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The Recommendations of Karnataka state Finance Commission: An Analysis

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Abstract: *Devolution is a global paradigm. It is referred to as a process of sharing of powers by the central ruling groups with other groups, each having authority within a specific area or the state. Devolution may involve creation or strengthening of the lower levels and allowing them to function outside the centres control. The devolution of financial resources to the local bodies has been ensured through constitution of State Finance Commission. The State Finance Commission provides a new dimension after 73rd Constitutional Amendment Act in 1992. It is expected to appropriate principles and design flexible method to address the aspects of financial devolution to Local Bodies. This chapter shows that to reviewing the criteria and weights assigned to the selected indicators by the earlier SFCs of Karnataka. Apart from sharing of revenue between the state and local bodies, the focus is on the methodological aspects of the recommendations. Such an exercise will help in understanding the financial issues relating to the state on the one hand, and local bodies, on the other besides paving the way for this Commission to make its recommendations.*

Key words: *Fiscal Decentralisation, Local governments, State Finance Commissions.*

1. INTRODUCTION:

Decentralization can be defined as governments at different levels of the political body having distinct powers, functions and financial resources which facilitate multi-level governments. Decentralization can go a long way in strengthening the roots of democracy. Multi-level governments, multi-level planning, and the democratic system go together. They have an organic relationship with one another.

The Articles 243 (I) and (Y) of the Constitution of India read with the section 267 of the Karnataka Grama Swaraj and Panchayat Raj Act 1993 as amended in 2015 and section 503C of the Karnataka Municipal Corporation Act, 1976 and section 302B of Karnataka Municipalities Act, 1964 provided for the
Formation of SFCs to address the financial issues confronted by the PRIs and ULBs. The SFCs have to look after the fiscal problems of both PRIs and ULBs. Before this mechanism came into existence, the state governments used to transfer funds to local bodies based on state laws and discretion. The Governor of a state, shall as soon as may be within one year from the 73rd (1992) amendment to the Constitution under Article 243(I), and thereafter at the expiry of every fifth year constitute SFC to review the financial position of panchayats and similarly, the SFC constituted under Article 243 (Y) of the 74th amendment shall also review the financial position of the municipalities and make Recommendations to the Governor.

2. REVIEW OF LITERATURE:

Rani, P Geetha (1999) ***"State Finance Commission and Rural Local Bodies***" Economic & Political Weekly 19-06-1999. [SPECIAL ARTICLES] VOL.34No.25, June 19-June 25, 1999.) The 73rd and 74th Constitutional Amendment Acts, 1992 have added a new dimension to fiscal federalism and decentralised public finance in the Indian federal system. The structure of inter-governmental fiscal relations and transfers necessarily will have to undergo significant changes. Their provisions relating to the creation of state finance commissions (SFCs) to rationalise fiscal relations at the sub-state level and make periodic fiscal corrections assume significance in this context. This paper seeks to critically review the recommendations of five SFCs, viz, Karnataka, Kerala, Punjab, Rajasthan and West Bengal, on fiscal devolution with reference to rural local bodies (PRIs).

Bhaat, P Mahesh and Shah, Ramesh *(2000)* "***Gujrat State Finance Commission***" Economic & Political Weekly, 10-06-2010, VOL.35 No.24, June-10-June 16, 2000.) The paper highlights that party politics has played havoc with the functioning of Gujarat State Finance Commission. Not only was it dissolved before it could submit its full report, but the recommendations made show that the Commission has protected the interest ,of the state government at the cost of Panchayat Raj Institutions.

Oommen, M A (2010) "The 13th Finance Commission and the 3rd Tier" Economic and Political Weekly 27-11-2010.:VOL45 No. 48November 27-December 03- 2010.) Evaluating the recommendations of the Thirteenth Finance Commission with reference to panchayati raj institutions and urban local bodies and their implications for genuine fiscal federalism in India, this paper finds data related to local governments across states and over time, to be wanting in many respects. Yet, as broad aggregates, they help throw some light on the magnitudes and trends in expenditure and own source revenue of the third tier from 2002-03 to 2007-08. It concludes that the Commission has in some ways departed significantly from the past and made suggestions that could strengthen democratic decentralisation if they are fully implemented.

Bandyopadhyay, D(2008) "Guiding Role of Central Finance Commission Regarding State Counterparts", Economic & Political Weekly 31-05-2008, VOL.-43 No.-22, May31- June06, 2008.) 19 State Finance Commissions ensure that finances are appropriately devolved to all the tiers of the Panchayat bodies. This role is supplemented by the Central Finance Commission, establishing an "organic" link between the two. The author has raised a question whether the Thirteenth Finance Commission would prove to be a better guide to the SFCs than its predecessors.

3. OBJECTIVES OF THE STUDY:

- To study the Criteria adopted and weights assigned by the three previous SFCs
- Recommendations of Karnataka first state finance commission
- Recommendations of Karnataka second state finance commission
- Recommendations of Karnataka third state finance commission

4. MATERIAL AND METHODS:

The study is based on secondary source of formation gathered from the Finance commission articles, journals, Newspapers and relevant websites etc.

