CHAPTER – 13

ESTIMATION OF REVENUE GAP AND FISCAL PACKAGE

13.1.0 Introduction

13.1.1 The State Finance Commission has reached almost the end of its journey. To reach this stage, it had to cover a long journey wherein each stage provided the building blocks and inputs for determining the Fiscal Package for ULBs of the State. We have reached the most crucial stage now when we have to determine the size and nature of the Revenue Gap of the ULBs in the State. ***The estimation of the Revenue Gap is crucial to the task of designing the Fiscal Package for the Devolution of Funds from the State Government to the Local Bodies. Not only we have to estimate the Actual Revenue Gap but also the Potential Revenue Gap,*** since the ***SFC*** is required to recommend Devolution of Resources for meeting the future requirements of ***Local Bodies***, taking into account the future potential of resources.

13.1.2 ***The Constitutional Amendment requires the CFC to recommend the Devolution of Resources form the Center to the States, for supplementing the resources of Local Bodies, on the recommendations of the SFC.*** For performing this constitutional obligation, the CFC needs some basis for determining the size of Fiscal Package for ULBs. The Revenue Gaps to be estimated by different SFC for the Local Bodies of their respective States can provide such basis to the CFC. So far, very few SFCs in the country have been estimating such Revenue Gaps to provide some basis for constructing the Fiscal Packages, for recommending devolution of resource from the States to Local Bodies, and also for facilitating the task of the CFC in the performance of its Constitutional Obligation. In the absence of estimation of ***Revenue Gaps***, the ***XIth*** and the ***XIIthFC*** had recommended transfers from the Centre to the States for supplementing the resources of ***Local Bodies*** mostly on adhoc basis. In this context we quote the observation made by the ***XIIthFinance Commission*** : "***A careful scrutiny of the SFCs reports reveals***

that very few SFCs have followed this approach. This has made impossible for us to adopt their reports as the basis for our recommendations. We strongly recommend that in future, all the SFCs, including those which are already set up but have yet to submit their recommendations, follow the above procedures so as to enable the Central Finance Commission to do full justice to its constitutional mandate." (page 150) The significance of estimating the Revenue Gaps of Local Bodies, to facilitate the task of both the CFC and the SFC in the performance of their constitutional obligations, needs not be over- emphasised.

13.2.0 What Is Revenue Gap?

13.2.1 ***The Revenue Gap represents the difference between own revenue of ULBs (Own Tax + Non-Tax Revenue) and their Revenue Expenditure.*** The Revenue Gap is reduced, if a larger proportion of their Revenue Expenditure is financed by Own Resources of ULBs.

13.2.2 Normally ***Revenue Expenditure of a ULB is = Total own revenue from tax and non-tax sources + total transfers from the State and the Central Government, on revenue account. Revenue Gap, therefore, equals the excess of Revenue Expenditur over Own Revenue Receipts of a ULB***. In other words, ***it is equal to the Total Transfer of Resources to ULBs from the State and the Central Government, on Revenue Account***. Already we have stated, in the last chapter that increase in Revenue Gap financed increasingly by Outside Sources of Finances, reduces the Self-Reliance of ***Local Bodies***. Since our task is also to determine the future financial needs of ULBs in the State, we need to arrive at ***Potential Revenue Gap*** also, which represents the ***difference between Expenditure needs and the Revenue raising capacity of ULBs in the future which in our case is next five years. This is known as the Potential Revenue Gap***. The expenditure needs is the amount which a ULB needs to spend to provide ULBs services of a given quality. The revenue raising capacity may be defined as the amount of money which ULBs can raise at a given tax burden of its citizens and also can realise adequate user charges for rendering certain services to them.

13.2.3 Revenue Gap arises on account of asymmetry in Revenue Expenditure and Own Revenue Receipts or entrusting greater Expenditure responsibilities and lower Revenue Raising Powers, and also because of Fiscal Handicaps of Local Bodies due to Poor Economic Base. Even though all ULBs may have Uniform Taxation Powers, variations on unit cost of providing services across ULBs on account of difference in topography, density pattern, physical shapes of the cities, limited autonomy of the ULBs, lack of adequate efforts made to raise Own Revenue, and increase in Revenue Expenditure due to poor planning and management of resources, may be some of the other factors accounting for the emergence of Revenue Gaps of Local Bodies.

13.2.4 The low level or Zero Revenue Gap, does not necessarily indicate better level of efficiency of a local body. Similarly a larger Revenue Gap may not necessarily mean inefficiency in the functioning of ULBs. A Zero level of Revenue Gap may indicate a vicious circle, charaterised by poor quality of services, leading to Low Level of Revenue and Low Level of Expenditure, bringing us back to the poor quality of services. ***We donot advocate equilibrium between Revenue and Expenditure at a low level, but at a higher level.***

13.3.0 The Actual Revenue Gap Of Urban Local Bodies During Three Years (2001-02 And 2003-04)

13.3.1 To arrive at ***Potential Revenue Gap*** or ***Normative Revenue Gap***, ***it becomes essential to estimate, in the first instance, the Actual Revenue Gap of ULBs in the State,*** to enable us to compare the two situations, the ***Actual*** and the ***Potential Revenue Gap***. The **Table No. 13.1** given ***below presents such a gap.***

13.3.2 The table shows that ***Municipal Corporations*** could meet only 27.71% of their through their Own Resources, the ***Municipal Councils*** 41.63% and ***Nagar Panchayats*** 30.36%. In this regard, the performance of ***Municipal Corporations*** seems to be the most unsatisfactory. The increasing ***Revenue Expenditure*** is met by transfers from the ***State and the Central Government***. ***The Actual Annual Average Gap of all types of ULBs comes to Rs. 142.90 crores, blow for the whole State to Rs. 163.40 crores. Taken together, ULBs in the State could meet only***

29.70% of their Revenue Expenditure through their Own Revenue Receipts. We have blown up the estimates for sampled ULBs on the basis of their population shares in respective total population of ULBs in each category.

