

## Chapter 5

# Empowering Local Bodies

5.1 All the previous Finance Commissions from the Tenth Finance Commission (FC-X) recommended grants to local bodies with certain variations from time to time. The FC-XIV, in the case of rural local bodies, had, unlike previous Commissions, recommended grants to only gram panchayats and not to the other tiers at the district and block levels. In the case of urban local bodies, no distinction was made among different sizes of municipalities. These grants were distributed between the rural and urban local bodies in the ratio of 70:30. Further, the FC-XIV did not recommend grants to Excluded Areas under the Fifth and Sixth Schedule of the Constitution and to Cantonment Boards in urban areas. The grants recommended by it were in two parts – a basic grant (unconditional) and a performance grant (conditional) in the proportion of 90:10 for duly constituted gram panchayats and of 80:20 for municipalities.

5.2 While considering the grants for local bodies for the year 2020-21, we have made significant departures from the FC-XIV in some of these aspects.

- i. First, after considering the views of all stakeholders, we have decided to recommend grants to all tiers of the panchayati raj so as to enable pooling of resources across villages and blocks to create durable community assets and improve their functional viability.
- ii. Second, we have decided to give grants to the Fifth and Sixth Schedule areas and Cantonment Boards.
- iii. Third, we have provided for tied grants in the critical sectors of sanitation and drinking water in order to ensure additional funds to the local bodies over and above the funds allocated (both Union and State share) for these purposes under the centrally sponsored schemes (CSS), Swachh Bharat and Jal Jeevan Missions.
- iv. Fourth, given the projection of 38 per cent urbanisation in India by 2025 and further acceleration of this trend with economic growth, the changing sectoral composition of gross domestic product (GDP) and rural-urban migration, we believe the share of urban local bodies in Finance Commission grants to local bodies should be gradually increased to 40 per cent over the medium term.
- v. Lastly, we are convinced that larger cities will have a tendency to grow faster with the agglomeration effect. Hence, the fifty Million-Plus cities in the country need differentiated treatment, with special emphasis on meeting the challenges of bad ambient air quality, ground water depletion and sanitation.<sup>1</sup>

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<sup>1</sup>There are fifty such Million-Plus cities in the country, excluding the Union Territory of Delhi, and Union Territory of Jammu and Kashmir (Srinagar). Such cities provide habitation to 38 per cent of the urban population.

5.3 Accordingly, we recommend the following for the year 2020-21:

i. **The total size of the grant for local bodies in twenty-eight States shall be Rs. 90,000 crore. This is equivalent to 4.31 per cent of the divisible pool estimated by the Commission for the first year of the award period. This compares with Rs. 87,352 crore (3.54 per cent of the divisible pool for the year 2019-20) recommended by the FC-XIV for 2019-20.**

ii. The inter se distribution of grants for local bodies among the States may be **based on population and area in the ratio of 90:10** (Annex 5.1). Because of the slower socio-economic progress of the scheduled castes and scheduled tribes relative to the rest of the population, we also recommend that State Governments, while allocating FC-XV funds among local bodies, should place special emphasis on areas with higher concentration of scheduled castes and scheduled tribes populations.

iii. **To begin with, for 2020-21, the proportion of grants between rural and urban local bodies recommended by us is in the ratio of 67.5:32.5.**

iv. **With this new sharing ratio, the recommended allocation for rural local bodies in 2020-21 is Rs. 60,750 crore, which is more or less unchanged from the Rs. 60,687 crore in 2019-20 recommended by FC-XIV.** (Annex 5.1)

v. All the tiers in the panchayats – village, block and district – shall receive the grants. The inter se distribution among the panchayati raj tiers by the States should be done on the basis of the accepted recommendations of the latest State Finance Commissions (SFC) and in conformity with the following bands of 70 per cent-85 per cent for village panchayats, 10 per cent-25 per cent for block panchayats and 5 per cent-15 per cent for district panchayats. In Goa, Sikkim, and Manipur, which have a two-tier system with only village and district panchayats, the allocation will be in the bands of 70 per cent-85 per cent and 15 per cent-30 per cent respectively. Furthermore, in the event of SFC recommendations not being available, the inter se distribution within the panchayati raj tiers should be decided by the State Government within the bands indicated above.