5. RESEARCH GAP:

There are number of research papers related to vision of a Finance Commission but there is no particular study related to Karnataka state finance commission recommendations and present study focused on major recommendations of Karnataka state finance commission. So the study is attempted.

6. ANALYSIS AND INTERPRETATION:

6.1 Criteria adopted and weights assigned by the three previous SFCs.

The PRIs in different states have been entrusted with various functions and powers to be effective units of self governance that will enable them to improve the quality of life in rural areas. While this is a continuous challenge in view of the limited resources available to the PRIs, the state governments have also showed resolve to address the inequalities that have existed in different areas and deprivations that have affected the population in these areas. The SFCs in their endeavour to ensure equitable distribution of funds for providing basic services for uplifting the standards of living of the people in the urban and rural areas have dwelt extensively on the factors that are responsible for the deprivation at the local level. These factors have been identified and analyzed for arriving at a scheme of devolution for sharing of the resources of the state with the local bodies. Though each of the SFCs has followed different yardsticks for their assessment, the effort is to assess the resource gap of the local bodies for delivery of basic services to their population. As is acknowledged by the SFCs of different states availability of reliable data regarding various indicators is a serious limitation. The criteria adopted and the weights considered along with methodology used by the earlier three SFCs are given in Table.

Criteria adopted and weights in percentage assigned for devolution of funds to PRIs and ULBs by the three previous SFCs, Karnataka

Sl. No	Criteria	First SFC			Second SFC			Third SFC		
		PRIs	ULBs	Total	PRIs	ULBs	Total	PRIs	ULBs	Total
01	Proportion of Population	23.03	10.30	33.33	19.81	10.19	30	26.41	13.59	40.00
02	Proportion of Area	32.59	0.74	33.33	29.33	0.67	30	19.46	0.54	20.00
03	Proportion of Illiterates	8.34	2.78	11.11	12.03	2.97	15	8.00	2.00	10.00
04	Proportion of	Not	Not	Not	11.75	3.25	15	7.78	2.22	10.00

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	SC/ST Population.	selected	selected	selected						
05	No. of Persons/ Hospital Bed	8.34	2.78	11.11	7.50	2.50	10.00	8.14	1.86	10.00
06	Road length per sq.km	8.35	2.78	11.12	Not selected	Not selected	Not selected	Not selected	Not selected	Not selected
07	Density of Population	Not selected	Not selected	Not selected	Not selected	Not selected	Not selected	0.51	9.49	10.00
Total		84.30	15.70	100	80.42	19.58	100	70.28	29.72	100
Rounded off		85	15	100	80	20	100	70	30	100

Source: Reports of the State Finance Commission of Karnataka.

A brief analysis of the indicators used by the earlier SFCs in the state reveals that population -rural and urban- as well as area was commonly employed as indicators by all the three SFCs with different weights. Other common indicators used by the earlier SFCs are the number of illiterates and number of persons per hospital bed. These indicators were selected by the Commissions to assess the gap in health care facilities between PRIs and ULBs and thereby provide more resources to local bodies which faced a resource crunch. The 1st and the2nd SFCs used five indicators while the 3rd used six. The new indicator added by the 3rd SFC was the density of population. The 2nd and the 3rd SFCs selected the percentage of SC and ST population as an indicator. This has also been selected to endow those local bodies with a relatively higher percentage of SC and ST in the population, with more funds under the devolution scheme. On infrastructure, the road length per sq. km. as an indicator was used by1st SFC but the 2nd and 3rd SFCs chose not to use it.

One of the main limitations of the scheme of indicators used by the earlier SFCs is that the indicators selected do not represent the functional responsibility of the local bodies. Giving weights to indicators is always debatable. There are no indicators to represent the basic services provided by the local bodies - PRIs and ULBs. There is some justification for using density as one of the indicators. This would give more funds to ULBs which are struggling with a continuing influx of rural labourers to urban areas in search of livelihoods. Secondly there are no indicators which represent the financial aspects (health) of the local bodies. The capacity of the concerned body depends on the availability of resources. Except GPs and ULBs, the ZPs and TPs do not have their own sources of revenue. GPs constitute the basic unit dealing with providing basic services directly to people at the grassroots level. Therefore, it is useful to include indicators relating to financial aspects to represent the capacity of the GPs. Indicators representing basic services namely, water supply, drainage; households without electricity could be used.

The 1st and the 2nd SFCs gave equal weights to population and area. The 1st SFC gave33.33 percent and 33.33 per cent to population and area respectively. The 2nd SFC gave 30per cent each to population and area in their scheme. However, the 3rd SFC has increased the weight to 40 per cent to population and reduced the weight for area to 20 per cent. In this scheme of indicators, the local bodies located in the regions full of valleys, forests, rivers etc, e.g. Kodagu, Uttara Kannada, Chikkamagaluru districts where density is relatively low and geographical area larger would get less funds under devolution.