13.4.0 Potential Or Normative Revenue Gap Of Urban Local Bodies :

13.4.1 ***More important than the Actual Revenue Gap is the estimation of Potential Revenue Gap on a Normative Basis***. The estimation of ***Actual Revenue Gap*** has limited relevance, since this would discourage the ***Local Bodies*** in their revenue raising effort and ***Local Expenditure*** restraint. Under this method, ***ULBs*** with the highest ***Per Capita Expenditure*** and the lowest ***Per Capita Own Revenue,*** may get the largest share in ***Transfers*** from the ***State Government***. Moreover such a gap does not represent the taxable capacity and expenditure needs of ***ULBs***. ***It becomes necessary, therefore, to estimate the Potential Revenue Gap, to help the SFC in designing its Fiscal Package.***

13.4.2 The exercise of estimating the Potential Revenue Gap requires some ***standardization of Expenditure and Revenue*** to ensure comparability of the estimates of gaps between different ULBs. We need some norms and standards to measure the expenditure needs of ULBs and their capacity to raise revenue. These norms and standards may also provide the bench-mark for estimating the deficits in the provision of different services and also for different sources of Own Revenue. It is a complex exercise because of large variations in the levels of economic activities of the people of the area, income levels, the capacity of ULBs to raise resources to provide and maintain services at a particular level.

13.4.3 A number of committees and expert groups have suggested certain levels of ***Per Capita Expenditure*** of different Urban services for achieving certain Physical Norms. Most of these norms and standards have been suggested for the national level, which need to be lowered for ULBs in less developed States like Chhattisgarh, where the existing level of development of Urban Services is very low. We have, therefore, to opt for such norms and standards which can be implemented by our State.

13.5.0 The Methodology Used For Estimating The Potential Gap :

13.5.1 We have already indicated the broad outlines of the methodology that we would be deploying for arriving at ***Potential Revenue Gap on a Normative Basis,*** in the chapter dealing with scope and methodology. Now we work out the details of this methodology. A number of methodologies have been suggested to make estimate of Revenue Gap on the basis of different norms and standards. But the methodology opted for must be simple and implementable and for which reliable and adequate data are available.

13.5.2 The ***XIIthFC*** has outlined a methodology in its report. The Commission has recommended that the ***SFCs*** should adopt a ***Normative Approach*** in the assessment of Revenue And Expenditure, Per Capita Norms for Revenue generation must take in to account data regarding Tax Base and avenues for raising Non-Tax Revenue, assuming reasonable Buoyancies And Scope for Additional Resource Mobilisation. ***Per Capita Expenditure norms should be evolved on the basis of Average Expenditure incurred by best three performing ULBs. Similarly for estimating potential revenue, the performance of, the best three ULBs is to be taken into account. Broadly speaking we have used the methodology suggested by the XIIth FC in its report.***

13.5.3 ***For arriving at the Revenue Potential and also Expenditure Needs of ULBs of different categories, we have taken the Average Per Capita Own Revenue and Per Capita Revenue Expenditure of the Best Three ULBs in each of the category, as a norm for all ULBs of each category, the level to which all ULBs in the category would raise their levels of Per Capita Revenue And Expenditure.*** This would provide us a rough measure of Per Capita Revenue Potential and Per Capita Expenditure needs of different categories of ***ULBs*** in the State. The underlying idea is that when some higher level of Revenue and Expenditure has been achieved by some ***ULBs*** why cannot the same be achieved by others in the same category? ***The methodology is hedged by the following assumptions:***

(i) Variations in revenue base of ULBs within each category are the minimal

(ii) That the ULBs in each category will apply the rates prevailing in the standard ULBs with the highest ***Per Capita Own Revenue***

Per capita norms of Revenue Generation and Revenue Expenditure have taken into account the ***Average Growth Rates of the last three years*** in respect of ***Revenue Growth and Expenditure Growth***. The methodology used may have a number of limitations and may not be perfect in all respects. But under the present circumstances, it seems to be the most workable. This is based on ***XIIth FCs*** suggestion.

13.6.0 The Estimates Of Potential Of Normative Revenue Gap Of Urban Local Bodies :

13.6.1 **Table No. 13.2**, given below gives the ***estimates of Potential Revenue Gap of different categories of ULBs in the State***.

