

**Fiscal Decentralisation :  
Approach, Recommendations  
and Status of Implementation of  
5<sup>th</sup> State Finance Commission, Kerala**

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# Objectives of the paper

- To present the approach of 5<sup>th</sup> SFC
- Recommendations on devolution of state taxes
- Recommendations on mobilisation of resources.
- Recommendations on restructuring plan formulation and execution.
- Status of implementation

## **SFC is a three member commission.**

- Prof. B A Prakash, Chairman
- Sri. James Varghese, Principal Secretary LSG Department, Member.
- Dr. V. K. Baby, Special Secretary, Finances (Resources) as members), Member.

# 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.

## **Terms of References of 5<sup>th</sup> SFC Contd..**

- 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 4 SFCs which were accepted but not implemented.



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

- Collected financial data from all LGs (1200) through online using a detailed questionnaire.
- Commission sittings in 14 districts to discuss fiscal issues with 104 sample LGs (GPs, BPs, DPs, Municipalities and MCs)
- Another sittings in five districts to examine plan performance and plan expenditure of 33 sample LGs covering all categories.

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

- 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.)

## 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.



## 5<sup>th</sup> SFC's Approach and Recommendations. Contd

- 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.

## **5<sup>th</sup> SFC's Approach and Recommendations. Contd**

- 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 Vertical 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 1).
- The amount of funds devolved for five years is given in Table 2.



**Table 1**  
**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 2

### Funds to be devolved during 5<sup>th</sup> 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 5<sup>th</sup> SFC, Part I.

# Table 3

## 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>	100	100	100	100	100

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

**Table 4****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>Grama Panchayat</b>	<b>5562.56</b>	<b>6523.62</b>	<b>7590.48</b>	<b>8976.80</b>	<b>9164.23</b>
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	
<b>Municipality</b>	<b>1446.45</b>	<b>1697.50</b>	<b>1977.40</b>	<b>2382.75</b>	<b>2108.01</b>
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	
<b>District Panchayat</b>	<b>1015.77</b>	<b>1197.52</b>	<b>1427.93</b>	<b>1696.43</b>	<b>2008.86</b>
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



**Table 4 Contd....**

<b>Name</b>	<b>2016-17</b>	<b>2017-18</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>
<b>Municipal Corporation</b>	<b>799.25</b>	<b>934.42</b>	<b>1090.81</b>	<b>1315.95</b>	<b>1175.00</b>
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	
<b>Block Panchayat</b>	<b>862.99</b>	<b>1009.44</b>	<b>1217.42</b>	<b>1460.79</b>	<b>1745.07</b>
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
<b>Grand Total</b>	<b>9687.02</b>	<b>11362.50</b>	<b>13304.04</b>	<b>15832.72</b>	<b>16201.17</b>

