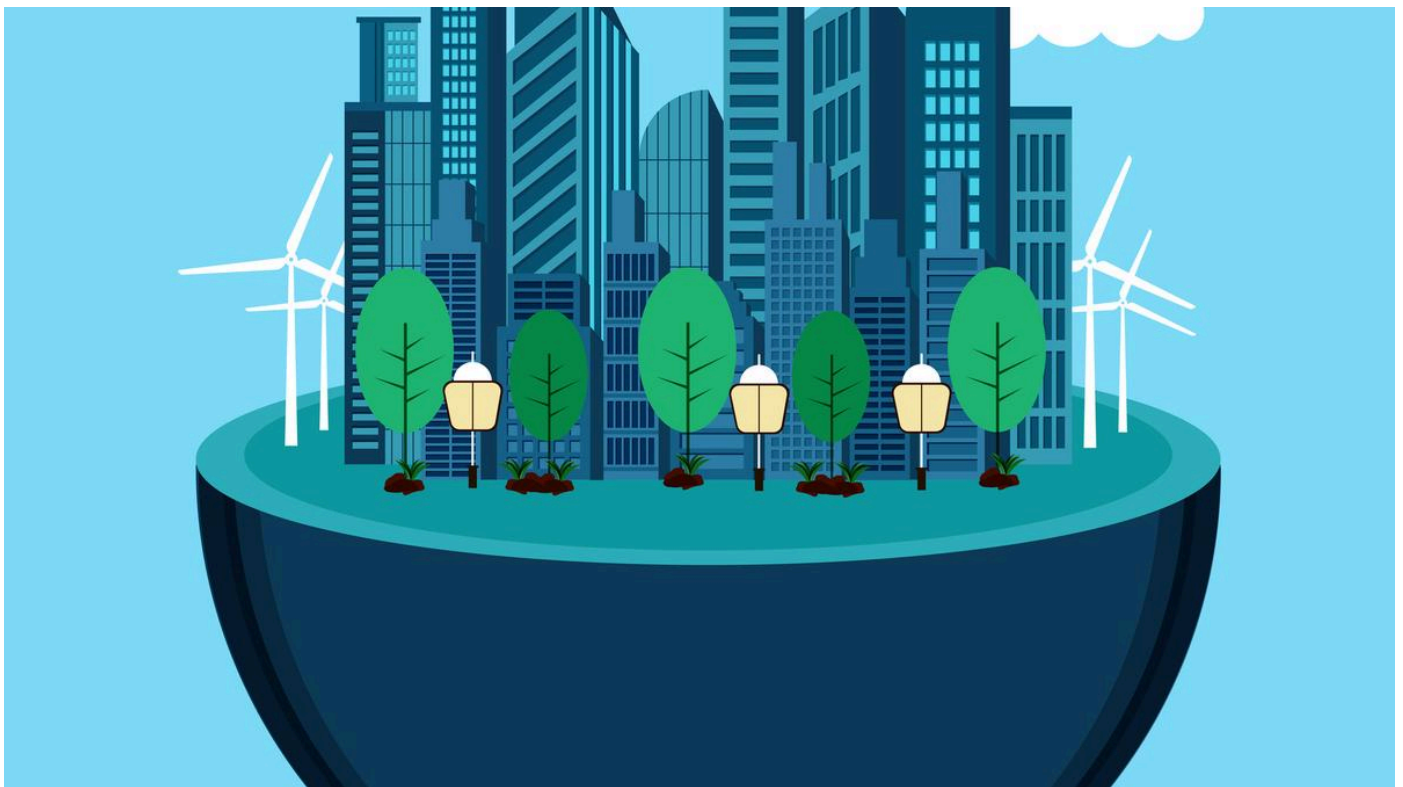


What is on the agenda for the 16th Finance Commission? | Explained

How do other countries devolve funds to their local governments? Why is the Census significant?

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For representative purposes. | Photo Credit: Getty Images

The story so far: The 16th Finance Commission (FC) has begun its work, established under Article 280 of the Indian Constitution, primarily focusing on the devolution of the consolidated fund. Since the 73rd and 74th constitutional amendments, local bodies have gained significant recognition within the federal system. These amendments introduced sub-clauses 280(3)(bb) and (c), which mandate the FC to recommend measures to augment State consolidated funds for supporting panchayats and municipalities.

What about cities?

The National Commission on Urbanisation in the mid-80s described cities as “engines of growth.” Although this view is somewhat narrow, the reality is that cities contribute

around 66% of India's GDP and about 90% of total government revenues. Cities, thus, are an important spatial zone for the overall development of the country. However, our economic scale is insufficient to meet rising needs. **The World Bank estimates that \$840 billion is needed for basic urban infrastructure in the next decade.**

Despite the efforts of five commissions since the 11th Finance Commission, financial devolution to cities remain inadequate. The fiscal health of municipalities is poor, affecting both city productivity and quality of life. Rapid urbanisation without appropriate fiscal action has adverse effects on development. **Intergovernmental transfers (IGTs) to Urban Local Bodies (ULBs) in India are about 0.5% of GDP, much lower than the 2-5% typical of other developing nations.** For instance, South Africa allocates 2.6%, Mexico 1.6%, the Philippines 2.5%, and Brazil 5.1% of their GDPs to their cities. Although IGTs make up about 40% of ULBs' total revenue, issues persist regarding their predictability, earmarking for vulnerable groups, and horizontal equity. IGTs are crucial for ULBs, given their financial state and the need for stable support until their own revenues improve.

What about the taxation system?

The introduction of the Goods and Service Tax (GST) has reduced ULBs' tax revenue (excluding property tax) from about 23% in 2012-13 to around 9% in 2017-18. IGTs from States to ULBs are very low, with State Finance Commissions recommending only about 7% of States' own revenue in 2018-19. Increasing the quantum of IGTs as a percentage of GDP is necessary. Despite the 74th constitutional amendment's aim to financially strengthen ULBs, progress over three decades has fallen short.

The 13th Finance Commission observed that "parallel agencies and bodies are emasculating local governments both financially and operationally." Local governments require support from Union and State governments through funds, functionaries, and technical aid. However, the growth of parallel agencies has distorted local governments' roles. Programs like the Member of Parliament Local Area Development Scheme and the Member of Legislative Assembly Local Area Development Scheme exacerbate this issue, distorting the federal structure.

How important is the Census?

In the absence of the 2021 Census, reliance on 2011 data is inadequate for evidence-based fiscal devolution. India has approximately 4,000 statutory towns and an equal number of Census towns, with an estimated 23,000 villages, all of which are effectively

urban. These figures must be captured by the 16th FC, including the significant migration to Tier-2 and 3 cities.

Thus, the 15th FC's nine guiding principles require a revisit. Not all of them but reference to enhancement in property tax collection in tandem to the State's GST; maintenance of accounts; resource allocation for mitigating pollution; focus on primary health care, solid waste management, drinking water, etc., deserve attention. The 16th FC must consider India's urbanisation dynamism and ensure IGTs to urban areas are at least doubled. A McKinsey Global Institute report warns that if India continues investing in urban infrastructure at current rates, urban infrastructure will fall short, leading to water supply issues and untreated sewage.

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