13.6.2 The **Table No. 13.2 & 13.3** show that the ***Potential Revenue Gap*** has been widening partly due to ***larger increases in Revenue Expenditure***, increasingly being financed by transfers from the State and Central Government, and by ***Own Revenue, at much lower rate of increase***. There would be considerable improvement in ***Revenue Gap of Municipal Councils*** where the percentage of ***Own Revenue*** to ***Revenue Expenditure*** has been higher as well as increasing, compared to other two categories of ***ULBs***. This has improved from 66.02% to 66.68% during 2005-06 and 2009-10 and higher when compared to the average of three years between 2001-02 to 2003-04. The position of ***Nagar Panchayats*** has also improved though very slowly, rising from 30.36 % during 2001-02 to 03-04 to 30.96% in 2009-10. In ***Municipal Corporations*** during same period Revenue Gap has been rising 27.71% to 30.19%, but the situation shows an improvement when compared with the average of 3 years, ***2001-02 to 2003-04***. ***The over all position, when considered by taking all categories of ULBs together, would show considerable improvement from 29.70%, the Average of 3 years to 37.62% in 2009-10***. Such improvement takes time to be reflected in Revenue Gap because of variety of complex factors influencing ***Revenue Expenditure and Revenue Receipts***. The most important factor being transfers from the State and the Central Government financing increasing level of ULB Expenditure.

13.6.3 The ***Total Revenue Gap*** of all sampled ***ULBs*** in the State would record an increase from Rs. 142.90 crores, the average of three years in the pre-projection period, to

Rs. 174.84 crores in 2005-06 and further increasing to Rs. 378.48 crores in 2009-10, as indicated in **Table No. 13.2** The improvement is considerable in respect of ***Municipal Councils*** but slow in respect of ***Municipal Corporations*** and ***Nagar Panchayats*** which have to make more vigorous efforts in the direction of raising additional resources through ***Tax And Non-Tax Revenue***. The ***Revenue Gaps*** have been widening because of rapid increase in ***Revenue Expenditure*** caused by increasing amounts of transfers to ***ULBs***, more particularly due to Compensation on account of loss caused by the Abolition of Certain Taxes like ***Octroi, Passenger Tax***, and also because of ***Assigned Revenue***.

13.7.0 The Potential Revenue Gap For The Whole Universe Of Urban *Local Bodies* :

13.7.1 The above mentioned ***Potential Revenue Gap*** is estimated on the basis of data provided by the ***sample ULBs***. When we ***blow up the figures of Revenue Gap for the entire universe of ULBs in the State, we get the*** **Table No. 13.4** pictures.

The blown up figure of Revenue Gap for all the ULBs is likely to register an increase from Rs. 210.78 crores in 2005-06 to Rs. 451.02 crores in 2009-10, the largest increase in the ***Revenue Gap*** of ***Municipal Corporations***, from Rs. 139.69 crores to Rs. 307.82 crores, of ***Municipal Councils***, the gap would increase from Rs. 30.30 crores to Rs. 60.57 crores and of ***Nagar Panchayats*** form Rs. 40.79 crores to Rs. 82.64 crores during 2005-06 and 2009-10.

13.8.0 An Alternative Approach To The Estimation Of Revenue Gap :

13.8.1 In the above section, we have estimated Revenue Gap on the basis of generally ***adopted approach which has also been suggested by the XII^th^ FC and also by the National Institute of Public Finance and Policy. New Delhi and also mostly adopted by the SFCs.*** We do not dispute this approach which considers Revenue Gap as the ***Excess*** of ***Revenue Expenditure*** over ***Own Revenue Receipts*** of ***ULBs***. This is a valid concept of Revenue Gap, accepted in theory and practice of Public Finance. We to have also adopted this concept while estimating ***Revenue Gap***, both ***Actual And Potential***. ***But in respect of this State, we venture to suggest a change, not in the concept of Revenue Gap but in the manner in which Own Revenue Receipts are measured***. ***The Revenue Gap appears to be very large because*** of one fact that a large part of ***Tax Revenue*** which legitimately belongs to ***Local Bodies*** and which used to be a part of own tax revenue of ULBs in the State in the past when these Taxes were levied and collected by them, is no longer considered as part of Own Revenue of ULBs on account of ***Abolition Of Such Taxes,*** and their imposition and collection has been taken over by the State Government and such revenue from these taxes becoming a part of the Revenue Receipts of the State Government. This revenue collected by the State Government are transferred to ULBs as compensation after netting out collection charges. So what legitimately belongs to ULBs and should have formed a part of own revenue of ULBs, has become a part of transfers from the State Government, being used for funding Revenue Expenditure and thereby increasing Revenue Gap of ULBs of the State. ***Assignment of Revenue to ULBs by the State Government in respect of these taxes, is in the nature of reimbursement of what would have accrued to them, had these Taxes been levied and collected by them.***

13.8.2 The concept of Revenue Gap remaining un-changed, had ***Revenue from such Taxes been included in the Own Tax Receipts of Local Bodies, their Revenue Gaps would have been reduced considerably.*** This is a mere procedural change in the accounting method. The suggested change is intended to give a more realistic picture of Municipal Finances and their Revenue Gaps which form the basis of the Fiscal Package recommended by the SFC. ***We have calculated the likely impact of the suggested change on Revenue Gaps of ULBs of different categories. We Present*** in the **Table No. 13.5.**

The discussion is a mere academic exercise but can also be given a concrete shape.