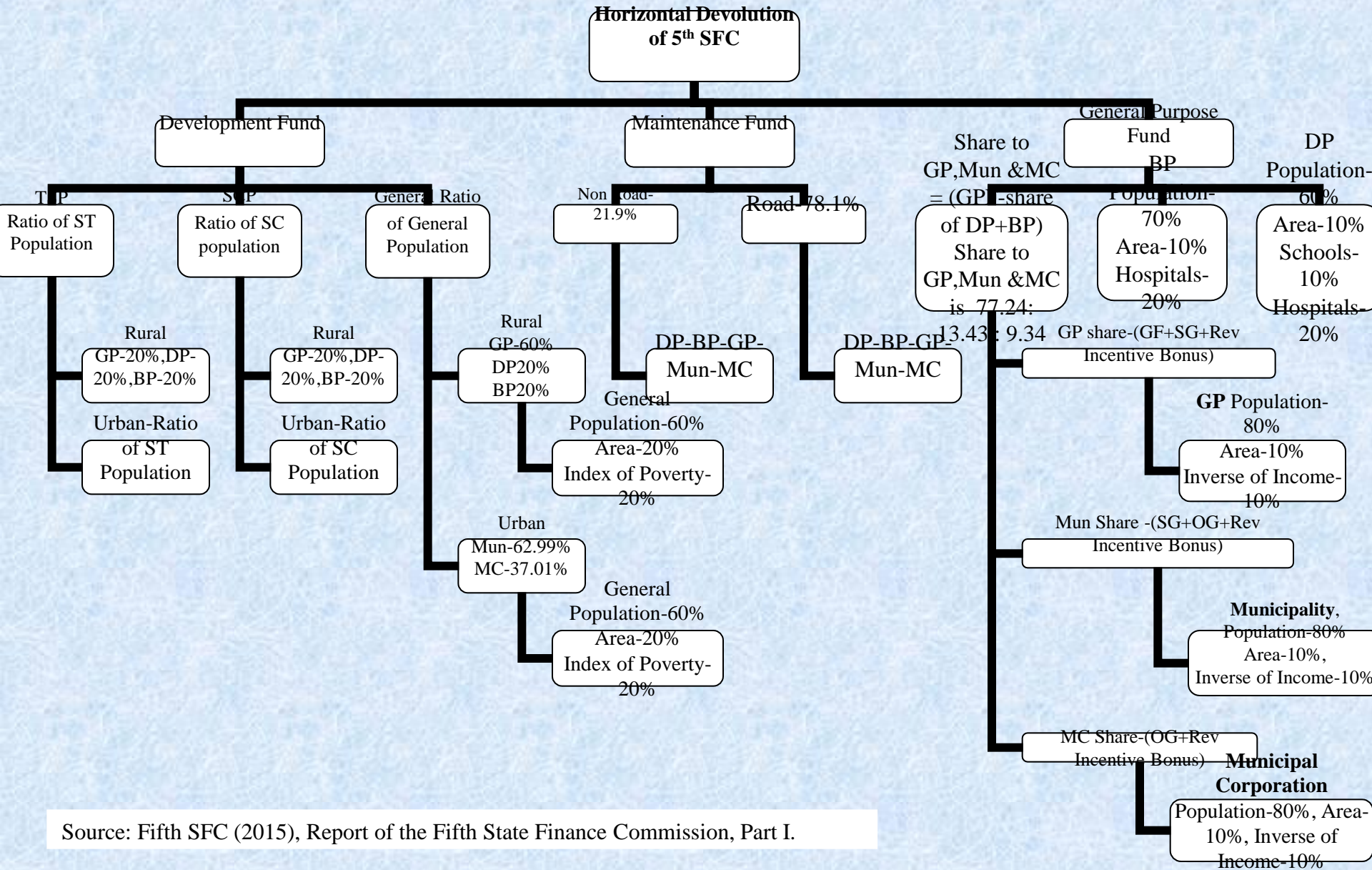
Source: Fifth SFC (2015), Report of the 5<sup>th</sup> SFC, Part I.



**Table 5****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
<b>Total</b>		-	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
<b>Total</b>		100	100	100	100	100

# Horizontal Devolution



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

## Table 6

### Major Devolution Recommendations rejected by State Govt

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.

## Table 6

## Contd....

<b>6</b>	5.5 to 6 percent of the net SOTR on t basis as maintenance fund.
<b>7</b>	Maintenance fund should be used only for the purpose of maintenance of road and non-road assets.
<b>8</b>	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.
<b>9</b>	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.
<b>10</b>	Transfer the devolved funds to public accounts of LGs in 12 instalments in a year.



# **Recommendations 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.
- The issue of bringing all buildings of Union Government under the property tax net shall be taken up with the Government of India.



# **Recommendations on Mobilisation of Tax and Non-tax Revenue**

## **Contd.....**

- 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.
- No revision of the ceiling limit of profession tax since 1988.
- The 14<sup>th</sup> UFC has recommended to revise the ceiling from ₹ 2500 to ₹ 12000 per annum.

# Recommendations on Mobilisation of Tax and Non-tax Revenue

## Contd.....

- Raise the ceiling limit of profession tax as recommended by 14<sup>th</sup> UFC. Take up the matter with the union government.
- The subscribers of both cable TV and Dish TV should be brought under the entertainment tax net. A sum of Rs. 10 per month from each subscriber shall be levied.
- Entrance fees in tourism centres and agricultural farms and operation of house boat shall be brought under the purview of entertainment tax.

# Recommendations on Mobilisation of Tax and Non-tax Revenue

## Contd.....

- 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.

# Recommendations on Mobilisation of Tax and Non-tax Revenue

## Contd.....

- 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 revenues 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.