vi. Once the State-level grants are earmarked for each tier, the intra-tier distribution among the relevant entities across the State should be on the basis of population and area in the ratio of 90:10 or as per the accepted recommendations of the latest SFC.

vii. The States should also make allotment of grants for both Fifth and Sixth Schedule areas falling within the State, based on population and area in the ratio of 90:10. The concerned State Government should allot these grants for the year 2020-21 in the month of April 2020 and intimate the same to the ministries of Home Affairs and Finance.

viii. The grants for rural local bodies and for Fifth and Sixth Schedule areas shall be distributed as basic and tied grants in the ratio of 50:50. The basic grants are untied and can be used by the local bodies for location-specific felt needs, except for salary or other establishment expenditure. The tied grants, on the other hand, can be used for the basic

services of (a) sanitation and maintenance of open-defecation free (ODF) status and (b) supply of drinking water, rain water harvesting and water recycling. The local bodies shall, as far as possible earmark one half of these tied grants each to these two critical services. However, if any local body has fully saturated the needs of one category, it can utilise the funds for the other category.

ix. **The total grants recommended for urban local bodies for 2020-21 are Rs 29,250 crore against Rs 26,665 crore recommended for the year 2019-20 by the FC-XIV. (Annex 5.2)**

x. For differential treatment of cities, we have divided the urban local bodies into two categories: (a) fifty Million-Plus urban agglomerations/cities, excluding Delhi and Srinagar, and (b) all other cities and towns with less than one million population. Within a State, the grants recommended across these two categories is on the basis of population. Thus, for urban local bodies, in 2020-21, we recommend Rs. 9,229 crore for the Million-Plus cities and Rs. 20,021 crore for the others. (Annex 5.2)

xi. For the Million-Plus cities/urban agglomerations, the recommended city-wise distribution of grants for 2020-21 is on population basis. In the case of urban agglomerations which contain more than one Million-Plus city, the concerned State Government, in consultation with all such entities within the urban agglomeration, shall entrust one urban local body as a nodal entity to receive the grants. This nodal entity will also have the responsibility of achieving the performance indicators for the entire urban agglomeration. (Annex 5.3)

xii. The States should also make allotment of grants on population basis for the Cantonment Boards within their territories. The list of fifty-nine Cantonment Boards in seventeen States along with the population is at Annex 5.4. For urban local bodies other than Million-Plus cities, the grants should be distributed to each urban local body on the basis of accepted recommendations of the latest SFC suitably modified to accommodate the Cantonment Boards. In case of non-availability of SFC recommendation for distribution within a particular category, the allocations should be on the basis of population and area in the ratio of 90:10.

xiii. For the Million-Plus cities, the Ministry of Environment, Forest and Climate Change (MoEF&CC) as the nodal ministry shall, in consultation with the State Governments, develop city-wise and year-wise targets on ambient air quality based on annual average concentrations of PM10 and PM2.5, monitor and evaluate the improvement and recommend disbursement of grants to such cities. The MoEF&CC shall publish the benchmarks in the beginning of April 2020. We recommend Rs. 4,400 crore in 2020-21 for the purpose of improving ambient air quality (Annex 5.3). This grant shall be released in two equal instalments. The first instalment may be used for air quality improvement measures, including capacity building of the local bodies within the

Million-Plus city/agglomeration, as well as meeting the additional needs of State Pollution Control Boards to appropriately assist the local bodies in monitoring the ambient air quality. MoEF&CC needs to expedite the establishment of an ambient air quality monitoring network, take up source apportionment studies and update the air-quality data for the fifty Million-Plus urban local bodies on the Ministry's website on a timely basis. To incentivise improvement in air quality in Million-Plus cities, the second instalment shall be disbursed against the stipulated performance-based outcomes in terms of year-on-year improvement in air quality in January 2021 (Annex 5.5).