13.9.0 The Fiscal Package For Urban Local Bodies :

13.9.1 ***The determination of the Fiscal Package for ULBs in the State is the core of the mandate contained in Article 243(Y) of the 74th Constitutional Amendment Act, 1992.*** The Amendment has proposed a large functional domain than what the ULBs have historically been responsible, the benefits of many of these functions may spill-over beyond the municipal boundaries. The constitution has not earmarked a separate list of taxes which may belong exclusively to the domain of ULBs, which, therefore, continue to depend upon the State Government for allocating of Taxes from the State list to Local Bodies through the legislation governing their functioning. The Municipal Government does not have the flexibility and autonomy in respect of fixing tax rates. The prices of municipal services bear no relation to the cost that is incurred on their provision and delivery. The Local Bodies being closer to the people are not effective tax collectors. Their tax rates are not revised periodically. The arrears of taxes are allowed to accumulate either due to sheer inefficiency or due to delays in assessment. All these result in their Own Revenue Receipts falling short of their Revenue Expenditure. Hence the need for transfers from the higher level government, arises in every federation.

13.9.2 Transfers are justified in a federal set up. We have already discussed at some length in an earlier chapter the justification for transfers to Local Bodies. But to make these transfers more effective in achieving their objectives, certain principles should govern their dispensation. ***These are***:

(i) Predictability (ii) Stability (iii) Transparency (iv) Not promoting dependency syndrome but should encourage ULBs to make efforts for Additional Resource Mobilization.

13.9.3 The Fiscal Package for Local Bodies has to be designed such that it provides adequate funds for meeting their Revenue Gap, arising out of mismatch between their Expenditure Responsibilities and Revenue Raising Capacity and also out of their Fiscal Disabilities.

13.9.4 ***While designing the Fiscal Package, the SFC also has to take into consideration the Fiscal Health of the State Government which provides the major proportion of Outside Funds to Local Bodies. We have also to take into account the absorptive capacity of Local Bodies to utilize their funds, and also their capacity to generate resource through Internal Sources.*** In this context, we again highlight the fact that huge surpluses have emerged both on Revenue Account and Capital Account and also in the over-all budgets of ULBs in the State. Their financial position may be apparently satisfactory but there seems to be no improvement in their functional efficiency and in their delivery of adequate services to the citizens. ***Their problems may not be mainly financial, but also administrative, technical and institutional.***

13.10.0 Classification Of Transfers From The *State Government*

13.10.1 The State budget should give sufficient information about the rationale of the budgetary allocations and their dis-aggregation into different heads and sub-heads. For ensuring transparency and for facilitating proper evaluation of transfers, ***we recommend that all transfers from the State Government to ULBs may be classified and presented in the following manner and data in the State departments may also be maintained accordingly.*** Separate demand numbers may be assigned in the budget to different transfers and

1. Share in the Divisible Pool of Own Revenue of the State on the recommendation of the SFC,
2. Assignment of Tax Revenue in respect of compensations for Octroi, Passenger Tax and Other Taxes,
3. Surcharge of State Taxes for allocation among Local Bodies,
4. (a) Grants-in-Aid on the recommendation of the SFC
   (b) Grant-in-Aid-General Purpose and Specific from the State Government,
5. Plan Grant on the recommendation of the State Planning Board,
6. Grants from the Central Government on the recommendation of the CFC,
7. Other Transfers and
8. Total Transfers.

Transfers on account of Assigned Revenue and Grants-in-Aid should not be clubbed together as at present.

13.11.0 The Size And Composition Of The Divisible Pool.

13.11. 1 ***The Divisible Pool includes that part of State Revenue which is to be shared with Local Bodies.*** The first issue that arises is; what should be ***Size Of Divisible Pool*** ? Should it include only ***Tax Revenue of the State Government*** or both ***Tax and Non-Tax Revenue*** ? Should we include the ***Entire Tax Revenue or Revenue only from some Specific Taxes*** ? Should we include the Entire Tax Revenue, including the share of the State in Central Tax Revenue or only the Own Tax Revenue of the State? There has been no unanimity in this regard among different SFCs in the country. The issue has been approached differently by different SFC. This has created some confusion. ***A majority of the SFCs have recommended sharing of only Tax Revenue of the State Government with Local Bodies.*** Some had recommended the concept of global sharing, by suggesting the inclusion of both Tax and Non-Tax Revenue of the State Government, and a few had suggested sharing of entire revenue of the State Government. Thus we have before us a variety of models of revenue sharing, to choose from.

13.11.2 In this context we have to look to the requirement of the ***Constitutional Provision*** which is the following :

"The distribution between the State and the Local Bodies of the net proceeds of taxes, duties, fees, livable by the State which may be levied and distributed between Local Bodies at all levels, of their respective shares of such proceeds."

