Chapter- 2

Approach and Issues

2.1 Articles 243 I and 243 Y of the Constitution laid down the duties of the State Finance Commission (SFC). In terms of the aforesaid Articles, the basic duties entrusted to the SFCs relate to (i) sharing of the net proceeds of taxes, duties, tolls and fees leviable by the State Governments with the panchayats/municipalities and its allocation between panchayats/municipalities at all levels of their respective share of such proceeds, (ii) the determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by, the panchayats/ municipalities and (iii) the grants-in-aid to the panchayats/municipalities from the Consolidated Fund of the of the State. In addition, the duties and responsibilities of SFCs are governed by the terms of reference (ToR) given to it by the respective State Governments. Accordingly, the approach of this Commission, shall be guided by the Constitutional mandate supplemented by its ToR. Incidentally, being the fourth generation SFC of Assam, this Commission will have the benefit of the views of the previous Commissions on these and other related issues, which have been taken note of.

Enlarged Functional Canvas of PRIs/ULBs

2.2 The basic thrust of the 73^{rd} and 74^{th} Constitutional amendments was to endow the rural and urban local bodies with adequate powers, functions, responsibilities and resources to enable them to function as autonomous institutions of self government. It follows from the radical empowerments that henceforth local governments will be expected to provide basic civic services expanding both the coverage and quality of services. It has also to ensure better matching of local services to the preferences of local needs and at the same time ensuring greater transparency and accountability. It goes without saying that functional autonomy without financial autonomy is meaningless. And as the revenue raising capacity of the local governments is extremely limited unless their resource base is suitably augmented through resource transfer from the upper tiers of governments, they can not be expected to provide even the required level of public services, let alone the quality. In this regard our approach would be to put the Local Self Governments (LSG) on a sound financial footing commensurate with their enlarged functional canvas as envisaged in Schedules XI and XII of the Constitution, keeping also in view the need to restore vertical and horizontal equalization in the scheme of resource distribution.

Vertical Imbalance

2.3 Vertical imbalance relates to transfer from the State Government to the LSGs and between different tiers of PRIs and categories of ULBs. Vertical imbalance arises as a result of mis-match between the expenditure responsibilities of LSGs and their revenue raising powers vis-à-vis the scheme of resource transfer. In terms of the Constitutional amendments, the local governments are expected to perform many important functions from their internal resources supplemented by transfer from upper tiers of governments. Apart from their traditional civic services, these included all matters listed in Schedules XI and XII of the Constitution for PRIs and ULBs respectively. In contrast, the internal resources locally available to them are of inadequate growth potential and suffer from extremely low yield. On the other hand, the amendments conferred Constitutional status to the LSGs, but subjected them to the exercise of such powers and responsibilities and access to such resources as the State Legislature may, by law, confer on them. Thus, the States still enjoy supreme power in the matter of devolution of powers, functions and resources. In this regard, the Union List, the State List and the Concurrent List included in Schedule VII of the Constitution enumerated the subjects allocated to the Union and the States along with the sources of revenue allocated to them. But in case of LSGs, Schedules XI and XII simply allocated the subjects entrusted to them without specifying their sources of revenue. This has further enlarged their growing dependence on the State and points to the need for taking a holistic view on vertical dimension of resource transfer from the State.

Horizontal Dimension

2.4 The aspect of horizontal imbalance relates to interse distribution of transferred resources between different tiers and categories of LSGs as well as among individual units of them. Horizontal imbalances arise due to differences in fiscal capacities engendered in inequitous resource endowments and differential costs of providing civic services. Cost disability may arise due to exogenous factors like large areas compared to population, hilly terrains, excessive rainfall and proneness to floods and draughts. In the matter of equalization of inter-governmental transfer, the successive Central Finance Commissions had adopted the approach of tax devolution supplemented by grants-in-aid to address simultaneously both vertical and horizontal imbalances.

Divisible Pool

2.5 In our view, the overall size of transfer of resources from the State to sub-Statal bodies requires to be determined keeping in view the availability of State resources after meeting its obligatory expenditure and the need of the LSGs in the context of their entrusted functions. A realistic assessment of State finances will indicate the availability of funds and a similar assessment of local government finances will provide the claim on such funds. The vertical dimension of transfer is sought to be addressed by creating a divisible pool (DP) funded from contribution out of the net proceeds of taxes and duties collected by the State Government supplemented by conditional and purpose specific grants-in-aid. The issue of horizontal disparities among PRIs/ULBs is sought to be redressed by an interse allocation mechanism based on some objectively defined criteria. While disparity in fiscal capacity is estimated by using proxies like per capita tax collection, per capita income from primary sector etc., cost disadvantages is sought to be taken into account with regard to differential expenditure requirements arising from factors like area, population, density of population and infrastructure facilities already in existence.

Design of Fiscal Transfer

2.6 As laid down in Articles 243 I and 243 Y of the Constitution read with paragraph 2 of the ToR, the main components in the scheme of fiscal transfer are three viz, (i) sharing the net proceeds of taxes and duties, tolls and fees leviable by the State government, (ii) determination of taxes, duties, tolls and fees which may be assigned to, or appropriated by the panchayats/municipalities and (iii) grants-in-aid from the Consolidated Fund of the State.

2.7 Para 2.5 refers to a divisible pool. The next step is to determine the composition and size of the divisible pool. The composition has to take into account the following alternatives: (i) sharing of revenue accrued to the State from some individual taxes, (ii) global sharing of State's own tax revenue, (iii) global sharing of State's own tax revenue including its share of Central taxes and (iv) global sharing of State's own tax revenue including its share of Central taxes and non-tax revenue collected by it.