# **Recommendations on Mobilisation of Tax and Non-tax Revenue**

## **Contd.....**

- The Commission recommended that no house should be exempted from the payment of property tax.
- Considering the issue of property tax receipt required by the residents of Idukki and Wayanad districts for various purposes in the absence of valid title deeds.
- The Commission recommended to increase the rate of honorarium of elected representatives in all rural and urban LGs.



# **Recommendations on Mobilisation of Tax and Non-tax Revenue**

## **Contd.....**

- For the elected representatives holding full - time executive positions such as President, Vice-President, mayor, deputy mayor etc, the honorarium shall be increased by 200 percent from the existing monthly rate.
- In the case of others, the honorarium shall be increased by 100 percent from the existing monthly rate
- To solve the pension payment issue of the staff of municipalities and municipal corporations, the Commission recommended a new procedure of pension disbursal system.

# Restructuring Plan Formulation and Execution

- Recommends to prepare three separate plan guidelines for the three categories, viz. (1) Grama and Block Panchayats, (2) District Panchayats and (3) municipalities and municipal corporations.
- Recommends that the GPs and municipalities facing problems due to geographic location (coastal area, hilly area, water bound and small islands) shall be permitted to spend 10% of the plan fund for meeting geographic related development projects.

# **Restructuring Plan Formulation and Execution**

## **Contd...**

- The amount and the rate of subsidies given to similar beneficiary schemes such as housing, land purchase and other schemes meant for BPL households, SC/ST, etc. of the Government Departments and LGs should be made uniform.
- Recommends four major changes in the plan procedures at pre-project formulation stage and project identification. First, reduce the number of working groups and make them more functional and effective.

# Restructuring Plan Formulation and Execution

## Contd...

- The number of working groups for Grama Panchayats, Block Panchayats and municipalities shall be reduced to three. (a) Sector wise (primary, secondary and tertiary) and overall development of the local economy (b) Infrastructure, civic amenities and welfare schemes (c) Development of transferred institutions.
- Five working groups shall be constituted in municipal corporations.



# Restructuring Plan Formulation and Execution

## Contd...

- Strengthening the role of Grama/Ward Sabhas/Ward Committees to have an effective role in review of projects implemented in the ward and identify the development requirements.
- At least two months should be given to LGs for preparation of projects other than the peak period of execution (January to March).

# **Restructuring Plan Formulation and Execution Contd...**

- Recommends to reduce the number of projects (plan and maintenance) to a level of two-thirds of the existing number of projects.
- In the case of projects using Development Fund, priority should be given to asset creating medium or large size projects in all category of LGs.
- A mechanism shall be formulated to scrutinize the work executed by the beneficiary committees.

# **Restructuring Plan Formulation and Execution**

## **Contd...**

- To prevent the unhealthy practice of bunching of plan expenditure, to the last quarter, the Commission recommends execution and completion of projects of non-engineering nature preferably in the first two quarters of the financial year.
- All the vacant posts of engineers, overseers and other field staff in Grama, Block and District Panchayats, municipalities and municipal corporations should be filled immediately.
- The unhealthy practice of frequent transfer of engineers should be stopped.

# Status of Implementation

- 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.
- 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.



# Status of Implementation

# Contd...

- As a result the LGs got only a lower amount than the amount recommended by the 5<sup>th</sup> SFC.
- Of the total recommendations of the commission only 59 percent was accepted by the State Government (Table 5).
- It is disturbing to note that except a few (14 percent) all the recommendations on devolution were rejected.
- The 1200 LGs in Kerala were denied their legitimate right to receive their due share of State taxes recommended by the 5<sup>th</sup> SFC for three years.

**Table 7****5<sup>th</sup> SFC: Number of Recommendations Accepted and Rejected**

Sl No	Item	Total Number of Recommendations	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 5<sup>th</sup> SFC : TVM, GoK.

# Status of Implementation

Contd...

- 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.

# Reference

- Report of the Fifth State Finance Commission, Part I (December, 2015) & II (March, 2016).
- 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).
- B. A Prakash (2018). Rejection of Kerala's Fifth State Finance Commission Recommendations. *Economic and Political weekly*. Vol. LIII. No 13. March 31.



THANK YOU