala function within the framework of the KMA, 1994. The state government controls the activities of urban local governments through a host of rules and regulations. Though the municipalities have the power to take disciplinary action against the staff, they do not have the power to appoint or terminate staff, decide wages and working conditions, etc. The staff of the urban local governments are appointed, posted, and transferred by the state. The urban local governments are not given the power to revise taxes, fees and user charges collected by them.

Table 9: Total Expenditure per Gram Panchayat—Amount, Growth Rate, and Composition

Item	2011–12	2012–13	2013–14	2014–15
Expenditure (₹ in thousands)	48,076.44	62,155.74	69,338.04	72,764.85
Growth rate (%)	–	29.3	11.6	4.9
Composition (%)				
Administrative	1.9	1.4	1.4	1.5
CSS	26.5	22.3	19.1	17.9
Annual plan	36.9	43.9	39.7	34.0
Establishment	9.5	7.7	8.3	9.0
Maintenance	6.0	3.8	11.2	8.9
Miscellaneous	1.7	1.1	2.0	2.1
O&M	3.4	2.8	2.6	2.5
Welfare pension	14.1	16.9	15.5	24.0
Total	100.0	100.0	100.0	100.0

Source: Sample study.

Growth and structure of receipts: The items of receipts of the municipalities are classified into five groups. They include items like tax and non-tax revenue, transfer of funds from the state resources, World Bank loan, and Thirteenth UFC grants, CSS and welfare pension receipts and borrowings (Table 10). The following broad changes were observed while analysing the structure of receipts. The share of tax and non-tax revenue ranged between 32% and 26.3%. Though there was considerable scope for increasing the own tax and non-tax revenue resources through periodical rate revisions, the municipalities could not avail these benefits for nearly two decades due to the inaction of the state government. The transfer of funds from the SOTR comprising general purpose fund (GPF), maintenance, fund and development fund ranged between 40.7% and 37.9%. The funds received from the CSS through the union government and social welfare pensions through the state government accounts for 18.8% and 21.2% of the total receipts. The other major items are welfare pension receipts, Thirteenth UFC grants and CSS receipts. Though there is considerable scope for borrowings, municipalities are not able to exercise this option due to the restrictive policy of the state government.

Based on the fourth SFC recommendations, three categories of funds are devolved to municipalities. These include funds for general purpose, maintenance, and development. The purpose of these funds are similar to the funds transferred to gram panchayats. An item-wise receipt of the funds received through devolution in (state funds) World Bank loan and the Thirteenth UFC grants are given in Table 11. On an average, a municipality in Kerala gets an amount of ₹11.21 crore as devolution and UFC grants. The municipalities also execute agency functions such as implementation of CSS of the union government and welfare pensions of the state government.

Table 10: Total Receipts per Municipality—Amount, Growth Rate, and Composition

Item	2011–12	2012–13	2013–14	2014–15
Receipts (₹ lakh)	1,599.07	1,649.25	2,174.33	2,170.81
Growth rate (%)	–	3.1	31.8	-0.2
Composition (%)				
Tax	19.4	21.0	21.4	17.9
Non-tax	12.6	9.2	9.9	8.4
Total transfer of funds	40.7	40.0	40.6	37.9
World Bank loan	1.9	3.5	1.2	3.3
Thirteenth UFC grants	6.5	10.3	8.3	10.4
Welfare pensions	7.7	11.4	9.9	13.7
CSS	11.1	4.0	8.4	7.5
Borrowing	0.1	0.6	0.2	0.9
Total	100.0	100.0	100.0	100.0

Source: Sample study.

Table 11: Receipts of Devolved Funds per Municipality—Amount, Growth Rate, and Composition

Item	2011–12	2012–13	2013–14	2014–15
Receipts (₹ lakh)	784.59	888.50	1,091.18	1,120.56
Growth rate (%)	–	13.2	22.8	2.7
Composition (%)				
General purpose	19.8	14.3	14.2	11.7
Development (excluding World Bank loan and Thirteenth UFC grant)	41.6	37.5	42.3	37.6
Maintenance (road)	12.1	12.6	13.4	12.7
Maintenance (non-road)	9.2	9.9	11.1	11.3
World Bank loan	3.8	6.5	2.5	6.4
Thirteenth UFC grant	13.3	19.2	16.5	20.2
Total	100	100	100	100

Source: Sample study.

