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ਡਾਇਰੀ ਨੰ...........
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MINISTRY OF FINANCE
DEPARTMENT OF EXPENDITURE
FINANCE COMMISSION DIVISION

Guidelines for Release and Utilisation of Grants recommended by the Twelfth Finance Commission for Augmentation of the Consolidated Funds of the States for supplementing the resources of the Rural and Urban Local Bodies (Local Bodies Grants)

1.0 TWELFTH FINANCE COMMISSION'S RECOMMENDATIONS OF LOCAL BODY GRANTS AND INTER-STATE DISTRIBUTION

1.1 The Twelfth Finance Commission (TFC) was required to make recommendations on the measures needed to augment the Consolidated Funds of the States to supplement the resources of the Panchayats and Municipalities on the basis of the recommendations of the State Finance Commissions (SFCs). TFC has given recommendations on this term of reference, which have been accepted by the Union Government.

1.2 The Twelfth Finance Commission (TFC) has recommended grants amounting to Rs.25,000 crores payable during the period 2005-10 (Rs. 20,000 crores for Panchayats and Rs.5,000 crores for Municipalities) to States for Rural and Urban Local Bodies. The inter-State allocation recommended by TFC for Rural Local Bodies i.e. Panchayati Raj Institutions (PRIs) and for Urban Local Bodies (ULBs), given at Table 8.1 of the Report of the TFC are reproduced at **Annex-I**. The inter-se allocation amongst States is based on factors and weights assigned by the TFC as under:

Criterion	Weight (per cent)
i) Population	40
ii) Geographical area	10
iii) Distance from highest per capita income	20
iv) Index of deprivation	10
v) Revenue effort	20
of which (a) with respect to own revenue of states	10
(b) with respect to GSDP	10

1.3 The allocation amongst various Municipalities and Panchayati Raj Institutions and also autonomous councils in excluded areas would be made by the States.

2.0 OBJECTIVES OF THE LOCAL BODY GRANTS SCHEME

2.1 TFC felt that grants for PRIs should be used to improve the service delivery by the Panchayats in respect of water supply and sanitation. Panchayats need to be encouraged to take over water supply assets created under the Swajaldhara Programme and maintain them with the help of these grants.

2.2 TFC has stressed the importance of public private partnership to enhance service delivery of solid waste management services in the urban areas. TFC has urged that States may require municipalities of towns of over 100,000 population as per 2001 census to prepare comprehensive scheme including composting and waste to energy programmes to be undertaken in the private sector for appropriate funding from the grants recommended by the TFC. TFC has suggested earmarking of at least 50% of grants for this purpose.

2.3 TFC has further felt it to be imperative that high priority need to be assigned to creation of database and maintenance of accounts at the grass root levels.

3.0 RECOMMENDATIONS OF THE TFC

3.1 The summary of the recommendations of the TFC is reproduced below:

i) The best practices listed in para 8.19 of the report (included in para 4 of these guidelines) may be considered for adoption by States to improve the resources of the panchayats.

ii) The States should avoid delays in the constitution of the SFCs, their constitution in phases, frequent reconstitution, submission of reports and tabling of the ATR in the legislature. It is desirable that SFCs are constituted at least two years before the required date of submission of their recommendations, and the deadline should be so decided as to allow the state government at least three months' time for tabling the ATR, preferably along with the budget for the ensuing financial year.

iii) The SFC reports should be readily available to the Central Finance Commission, when the latter is constituted so that an assessment of the state's need could be made by the Central Finance Commission on the basis of uniform principles. This requires that these reports should not be too dated. As the periodicity of constitution of the Central Finance Commission is predictable, the States should time the constitution of their SFCs suitably.

iv) SFCs must be constituted with people of eminence and competence with qualification and experience in the relevant fields.

v) The convention established at the national level of accepting the principal recommendations of the Finance Commission without modification should be followed at the State level in respect of SFC reports.

vi) The SFCs must clearly identify the issues which require action on the part of the central government to augment the consolidated fund of the State and list

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them out in a separate chapter for the consideration of the Central Finance Commission.

vii) The suggestions made by SFCs regarding raising the ceiling on professional tax is endorsed for action by Central Government.

viii) It is desirable that the SFCs follow the procedure adopted by the Central Finance Commission for transfer of resources from the Centre to the States in respect of resources transfers from State Governments to local bodies. The SFC reports should contain an estimation and analysis of the finances of the State government as well as the local bodies at the pre and post transfer stages along with a quantification of the revenues that could be generated additionally by the local bodies by adopting the measures recommended therein. The gaps that may still remain would then constitute the basis for the measures to be recommended by the Central Finance Commission.