13.11.3 Looking to the ***Constitutional Requirement***, we find that there seems to be no justification for the inclusion of Entire Tax and Non-Tax Revenue of the State Government in the Divisible Pool. The constitution does not require us to recommend sharing of entire tax and non-tax revenue, when it clearly States ***"net proceeds of taxes, duties livable by the State".*** Obviously, we have to exclude share of the State in Central Tax Revenue on the recommendations of the CFC. ***Thus we are required to include in the Divisible Pool only the Net Own Tax Revenue of the State, to be arrived at after netting out the Collection Charges.***

13.11.4 The Commission is now in a position to recommend the Size and Composition of Sharing of Revenue of the State with Local Bodies. It can be worked out on the basis of Own Tax Revenue of the previous year, for devolution among Local Bodies. The fact that Tax Revenue every year takes care of the growth rate and the inflation rate since both are built-in the current Tax Revenue, we need not take into account the Tax Revenue of some base year and recommend annual increase in that amount for the subsequent years, to accommodate growth rate and inflation rate.

13.11.5 ***The Commission recommends that Local Bodies in the State should receive every year, a certain percentage of Own Tax Revenue of the State to be arrived at by deducting a sum equal to 10% as collection charges from the gross own tax revenue.***

13.11.6 ***Our next task*** is to determine the size of shareable revenue and also evolve a ***Sharing Mechanism which is a three stage mechanism, (i) to suggest the percentage share of Local Bodies in the Divisible Pool (ii) to suggest the share of PRIs and ULBs separately in the earmarked amount, (iii) to determine the criteria for inter-se distribution among different PRIs and ULBs.***

13.11.7 ***The Percentage Share will remain valid for the entire award period. We have recommended a Flat Rate for determining the share of Local Bodies and also the shares of PRIs and ULBs.*** But the amount of gross and net own tax revenue of the State Government would have to be worked out every year, on the basis of certain percentage, and criteria recommended by the State Finance Commission and accepted by the State Government.

13.11.8 What percentage of the Divisible Pool may be allocated to ***Local Bodies*** of the State ? We have to take into account a number of factors for suggesting this percentage. ***These may be, the Size of the Revenue Gap of Local Bodies, Rural And Urban, The Capacity of Local Bodies to raise their Own Resources, their Over-All Financial Position, the Fiscal Health of the State Government, the over-all performance of the State economy, the needs of Local Bodies. Taking all these factors into consideration,***

THE COMMISSION RECOMMENDS THAT 8.287% OF THE OWN NET TAX REVENUE OF THE STATE GOVERNMENT, BE SHARED WITH LOCAL BODIES EVERY YEAR DURING THE AWARD PERIOD. It is not possible to meet the entire Revenue Gap through the recommended Fiscal Package. Since the creation of the Chhattisgarh State, the State Government has been implementing the recommendations of the ***First State Finance Commission*** of the erstwhile ***Madhy Pradesh*** Government, according to which ***3.42% of the***

Total Revenue of the State Government, both Tax and Non-Tax Revenue was to be allocated to Local Bodies. At the time of the creation of the New State, the Second Finance Commission of MP which was in session, had not submitted its report. The ***Second SFC of Madhya Pradesh*** has recommended a share equal to ***4% of only Own Tax Revenue of the State Government*** for sharing with ***Local Bodies***.Against this background and taking all other factors into consideration, ***this Commission recommends that 8.287% of the net own tax revenue of the State Government be shared with Local Bodies every year during the award period 2005-06 and 2009-10. In addition to this, the Commission would be recommending general purpose grants-in-aid for Local Bodies and also an increase in assigned revenue to Local Bodies.***

13.11.9 We have worked out the amount of Own Tax Revenue which the State Government will share with the Local Bodies, on the basis of Own Tax Revenue which we have projected for the award periodt. This is given in Table No. 13.6

13.11.10 The amount determined in the above manner needs to be allocated between the PRIs and the ULBs in the State. This Commission recommends that the amount be distribute among the two categories of Local Bodies on the basis of Rural and Urban Population in the Total Population of the State according to 2001 Census. The Ratio of Rural and Urban Population in the Total Population of the State was 79.91% and 20.09% respectively. On the basis of this ratio, the share of PRIs and ULBs in the percent share of State Net Own Tax Revenue comes to the following figures:

SHARE OF PRIs	6.628 %
SHARE OF *ULBs*	**1.659 %**
TOTAL	**8.287% OF NET OWN TAX REVENUE OF THE *STATE GOVERNMENT***

On the basis of the above formula, we have worked out the amount of shares separately for PRIs and ULBs in each of the five years during the award period shown in **Table No. 13.7**. ***The actual figures may***

depend upon the actual amount of Net Own Tax Revenue accruing to the State Government every year.

13.11.11 ***The next requirement is to determine inter-se allocations to the PRIs and ULBs.*** The inter-se distribution of earmarked funds for rural ***Local Bodies*** would be made in a separate report relating to ***Panchayat Raj Institutions***, by the State Finance Commission. ***In this Report, the Commission is concerned only with the allocation of the share of Urban Local Bodies, among different ULBs in the State. While recommending the criteria the Commission has taken into account 3 factor***, ***(i) The Needs (ii) The Revenue Effort and (iii) The Equity Factor***.