2.8 Prior to the constitutional amendments, the procedure followed by Government of Assam in this respect had been sharing of the yield from individual taxes with panchayats/municipalities on the basis of prevailing statutory provisions or executive decisions. Thus only the proceeds of land revenue and local rates, entertainment tax and tax on motor vehicles had been sharable with the local bodies. But the amount of transfer on this account had been nominal as it was mostly dependent on year to year budgetary allocation and ways and means position of the State government.

2.9 In this regard, the First SFC of Assam favoured continuance of the existing arrangement of individual tax sharing but with some modification to ensure that the devolved amount conforms to 2 per cent of State's own tax revenue. The Second SFC of Assam, for the first time, recommended global sharing of State's own tax revenue leaving aside the proceeds of central taxes and non-tax revenue from the divisible pool. Likewise, the Third SFC of Assam also favoured the concept of global sharing of State's own tax revenue (other than Central taxes and non-tax revenue) with the PRIs and ULBs.

2.10 As regards inclusion of non-tax revenue in the DP, it may be noted that except forest revenue and royalty on minerals, all other taxes in this category are of the nature of user charges and fees collected from beneficiaries in lieu of services provided by the State Government and as such not appropriate for sharing. Again, in the context of the great need for forest protection the emphasis should be on planting and rearing of trees rather than their extractions. We have therefore decided to leave out the forest revenue. Royalty on crude oil is one of the most important sources of State's revenue. Considering the resource need of a flood prone deficit state like Assam the Commission has decided to leave out royalty on crude oil too from the divisible pool.

2.11 Having considered all these aspects, we are of the view that the concept of global sharing of the net proceeds of State's own tax revenue will be the best option. However, State's share of central taxes and non-tax revenue collected by the state shall be excluded from the purview of sharing. Wherever necessary global sharing will be supplemented by grants-in-aid. The mechanism of global sharing would enable the LSGs to enjoy the benefit of buoyancy in the overall taxes of the State instead of an individual tax. It will also ensure better predictability in transfer as well as transparency.

Assigned Taxes

2.12 The ToR mandated the Commission to recommend the principles which should govern the determination of the taxes, duties, tolls and fees, which may be assigned to, or appropriated by, the panchayats/municipalities. By and large, assignment of taxes refers to those taxes which are mainly origin based viz, land revenue, local rates, entertainment tax, entry tax, tax on profession etc,. States, where the process of decentralization had started early and local bodies had been put in place on a firm footing, collection and appropriation of some of these taxes have already been assigned to their local bodies. However, in case of Assam, the local bodies particularly the PRIs are still in a fledgling state having a skeletal administrative set up. It would be administratively difficult for them to assess and collect wide range of taxes. Moreover, as the base of these taxes is narrow compared to cost of collection, assignment of these taxes may prove to be counterproductive. There is no doubt that the State Government is usually better placed in the matter of assessment and collection of taxes than the LSGs. It would therefore be administratively more convenient and efficient to collect such taxes at the State level and share the net proceeds thereof with the LSGs. And besides, the concept of global sharing has brought all State taxes within the fold DP.

Need Based Assessment

2.13 In the matter of inter-governmental transfer, the basic principle is to make a proper assessment of the available resources of the donor body and the need in relation to revenue raising capacity of the recipient bodies. In respect of assessment of State resources, the Commission had virtually no difficulty in getting classified, updated, audited and authentic data relating to various aspects of State finances and economy. However, similar assessment in respect of local bodies as a whole or each individual unit of them, has become difficult in the absence of reliable, authentic and audited data concerning their income and expenditure. In order to determine a need based fiscal package for the local bodies, the first and foremost requirement is the availability of a reliable and firm data base involving their sources of income and level of expenditure. The main hurdle faced by this Commission, or for that matter by the previous SFCs and Central Finance Commissions, in finalizing the appropriate modalities of resource transfer has been the utter inadequacy of relevant data. Apart from inadequacy, the available data base also suffers from lack of credibility. This is so because accounts are not kept properly and audit of accounts are not done regularly. All aspects relating to data infirmities and the need for a proper organizational set up to overcome this sad State of affairs has been discussed in detail in the relevant Chapter- 11.

2.14 In making its assessment during the forecast period, the Commission is expected to build up the estimates over the level obtained in the base year which is 2008-09. As stated earlier, local bodies in Assam, more importantly, the PRIs are yet to be put in place on a firm footing. As of now, they do not have the required manpower or machinery to carry on even their traditional functions. Hence, the base year figure in respect of maintenance of civic services, other than establishment expenditure, is likely to be negligible. Any forecast based on that depressed level of maintenance expenditure would mean acceptance of such low level for the years to come. Surely that will not be in the interest of sound fiscal decentralization. Therefore, the Commission would like to firm up the base year estimates to enable the LSGs to provide a minimum level of service covering particularly the four service sectors of water supply, sewerage, storm water drainage and solid waste management. Our assumption about maintenance expenditure and service delivery during the forecast period is that it will be limited to the extent of devolution recommended by us minus the obligatory expenditure on salary and establishment.

2.15 To put it in a nutshell, our overall approach would be to put PRIs and ULBs on a sound financial footing in keeping with the vast empowerment envisaged in the Constitutional amendments. At the first instance, to buttress their capacity building adequate manpower need to be ensured. To upgrade the skill of both elected representatives and official functionaries, comprehensive training programmes need to be put in place. This has to be followed by providing physical infrastructure where there is none and upgrading the same where it is below par. Above all, we are inclined to maintain a healthy equilibrium between the vertical and horizontal dimensions of transfer. An important element in our approach would be to strike a fair balance between the interests of State Government, the LSGs and the people's welfare. Ultimately, the LSGs must appreciate that the transfers recommended by the SFCs or the Central Finance Commission are meant to supplement and not to substitute their own sources of revenues and that determined and sustained efforts have to be made by them to raise their own revenues from all sources allocated to them.