xiv. In case of non-achievement of improvement targets by cities, the balance distributable fund would be divided equally in two parts. Fifty per cent will be distributed to cities in a manner so that top performers (>5 per cent improvement) get 40 per cent of the amount, second best performers (4-5 per cent improvement) get 35 per cent and third best performers (3-4 per cent improvement) get 25 per cent. The MoEF&CC, in consultation with State Governments, shall distribute the remaining 50 per cent of the funds amongst the non Million-Plus cities in proportion to their population. The eight Million-Plus agglomerations of Kannur, Kochi, Kollam, Kozhikode, Malappuram, Thiruvananthapuram and Thrissur in Kerala and Coimbatore in Tamil Nadu, where air quality is not a problem partly because of locational reasons, the full amount of FC-XV grants may be used for improving conservation, supply and management of water and efficient solid waste management.

xv. We are also deeply concerned with the issue of 'ease of breathing' in the National Capital Region (NCR), especially the extremely hazardous levels of pollution in October-November of each year. One of the main reasons for this is the burning of crop residue in the surrounding States of Haryana, Punjab and Uttar Pradesh. We are unable to make an allocation to address this as Delhi is not a State. Besides, the pollution hazard in the NCR is very unique as the air-shed contributing to pollution extends to three neighbouring States. We, therefore, recommend that the Union Government constitute a high power committee, consisting of the ministries of Finance, Environment, Forest and Climate Change and Agriculture and Farmer Welfare, the Governments of Haryana, Punjab and Uttar Pradesh, to devise, implement and monitor a time-bound action plan for pollution mitigation under the National Clean Air Programme.

xvi. For the Million-Plus cities, Rs. 4,829 crore have been earmarked for improving conservation, supply and management of water and efficient solid waste management (Annex 5.3), which are critical for planned urbanisation. For water and solid waste management, the Ministry of Housing and Urban Affairs (MoHUA), as the nodal ministry, shall, in consultation with the State Governments, develop city-wise and year-wise targets for 2020-25 and recommend disbursement of grants to such cities. The targets will be improvements over the base year to provide incentives to make up for any slippage in performance during the years succeeding 2020-21. For 2020-21, while no

conditions may be applied for release of the Rs. 4,829 crore recommended by us, the amount shall be spent exclusively for improving water and solid waste management and achieving of star ratings by the urban local bodies. In 2020-21, the States need to draw up a detailed project report for capacity development and address the infrastructural issues for meeting the service level benchmarks. (list detailed at Annex 5.6)

xvii. For urban local bodies other than in Million-Plus cities, we recommend an allocation of Rs. 20,021 crore consisting of two equal parts - 50 per cent basic grants and 50 per cent grants tied to (a) drinking water (including rainwater harvesting and recycling) and (b) solid waste management (Annex 5.6). These urban local bodies shall earmark one half of the tied grants each to these two critical services and this amount will be in addition to the funds received from relevant CSS like Swachh Bharat Mission and Atal Mission for Rejuvenation and Urban Transformation (AMRUT) and other similar schemes being implemented by the States. These grants shall not be used as a substitute for either Union or State share of such schemes. However, if any local body has fully saturated the needs of one category, it can utilise the funds for the other category.

*Fifteenth Finance Commission*

xviii. The summary of above recommendations is as follows:

