PROCEEDINGS OF THE GOVERNMENT OF KARNATAKA

Subject:	Devolution of funds to the Panchayat Raj Institutions and Urban Local Bodies on the recommendations of the Third State Finance Commission

READ: 1) Govt. Notification No: FD 8 ZPA 2006 Dated: 28.8.2006

PREAMBLE:

In the Government Notification read at (1) above, Government had constituted the Third State Finance Commission (TSFC) as required under Article 243-I and 243-Y of the Constitution of India to review financial position of the Panchayats (PRIs) and Municipalities/Urban Local Bodies (ULBs) and make recommendations to the Governor regarding matters affecting their finances. The terms of reference of this Commission are detailed in the said notification. The TSFC has submitted its final report to the Government in December 2009. As the recommendations of the Second State Finance Commission (SSFC) were implemented from 2006-07 to 2010-11, the recommendations of the TSFC have to be implemented from financial year 2011-12 until 2015-16.

On devolution of finances, the main recommendations of TSFC are as follows:

a. 33% of the Net Own Revenue Receipts (NORR) of the State Government should be distributed to the PRIs and ULBs, out of which 23% should be provided to PRIs over and above salary expenditure of PRI officials and remaining 10% should be provided to ULBs.

b. Grants to Gram Panchayats (GPs) should increase from existing Rs.338 crore to Rs.804.50 crore per year.

c. Grants amounting to Rs.600.50 crore per annum should be given to Zilla Panchayats (ZPs) and Taluka Panchayats (TPs). Out of this untied grants ranging from Rs.5 to 10 crore per annum should be given to ZP based on rural population and untied grants ranging from Rs.1 to 4 crore per annum to Taluk Panchayats based on their backwardness.

Subsequently the Government analysed the report of the TSFC and examined in detail the implementabilty of the recommendations with regard to devolutions and its overall implications on the available resources of the State if the recommendations are accepted in full. If the recommendations on devolution are accepted fully, then the total devolution to the local bodies will increase from existing 40% to 52.3%. The increase in devolution to local bodies would be 76% in 2011-12 as compared to 2009-10, with a corresponding increase of only 40% in Non Loan Net Own Revenue Receipts (NLNORR) over the same period. Funds left with the State Government for its overall responsibilities would be limited to the balance 47.7% of NLNORR, devolution of central taxes and borrowings limited by the fiscal deficit. Only Rs.2671 crore out of the total incremental growth of NLNORR would be available with the State Government for the entire increase in its expenditure over two years.

A clear inference from this analysis is that the responsibilities of the State Government (both development and regulatory) have not been considered appropriately in the recommendations even though the terms of reference of the TSFC had mandated it to do so. In view of the above, the Government is of the view that the implementation of the recommendations of TSFC in toto will have severe adverse impact on financial ability of the Government to shoulder its overall responsibilities and hence the following order:

GOVERNMENT ORDER NO: FD 1 ZPA 2009 DATED:31st OCTOBER 2011

After having studied the recommendations of TSFC on devolution, the Government in partial modification of these recommendations, is pleased to order the following:-

1. The recommendations of the TSFC as modified by this Government Order would be applicable from FY 2011-12 to FY 2015-16.

2. Total funds to be devolved to local bodies is increased from the current 40% to 42% of the Non Loan Net Own Revenue Receipts (NLNORR) of the State;

3. Out of this 42%, 32% of NLNORR would be assigned to PRIs. This would be inclusive of their salary expenditure;

4. In the case of ULBs, their share would be increased from the current 8% to 10% of NLNORR (including their salary expenditure), over a four year period by increasing the share by 0.5% every year as shown below:

ULB Share	2011-12	2012-13	2013-14	2014-15	2015-16
% of NLNORR	8.50%	9.00%	9.50%	10.00%	10.00%

5. During the TSFC implementation period, devolution to ULBs would be under the categories of Entry Tax Devolution and Other Devolution. Since the entry taxes are largely collected in the urban areas, the entire entry tax proceeds would be assigned to the ULBs. The entry tax collection in 2011-12 is estimated to be around Rs.1510 crore, which will be around 3.3% of the NLNORR. This amount would be devolved directly. The balance required share to ULBs would be met under 'Other Devolution'. Hence the devolution under the heads Entry Tax Devolution and Other Devolution would be as follows:

Devolution to ULBs	2011-12	2012-13	2013-14	2014-15	2015-16
Entry Tax devolution (in Rs. crore)	1510 (3.3%)	*As per actual collection*			
Other devolution (% of NLNORR)	5.2%	5.7%	6.2%	6.7%	6.7%

6. To ensure that the overall mandated devolution to ULBs is achieved annually as per the targets fixed at para 4 above, any shortfall in actual collection and transfer of Entry Tax (i.e. below 3.3% of NLNORR), would be made good by transfer of equivalent additional funds under 'Other Devolution' to the ULBs.

7. It is desirable to have a system where all components being earmarked under Global Protection and Global Provision, attributable to a particular ULB, are earmarked in the same ULB's SFC allocation after applying the devolution formula on the entire SFC allocation. For a start, from F.Y 2012-13 onwards salaries, pension contribution and power sector dues would be clubbed together and earmarked in the individual ULB's allocation as per devolution formula. However over the implementation period of TSFC, efforts would be made to earmark debt servicing also from individual ULB allocation. Urban Development Department would separately issue a G.O indicating the devolution formula to be used for inter-se allocation of TSFC funds among ULBs.

8. For the Panchayat Raj Institutions, following annual grants would be provided:
   a. Rs. 8 lakh per Gram Panchayat (G.P)
   b. Rs. 1 crore per Taluka Panchayat (T.P)
   c. Rs. 2 crore per Zilla Panchayat (Z.P)

The above mentioned grants would be revised appropriately in due course based on overall fiscal situation and impact of GST on the State finances.

By Order and in the name of
the Governor of Karnataka

(M.K.BHARMARAJAPPA)
Under Secretary to Government,
Finance Department (Exp.5)

31/10

To
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