13.11.12 ***The SFC recommends the following criteria along with weights for each criterion, for working out the inter-se allocation to different ULBs in the State :***

S.No.	Criteria	Weight (%)
1	**Population** of Urban Local Bodies	80
2	**Area** of Urban Local Bodies	10
3	**Slum Population** of Urban Local Bodies	10

Population of each ULBs to be determined according to 2001 census. Population by and large, represents needs. ***Area*** implies the legal jurisdiction of each ULB. It can be estimated as the percent share of area of each Urban Local Body in the total area of all ULBs in the State. This is an another objective criteria which by and large, represents needs. ***Slum Population*** takes care of equity to some extent. The 10% of the total amount earmarked for ULBs may be distributed among such ULBs which have a slum population of 10% or more of their respective populations. A lower cut off point is recommended to enable larger number of ULBs to take benefit of this proposal. The total amount is to be allocated among such ULBs on the basis of percentage of slum population in the total slum population of the State , ***according to 2001 Census***. The amount so allocated to the ULBs will have to be exclusively used for the improvement of slums.

13.12.0 Grants-In-Aid (General Purpose).

13.12.1 ***In addition to share in Own Tax Revenue of the State Government the Commission recommends that State Government may allocate Rs. 16 crores for disbursement among ULBs as General Purpose Grants for first year of the award period but the amount may be increased every year by 01 crore over the previous year. These are General Purpose Grants, to be utilized by ULBs at their discretion but according to their priorities, subject to the approval of the State Government. The Commission recommends the following criteria for the Inter-Se allocation of Grants-in-Aid and the criteria will remain applicable during the award period.***

S No.	Criteria	Weight (%)
1.	Population	10
2.	Revenue Effort	40
3.	Distance From The Highest Per Capita Expenditure On Public Health & Convenience.	50

13.12.2 The 40% weight of Urban Local Body is to be determined by the ***Ratio of Own Revenue (Tax Revenue + Non-Tax Revenue)*** to the ***Total Revenue Expenditure (Revenue Effort)*** in the previous year. ***This criterion is recommended to spur ULBs to make efforts of raise their Own Resources*** . We have observed while making review of Municipal Finance in the State, that at present, efforts made by ***ULBs*** to raise their Own Resources , are inadequate, rather poor in may cases, with the result that their dependence of outside sources, more particularly transfers form the ***State Government***, has been increasing. ***The following formula is recommended to implement the criterion :***

13.12.3 ***The allocation to each Urban Local Body is to be made on the following basis***:

1	If The Ratio of Own Revenue To Revenue Expenditure is Below 30%	No Grant
2	If The Ratio is Between 30 To 40%	Per Capita Grant of Rs. 3
3	If The Ratio is Between 41 To 60%	Per Capita Grant of Rs. 5
4	It The Ratio is Between 61 To 80%	Per Capita Grant of Rs. 7
5	If The Ratio is Above 81 %	Per Capita Grant of Rs. 10

The ratio of the previous year is to be taken into account for determining the amount of Grant-in-Aid for each ULB.

13.12.4 ***The third criterion*** with a weightage of 50% of the amount of ***Grants-In-Aid*** is the ***distance from the Average of 3 Best ULBs in a category in terms of the Per Capita Expenditure on Public Health and Convenience***, is intended to assist such ULBs which are spending low per capita on a very important function of ULBs which includes water supply, drainage, sewerage, waste disposal, cleaning of roads, hospitals and dispensaries, parks and gardens, prevention of communicable diseases, checking adulteration of food articles. The distance between the per capita expenditure on public health and convenience of ***ULBs***, can easily be estimated. Such data can be made available easily. This criterion meets the requirement of equity in the scheme of inter-se allocation. The amount allocated to a ULBs has to be spent on this head of **ULB** expenditure.

We are now in a position to present an integrated picture of Fiscal Package for ULBs in the State. The Table No. 13.8 given this picture.

The figures of amount of Compensation and Assigned Revenue have been estimated on the basis of data given by Sample ULBs and then blown up for the Universe. There seems to be no consistency in the data of such transfers, provided by the State Government.

13.12.5 The estimates of the amount of different components are approximation, made of the basis of projections of revenue made by this Commission. The actual figures may turn out to be different from these projections. ***The actual may be different in respect of Own Tax Revenue, but the percent of Own Tax Revenue sharing with***

the ULBs will remain the same every year during the award period. Similarly the figures of actual transfers in respect of compensation and assigned revenue may be different from what we have estimated. ***In this context, what we have recommended is that every year the amount has to be increased in Octroi Compensation should increase accordingly with Entry Tax..*** The whole exercise of Fiscal Package is based on certain assumptions.

13.12.6 ***These Transfers from the State Government recommended by the SFC may fill up only a part of the Revenue Gap. The remaining amount may be raised by the ULBs through their Own Resources, both Tax And Non-Tax, and partly by the central transfers made on the recommendations of the CFC.*** Despite the availability of resources made available through internal and outside resources, there is very possibility of a part of Revenue Gap remaining unmet. The main purpose of this exercise is to facilitate different agencies in arriving at the amount of resources which need to be provided to ***ULBs***. The manner these tasks are carried out by different agencies, will determine the journey to effective Fiscal Decentralization. This is a major step towards strengthening **ULB** finances.