ix) While estimating the resources of the local bodies, the SFCs should follow a normative approach in the assessment of revenues and expenditure rather than made forecasts based on historical trends.

x) A permanent SFC cell may be created in the finance department of State governments as the collection and collation of data would need to be done constantly and data would need to be made available to the SFC as and when it is constituted.

xi) A sum of Rs. 20,000 crore for the Panchayats and Rs. 5000 crore for the Municipalities may be provided as grants-in-aid to augment the consolidated fund of the States for the period 2005-10 to be distributed with inter-se shares as indicated in table 8.1 of the report. (Annex –I)

xii) The PRIs should be encouraged to take over the assets relating to water supply and sanitation and utilize the grants for repairs / rejuvenation as also the O&M costs. The PRIs should, however, recover at least 50 percent of the recurring costs in the form of user charges.

xiii) Of the grants allocated for Panchayats, priority should be given to expenditure on the O&M costs of water supply and sanitation. This will facilitate Panchayats to take over the schemes and operate them.

xiv) At least 50 per cent of the grants-in-aid provided to each State for the urban local bodies should be earmarked for the scheme of solid waste management through public-private partnership. The Municipalities should concentrate on collection, segregation and transportation of solid waste. The cost of these activities whether carried out in house or out sourced could be met from the grants.

xv) Most States do not have credible information on the finances of their local bodies. Local bodies would continue to need funding support for building data base and maintenance of accounts. States may assess the requirement of each local body in this regard and earmark funds accordingly out of the total allocation recommended by us.

xvi) Separate grants-in-aid for the normal and the excluded areas are not proposed. It is for the State concerned to distribute the grants recommended for the State among the local bodies including those in the excluded areas in a fair and just manner.

xvii) No conditionality over and above those recommended by us need be imposed by the Central Government for releasing the grants-in-aid.

4.0 BEST PRACTICES FOR AUGMENTING THE RESOURCES OF THE PRIs

4.1 TFC has recommended best practices for augmenting the resources of the PRIs based on a study conducted by the TFC and have commended them for adoption by the States. The best practices are reproduced below:

i) Levy of certain major taxes and exploitation of non-tax revenue sources be made obligatory for the Panchayats. The minimum rates for all such levies be fixed by the state government;

ii) A minimum revenue collection from the Panchayat taxes be insisted;

iii) Incentive grants related to revenue collection beyond a prescribed minimum be introduced by the State government;

iv) User charges be made obligatory levies;

v) All common property resources vested in the village Panchayats may be identified, listed and made productive of revenue;

vi) Valuation of taxable lands and buildings should be done by a separate cell in the Panchayati Raj Department of the State Government and not left to the panchayats;

vii) Powers to levy a tax/surcharge/cess on agricultural holdings should be given to the intermediate or district Panchayats;

viii) Revenue transfers from the States to Panchayats in the form of revenue sharing/revenue assignment be made statutory in nature;

ix) State Governments should desist from unilaterally taking decisions in regard to revenues whose proceeds are to be transferred either in full or in part to the panchayats;

x) The quantum of revenue that a Panchayat can reasonably expect under the revenue sharing mechanism should be predictable;

xi) State Government should adhere to its commitment in regard to the grants-in-aid; all untied grants to the panchayats should be made statutory in nature;

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xii) SFC should be constituted for a lifespan of 18 months and a time limit of six months be prescribed for a State government to act on the SFC recommendations;

xiii) The maintenance of accounts by the Panchayats be standardized; Panchayat department officials should not be made statutory auditors of the village Panchayats; the accounts of the intermediate and district Panchayats be subjected to audit by Comptroller and Auditor General (C&AG);

xiv) A performance audit system be adopted.

5.0 MONITORING AGENCIES

5.1 Every State shall constitute a High Level Committee (HLC) to ensure proper utilisation of Local Bodies Grants.

5.2 This HLC shall be headed by the Chief Secretary to the State Government and will include Finance Secretary and Secretaries of the concerned Departments as members.

5.3 HLC shall be responsible for the following:

a. Approval of the projects at the beginning of every year to be undertaken in each sector, quantify the targets, both in physical and financial terms and lay down a time-table for achievement of specific milestones;
b. Monitoring both physical and financial targets and ensuring adherence to the specific conditionalities in respect of each grant, wherever applicable;

5.4 HLC shall meet at least once in every quarter to review the utilisation of grants and to issue directions for mid-course correction, if considered necessary. Minutes of HLC meetings shall be provided to the Department of Expenditure (Finance Commission Division), Ministry of Finance, Government of India for information.