Total Grant	Nature of Grant	Mode of Disbursement
<b>Rural Local Bodies</b>		
Rs 60,750 crore	50 per cent basic 50 per cent tied to: (a) sanitation and maintenance of ODF status (b) supply of drinking water, rain water harvesting and water recycling.	The inter se distribution amongst the panchayati tiers – village, block and district – by the States should be on the basis of the accepted recommendations of the latest SFCs and in conformity with the following bands of 70 per cent-85 per cent, 10 per cent-25 per cent, and 5 per cent-15 per cent for village, block and district panchayats, respectively. In Goa, Sikkim and Manipur, where a two-tier system with only village and district panchayats is in place, the allocation will be in the band of 70 per cent to 85 per cent and 15 per cent-30 per cent. If the SFC recommendation is not available, the inter-se distribution within tiers should be decided by the State Government within the bands indicated above. Grants to Fifth and Sixth Schedule Areas within the State should be on the basis of the population and area in the ratio of 90:10.
<b>Urban Local Bodies</b>		
Million-Plus cities/agglomerations Ambient air quality Rs. 4,400 crore	Ambient air quality - 50 per cent for air quality improvement measures, including institution building; 50 per cent based on performance in year-on-year improvement in air quality.	For Million-Plus cities/urban agglomerations, the city-wise distribution of grants for 2020-21 is on population basis (Annex 5.3)
Service Level Benchmarks Rs. 4,829 crore	Service Level Benchmarks: 100 per cent grants tied for improving water and solid waste management and achieving of star ratings by the urban local bodies	
Other than Million-Plus cities Rs. 20,021 crore	50 per cent basic 50 per cent tied to: (a) drinking water (including rainwater harvesting and recycling) and (b) solid waste management	On the basis of recommendations of the latest SFC. In case the SFC recommendation is not available for distribution within a particular category, allocations should be based on population and area in the ratio of 90:10. The States should also make allotment of grants on population basis for the Cantonment Boards within their territories.

xix. Grants to all rural and urban local bodies (other than Million-Plus category) shall be released in two equal instalments in June 2020 and October 2020. For Million-Plus cities/urban agglomerations, disbursement of the respective grants shall be done on the recommendations of the MoHUA and MoEF&CC.

xx. The States shall transfer grants-in-aid to the local bodies within ten working days of receipt from the Union Government. Any delay beyond ten working days will require the State Governments to release the same with interest as per the effective rate of interest on market borrowings/State Development Loans (SDLs) for the previous year.

xxi. The importance of mobilisation of own revenues by self-governing local bodies cannot be overemphasised. It leads to better ownership and accountability. Internationally, property tax is one of the most effective instruments for revenue mobilisation by local bodies. For historic reasons as well as because of vested interests, property tax yields remain negligible in India. We recommend that to qualify for any grants for urban local bodies in 2021-22, States will have to appropriately notify floor rates and thereafter show consistent improvement in collection in tandem with the growth rate of State's own GSDP.

xxii. The timely availability of audited accounts – separately at the local body level and jointly at the State and all-India level – continues to be a persistent problem despite the emphasis laid by previous Commissions. We consider such availability of accounts online, both before and after audit, of individual local bodies and at the State and all-India level a critical reform agenda. With the help of modern digital infrastructure, a receipt or expenditure can have the necessary characterisation at the input stage itself. This will enable appropriate processing of data to produce the various required reports.

xxiii. In this context, for rural local bodies, it is high time to transit to an upgraded accounting code structure of the Panchayati Raj Institutions Accounting Software (PRIAsoft) system from the current four levels to the six-level structure followed by the Union and State Governments. Further, such upgraded PRIAsoft needs to be integrated with Integrated Financial Management Information System (IFMIS) of the State Governments (wherever it exists) and the Public Financial Management System (PFMS) of the Controller General of Accounts (CGA) in order to generate online accounts by each rural local body, enable online auditing of such accounts and their consolidation at the State and all-India level.

xxiv. For urban local bodies, the National Municipal Accounts Manual (NMAM) developed by the MoHUA required all State Governments to draft State-specific municipal accounts manuals. Thus, at present urban local bodies are following NMAM or State-specific manuals based on NMAM. Each urban local body needs to generate online accounts by taking advantage of IFMIS/PFMS after it is duly integrated by using appropriate IT tools. The MoHUA shall put these online accounts on a common platform,

*Fifteenth Finance Commission*

thus having consolidated accounts, both before and after audit, at the State and all-India levels.

xxv. In view of above, this process shall be in two stages. First, the integration of the PRIASoft and NMAM systems with the State-level IFMIS and, subsequently, with PFMS to achieve complete integration. In 2020-21, under the guidance of the Comptroller and Auditor General (CAG), the concerned ministries and CGA shall develop an integrated account maintenance system as stated above on trial basis by the States before 31 March 2021, and ready for full roll-out from 1 April 2021.