6.2 Recommendations of Karnataka first state finance commission

The 1st SFC, after an elaborate review of ‘federal fiscal relations’ at the state and the practice prevailing at the centre decided that the gap filling method of transferring revenue to the local bodies is not suitable to the present conditions. The Commission instead adopted what it calls ‘pragmatic normative approach’ and observed that this approach was necessary to fulfil the basic aim of providing basic services. The philosophy is ‘any person living anywhere in Karnataka should get a minimum level of essential public/civic services’. This is the yardstick used by the Commission to determine the devolution of funds from the state to local bodies.

Prior to 1995-96 PRIs received on an average 35.82 per cent from the state’s non loan gross own revenue receipts (NLGORR) per year and in the entire 12 year period from 1995-96 to 2007-08 the average devolution was similar to this. The 1st SFC observed that the rural local bodies are deprived of adequate resources and taxing powers, share in taxes, grants-in-aid and power to dispose of the devolved funds to be on more independent and firmer ground and not becoming a mere spending agencies. Though the 1st SFC recommended 36 per cent of NLGORR to local bodies, the allocations in 1997-98 and 1998-99 were 38.56 per cent and 39.73 per cent respectively. The average amount works out to 38.98 per cent. Therefore, the 2nd SFC recommended a marginal jump of only 40 per cent of the NLGORR. The real increase would be only 1.02 per cent. This made the 2nd SFC to adopt a “balanced financial allocation approach’’.

The respective shares of ZP, TP and GPs would be 40:35:25 respectively. In absolute terms, the total devolution to PRIs in 1996-97 would be 2274.19 crore and the amount for the ULBs would be 2675 crore excluding the 10th FC grants. The 10th FC recommended that the criteria recommended by the SFC for the distribution of state government grants to PRIs (40:35:25) should be followed for the 10th FC funds also. The Commission recommended the continuation of the statutory grant of one lakh to GPs under section 206 of Karnataka Grama Swaraj and Panchayat Raj Act (Amendment) 1993 and it should be treated as additional over and above the share recommended by SFC.

6.3 Recommendations of Karnataka second state finance commission

The 2nd SFC continued the concept of NLGORR for devolving the funds to local bodies. But, the state government modified it to non-loan net own revenue resources (NLNORR) and implemented it. The Commission introduced the proportion of SC and ST population as a criterion and discontinued the criterion of road length per sq.km, adopted by the 1st SFC. The population below poverty line and per capita income were not considered by the 2nd SFC as the data were not reliable. The SC/ST population was taken as a justifiable criterion. The indicators and the weights assigned to backwardness represented by illiteracy at 15 percents/ST population at 15 per cent person per hospital bed at 10 per cent and the total amounting to a 40 per cent was considered. The Finance Commission also examined whether population below were not used. The 2nd SFC evolved a devolution framework for inter-se allocation of 11th FC grant, but in actual practice this grant is counted as a part of the SFC grant by Government of Karnataka. This is against the recommendation of SFC. Much of the increase in non- plan expenditure is due to incremental benefits given employees in salaries and allowances.

The decision of the state government regarding changing the concept NLGORR to NLNORR was appropriate as net revenue receipts (NLNORR) is more practical and relevant than the gross revenue receipts (NLGORR).

6.4 Recommendations of Karnataka Third state finance commission

Under the recommendation of the 1st SFC, the relative shares of PRIs and ULBs in the ratios 80:15 respectively. The 2nd Commission changed it to 80:20. The 3rd Commission recommended that the ratios of PRIs and ULBs in the NLNORR should be 70:30. Given the higher rate of growth of urban population, the increase in the share of ULBs is justifiable. Besides the criteria adopted by the 2nd SFC (SSFC) and the 3rd SFC (TSFC) adopted an additional criterion, ‘density of population’ Soon after the submission of the report by the 3rd SFC on December 2008, the government constituted an implementation Committee to ensure the implementation of the recommendations of the 3rd SFC .

With regard to devolution of funds, the Commission recommended a separate devolution component for salaries. Considering the huge financial implications, the state government did not accept this. The Commission has extensively recommended on issues relating to amendment of Act, administrative, technical, functional, etc.

7. CONCLUSION:

Devolution of financial resources to local bodies has been ensured through SFCs. Karnataka has had three SFCs. The 1st SFC constituted in 1994, gave its report in 1996 for the award period of 1997-2002. The 2nd SFC was constituted in 2000 and submitted the report in 2002 and its period was till 2006 -2011. The 3rd SFC constituted in 2006 submitted its report in December 2008 and its award period was 2011-2016. However, owing to the non constitution of the 4th SFC before the expiry of the award period the state government extended the award period of the 3rd SFC till 2017-18. This SFC being the fourth has its award period applicable from 2018-19 to 2022-23.It is pertinent to note that action taken report (ATR) on the recommendations of the three SFCs has not been presented before the legislature as mandated. The task faced by SFC seems to be more difficult than that of the FCs under Article 280 in that, the SFC is required to assess and evaluate the functions of PRIs and ULBs before making recommendations.

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