Growth and structure of expenditure: The average total expenditure per municipality ranged between ₹1,988 lakh and ₹2,628 lakh during 2011–12 and 2014–15 (Table 12). An examination of the structure of expenditure indicates the following. Annual plan accounts for the single largest item of expenditure, ranging between 33% and 40% of the total expenditure. Establishment expenditure is the second major item of expenditure ranging between 19% and 22% of the total expenditure. Welfare pension is the third major item of expenditure accounting for 6%–13% of the total expenditure. Maintenance expenditure inclusive of road and non-road was the fourth item of expenditure.

Table 12: Total Expenditure per Municipality—Amount, Growth Rate, and Composition

Item	2011–12	2012–13	2013–14	2014–15
Expenditure (₹ lakh)	1,987.83	1,898.22	2,628.25	2,306.09
Growth rate (%)	–	-4.5	38.5	-12.3
Composition (%)				
Administration	3.0	5.4	5.5	2.5
CSS	9.4	3.9	6.4	7.0
Decentralised plan	40.4	32.6	38.8	38.6
Establishment	19.8	22.0	18.8	20.4
Maintenance	6.8	8.3	10.8	12.0
Miscellaneous	2.8	9.2	6.3	2.5
O&M	11.6	8.7	5.4	4.3
Welfare pension	6.2	9.9	8.0	12.8
Total	100.0	100.0	100.0	100.0

Source: Sample study.

Payment of pension to retired staff: A serious problem faced by municipalities is the payment of retirement benefits and monthly pensions to retired municipal staff. In the case of three-tier panchayats, the retirement benefits and monthly pensions are paid by the state government similar to any other government staff. But in the case of municipalities and municipal corporations, the temporary staff are appointed by them and permanent staff through the Kerala Public Service Commission. The responsibility to pay the retirement benefits and pensions is vested with the municipalities and municipal corporations. Though an arrangement was made between the state government and urban local governments to pay pensions based on the contribution from both sides, the system has not been working satisfactorily. Due to this, municipalities are forced to pay pensions and retirement benefits by diverting other funds, resulting in serious fiscal problems for them. The data collected from the 13 sample municipalities revealed that the total number of pensioners was 1,259 and the total retirement benefits and monthly pension paid to them was ₹1,691 lakh in 2013–14.

The norm forcing the payment of retirement benefits and pensions for the staff retired from other municipalities, failure of timely release of pension funds by urban affairs department, non-remittances of pension contribution by municipalities due to huge arrears they have to get, etc, compel municipalities to divert their funds for payment of pensions.

Conclusions

The four pillars of sound fiscal decentralisation are: expenditure assignment, revenue assignment, intergovernmental fiscal transfers, and adequate borrowing by local governments. This analysis, based on a sample of 56 gram panchayats and 14 municipalities, came to the conclusion that in all the four factors, the fiscal decentralisation implemented in Kerala is partial. In the case of intergovernmental fiscal transfers through SFCs, there has been delayed implementation of the SFC reports, rejection of devolution recommendations, implementation of very few recommendations and non-implementation of accepted recommendations, indicating a distorted implementation of fiscal decentralisation. The non-transfer of financial powers to revise rates or effect periodical revision of taxes and non-tax items of gram panchayats and municipalities; non-transfer of new tax and non-tax items to meet additional expenditure responsibilities; failure of successive state/central governments to effect periodical revision of rates for about two decades and low priority given by rural and urban local governments for own resource mobilisation have led to poor own resource mobilisation and heavy reliance on transferred funds. The analysis supports the hypotheses we put forward to explain the partial and distorted fiscal decentralisation implemented in Kerala.

The assignment of agency functions without expanding administrative machinery, staff strength and financial powers have resulted in a change in the priority of the functions of gram panchayats and municipalities. This resulted in a steady deterioration of the civic services provided by them. Instead of giving financial autonomy for fund utilisation, the state government has compelled the rural and urban local governments to divert their funds for certain state schemes and incurring the capital cost of upgraded transferred institutions resulting in serious financial problems. The municipalities have been facing serious fiscal problems due to the diversion of their funds for the payment of retirement benefits and pensions. All these suggest that the fiscal decentralisation implemented in Kerala is partial and distorted.

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