13.12.7 ***The Amount of Transfers that the SFC has recommended is within the competence of the State Government to provide and may, therefore not impose any Unbearable Financial Burden on the State Government. Taking into account the Sound Fiscal Position of the State Government that we have projected while making review of State Finances, we find that their financial position permits a larger amount of transfers to Local Bodies than what is currently being transferred.***

13.12.8 Looking to the State budget for 2005-06, we find that a provision of Rs. 332.17 crores has been made for All Types of Transfers to ***Local Bodies***, both Rural And Urban. Against this, our recommendations for ***ULBs***, translated in monetary terms, come to Rs.181.71 crores. When provisions of transfers for ***PRIs*** as recommended by the SFC, are added up, this figure may require a larger provision in the State budget. ***But we are sure that taken together the amount of transfers recommended by the SFC, for both Rural& Urban, will be within the competence of the State Government for meeting their Financial Obligations, in view of the Increasing Buoyancy of Own Tax Revenue of the State Govt.***

13.12.9 ***We have worked out the percentages of recommended transfers to different Fiscal Aggregates in the* Table No. 13.8**, ***to see the impact on State budget during the Award Period.***

13.12.10 **Table No. 13.9** ***demonstrated the fact that the impact of our recommendations on the State Exchequer would be within the Financial Capacity of the State Government.*** On the other hand, in terms of percentage, the impact would go on declining from 3.32% of ***Own Revenue of The State Government*** in 2005-06 to 2.78% in 2009-10, from 4.55% of ***Own Tax Revenue*** to 3.64%, and from 2.04% of ***Total Revenue Receipts*** to 1.68% during the same period***. This decline may be attributed to the expected buoyancy in the State Tax and Non-Tax Revenue in the period under study.***

13.13.0 Distribution of XII th Finance Commission Grant:

13.13.1 **For the distribution of Rs.88 Crore (17.60 Crore per annum) received as grant from XIIth Finance Commission to Urban Local Bodies for five years. The SFC recommends the following criteria along with weights for each criterion, for working out the inter-se allocation of differen ULBs in the State:**

S.No.	**Criteria**	**Weight (%)**
1	**Population** of Urban Local Bodies	80
2	**Area** of Urban Local Bodies	10
3	**Slum Population** of Urban Local Bodies	10

Table No. 13.1

Actual Revenue Gap Of ULBs

(2001-02 To 2003-04)

(In Thousands Rs.)

SNo.	Indicators & ULBs	2001-02	2002-03	2003-04	Annual Average Revenue Gap
1	2	3	4	5	6
1.	**Municipal Corporations**				
i)	Revenue Expenditure	1631152	2044917	1294821	1656963
ii)	Own Revenue Receipts	400558	445084	531647	459096
iii)	**Revenue Gap (ii-i)**	**-1230594**	**-1599833**	**-763174**	**-1197867**
2.	**Municipal Councils**				
i)	Revenue Expenditure	245733	258100	311357	271730
ii)	Own Revenue Receipts	96418	102124	140896	113149
iii)	**Revenue Gap (ii-i)**	**-149305**	**-155976**	**-170461**	**-158581**
3.	**Nagar Panchayats**				
i)	Revenue Expenditure	89354	105498	117353	104068
ii)	Own Revenue Receipts	31534	31298	31983	31605
iii)	**Revenue Gap (ii-i)**	**-57820**	**-74200**	**-85370**	**-72463**

Average For Three Years (2001-02 To 2003-04)

(In Crores Rs)

S. No.	Indicators & ULBs	Actual Revenue Gap	Blown Up For Whole State	Own Resources As % of Rev. Exp.
1	2	3	4	5
1.	Municipal Corporations	119.79	119.79	27.71
2.	Municipal Councils	15.86	23.53	41.63
3.	Nagar Panchayats	7.25	20.08	30.36
	Total	**142.90**	**163.40**	**29.70**

Table No. 13.2

Potential Revenue Gap Of ULBs In The State

(2005-06 To 2009-10)

(In Crores Rs.)

S. No	Indicators & ULBs	Actual Revenue Gap-Average for 2001-02 To 2003-04	Projections				
			2005-06	2006-07	2007-08	2008-09	2009-10
1	2	3	4	5	6	7	8
1.	**Municipal Corporations**						
i)	Revenue Expenditure	165.70	239.38	278.88	324.89	378.50	440.95
ii)	Own Rev. Receipts	45.91	99.69	107..17	115.20	123.84	133.13
iii)	**Revenue Gap (ii-i)**	**-119.79**	**-129.69**	**-171.71**	**-209.69**	**-254.66**	**-307.82**
2.	**Municipal Councils**						
i)	Revenue Expenditure	27.17	60.09	71.81	85.81	102.54	122.54
ii)	Own Rev. Receipts	11.31	39.67	47.53	56.93	68.21	81.71
iii)	**Revenue Gap (ii-i)**	**-15.86**	**-20.42**	**-24.28**	**-28.88**	**-34.33**	**-40.83**
3.	***Nagar Panchayats***						
i)	Revenue Expenditure	10.41	23.87	27.69	32.12	37.26	43.22
ii)	Own Rev. Receipts	3.16	9.14	10.05	11.06	12.17	13.38
iii)	**Revenue Gap (ii-i)**	**-7.25**	**-14.73**	**-17.64**	**-21.06**	**-25.09**	**-29.84**
4.	**Total Urban *Local Bodies***						
i)	Total Revenue Expenditure	203.28	323.34	378.38	442.82	518.30	606.71
ii)	Total Own Rev. Receipts	60.38	148.50	164.75	183.20	204.22	228.23
iii)	**Total Revenue Gap (ii-i)**	**-142.90**	**-174.84**	**-213.63**	**-259.62**	**-314.08**	**-378.48**