5.5 A Central Review Committee will be constituted in the Government of India, headed by Secretary to Government of India, Ministry of Finance, Department of Expenditure to review the releases and utilisation of grants. The Committee will include representatives from the Ministry of Panchayati Raj, Ministry of Urban Development and Poverty Alleviation, Ministry of Home Affairs and Ministry of Finance (Department of Expenditure). The Committee shall meet at least once in a year.

5.6 Given the much higher quantum of grants and larger number of rural local bodies, a separate Committee for Panchayati Raj Institutions (PRIs) will be constituted to monitor the mode of release of local body grants to Panchayats as mentioned in the guidelines from para 6.1 to para 7. The Committee will be chaired by Secretary to

Government of India, Ministry of Panchayati Raj with the Joint Secretary (State Finances) and Financial Adviser (Panchayati Raj) as Member and Jt. Secretary (Panchayati Raj) as Member Secretary. The Committee shall meet at least once in a quarter. This Committee shall bring out the points for intervention by Government of India in Ministries of Panchayati Raj and Finance to ensure smooth and uninterrupted flow of funds to PRIs.

6.0 MODE OF RELEASE OF LOCAL BODY GRANTS TO STATES.

6.1 Local bodies grants will be released in two equal instalments in July and January every year. States have to mandatorily transfer the grants released by the Centre to the PRIs and ULBs within 15 days of the same being credited to the State's account. Also, Panchayats as defined in the Constitution can exist only when they are constituted as per the mandatory provisions of Articles 243B and 243 C. Hence, grants will not be provided to a State (which is covered under Part IX of the Constitution) where elections for constituting these Panchayats have not been held for the period for which there were no elected panchayats as per the provisions of the Constitution.

6.2 Two sets of details, one on allocation of funds and another on release of funds, will be reported by the State Government in the format prescribed at Annex – II for the purpose prior to the release of each instalment by the Government of India. However, the first six monthly instalment for 2005-06 shall be released to a State after receiving only the details (in the above said format) of the allocation of these funds to the PRIs and ULBs in that State. All subsequent instalments shall be released after receiving both sets of details – the certificate of the release of funds to the PRIs and ULBs for the previous instalment and the information about allocation of funds for the subsequent instalment. For the first instalment for 2005-06, information on allocation upto district level alone need to be sent by the State. For the subsequent releases, the breakup of the allocation to each PRI and ULB at the three levels should be provided. The States are advised to inform Government of India about allocated share of each PRI and ULB at all levels before October 31, 2005. The certification and allocation information (as per the format) may please be sent to the Ministry of Finance both in hard copy as well as on a magnetic media (e.g. floppy or CD). State Finance Secretary would be required to provide a certificate within 15 days of the release of each instalment by Government of India under his signature certifying the dates and amounts of local grants received by the State from the Government of India, and the dates and amounts of grants released to the PRIs and ULBs. This certification and information will be in the above mentioned format.

6.3 State Finance Secretary would also be required to provide a certificate every year of the percentage of grants spent by the ULBs on schemes of solid waste management and on schemes of water supply and sanitation by the PRIs. States would also be required to provide details of recurring O&M cost recoverable by the PRIs on schemes of water supply.

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6.4 The second instalment of local bodies grants for the year 2005-06 shall be released upon receipt of the release certificate for the previous instalment and allocation information for the subsequent instalment referred to in para 6.2 . In case of delayed transfer to PRIs / ULBs beyond the specified period of 15 days, the State Government shall transfer to PRI / ULB amount of interest at the rate equal to the RBI Bank rate alongwith such delayed transfer of grants.

6.5 The second instalment from the year 2006-07 would be released on receipt of the certificate referred to in para 6.3 in addition to the release certificate and allocation information referred to in para 6.2. Government of India will withhold the amount short spent on the schemes of solid waste management by the ULBs and on schemes of water supply and sanitation by the PRIs. The withheld amount will be subsequently reimbursed upon confirmation that the short spending has been compensated in the subsequent period.

7.0 AUDIT BY THE COMPTROLLER AND AUDITOR GENERAL OF INDIA

7.0 Comptroller and Auditor General of India would be expected to audit the release and use of the local bodies grants within the time and for the purposes mentioned by the TFC, reproduced above. Government of India may take appropriate decision about withholding grants of a State if the Comptroller and Auditor General of India reports that the State has either not transferred the grants to the local bodies or has allowed the grants to be used for purposes other than for which these are being provided or that local bodies have not been able to give priority to spend on the O&M of water supply and sanitation for the rural areas and on schemes of solid waste management in the urban areas.

A Goel
15.6.2005
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