Table No. 13.3
Percent Of Own Revenue Receipts To Revenue Expenditure Of ULBs
(2005-06 To 2009-10)

(In %)

S. No.	ULBs	Average of 2001-02 To 2003-04	2005-06	2006-07	2007-08	2008-09	2009-10
1	2	3	4	5	6	7	8
1.	Municipal Corporations	27.71	41.65	38.43	35.46	32.72	30.19
2.	Municipal Councils	41.63	66.02	66.18	66.35	66.52	66.68
3.	Nagar Panchayats	30.36	38.29	36.31	34.43	32.65	30.96
All Categories		**29.70**	**45.93**	**43.54**	**41.37**	**39.40**	**37.62**

Table No. 13.4
Potential Revenue Gap Of All ULBs In The State
On The Basis Of Blown – Up Figures
(2005-06 To 2009-10)

(In Crores Rs.)

S. No.	ULBs	Potential Revenue Gap for all the ULBs (of Blown-Up Figures 2001-02 To 2003-04	2005-06	2006-07	2007-08	2008-09	2009-10
1	***2***	**3**	**4**	**5**	**6**	**7**	**8**
1.	Municipal Corporations	119.79	139.69	171.71	209.69	254.66	307.82
2.	Municipal Councils	23.53	30.30	36.03	42.84	50.94	60.57
3.	Nagar - Panchayats	20.08	40.79	48.84	58.32	69.49	82.64
Total Potential Revenue Gap		**163.40**	**210.78**	**256.58**	**310.85**	**375.09**	**451.02**

Table No. 13.5

The Revenue Gap of ULBs According To The Two Approaches

(2005-06 To 2009-10)

(In Crores Rs.)

S No.	Description	2005-06	2006-07	2007-08	2008-09	2009-10
1	**2**	**3**	**4**	**5**	**6**	**7**
1	On the basis of first approach	210.78	256.58	310.85	375.09	451.02
2	Alternative approach	137.74	174.89	220.56	276.55	345.04
3	**Reduction in the magnitude of revenue Gap**	**73.04**	**81.69**	**90.29**	**98.54**	**105.98**

Table No. 13.6

Determination Of Share Of *Local Bodies*

In Net Own Tax Revenue Of The State Government

(2005-06 To 2009-10)

(In Crores Rs.)

S. No.	Description	2005-06	2006-07	2007-08	2008-09	2009-10
1	**2**	**3**	**4**	**5**	**6**	**7**
1	Own Tax Revenue of The ***State Government***	3994.79	4956.29	6161.76	7673.72	9571.23
2	Deduct, Collection (10%)	399.48	495.63	616.18	767.37	957.12
3	Net Amount	3595.31	4460.66	5545.58	6906.35	8614.11
4	**8.287% of Net Tax Revenue to be Allocated to Local Bodies**	**297.94**	**369.65**	**459.56**	**572.33**	**713.85**

Table No 13.7

Projected Shares Of PRIs And ULBs
In The Net Tax Revenue Of The State Government
(2005-06 To 2009-10)

(In Crores Rs.)

S.No.	Description	2005-06	2006-07	2007-08	2008-09	2009-10
1	2	3	4	5	6	7
1.	Share of PRIs	238.29	295.65	367.56	457.75	570.94
2.	**Share Of ULBs**	**59.65**	**74.00**	**92.00**	**114.58**	**142.91**
3.	Total Amount	297.94	369.65	459.56	572.33	713.85

Table No. 13.8
Fiscal Package And Its Components For ULBs
(2005-06 To 2009-10)

(In Crores Rs.)

S No.	Description	2005-06	2006-07	2007-08	2008-09	2009-10
1	2	3	4	5	6	7
1	Share of **ULB*s*** in the Divisible Pool of Net State Own Tax Revenue	59.65	74.00	92.00	114.58	142.91
2	Transfers from the State Govt. on Account of Compensation of Certain Taxes and Assigned Revenue	106.06	121.97	140.26	161.30	185.50
3	General Purpose Grants-in-Aid on the Recommendation of The State Finance Commission	16.00	17.00	18.00	19.00	20.00
Total		**181.71**	**212.97**	**250.27**	**292.88**	**348.41**

Table No. 13.9

The Impact Of Recommendation Of The SFC On Projected Figures Of Fiscal Aggregates (2005-06 To 2009-10)

S. No.	Indicators	2005-06	2006-07	2007-08	2008-09	2009-10
1	2	3	4	5	6	7
1.	Total Transfers Recommended by the **SFC** (Rs. Crores)	181.71	212.97	250.27	292.88	348.41
2.	Item I as % Of Projected Own Revenue of State Government	3.32	3.17	3.03	2.90	2.78
3.	% of Own Tax Revenue	4.55	4.30	4.06	3.84	3.64
4.	% of Total Revenue Receipts	2.04	1.94	1.85	1.76	1.68
5.	Total Potential Rev. Gap (Rs. Crores)	210.78	256.58	310.85	375.09	451.02
6.	**Fiscal Package as % of Revenue Gap.**	**86.21**	**83.00**	**80.51**	**78.62**	**77.25**