# Annexure – 16
# Government Order regarding implementation of Second SFC recommendations issued by Finance Department, GOK (G.O.No.FD 338 Exp-9/2006, Dated:29.06.2006)

**PROCEDINGS OF THE GOVERNMENT OF KARNATAKA**

Sub: Devolution of funds to Urban Local Bodies and Panchayath Raj Institutions on the recommendations of the Second State Finance Commission.

Read: 1. G.O.No FD 09 ZPA 94. dated 31.3.97.

**Preamble:**

1. The Second State Finance Commission (SSFC) was set up on 25th October 2000. The final report was presented during Dec. 2002/Jan 2003. The Terms of reference of the Commission were:

   (a) Determination of the Principles Governing the distribution of the proceeds between ULBs and PRI's.
   (b) Measures needed to improve the financial position of the ZP's, TP's, GP's and ULB's.
   (c) Examining and suggesting the best utilization of expenditure of these bodies.
   (d) Detailed analysis of repayment of loans and advances extended by Government from time to time making suitable recommendations for repayment of Government dues and the possibility of adjusting these dues against future devolution by Government to these bodies.

2. Summary of Recommendations:

   (a) The Second State Finance Commission (SSFC) recommends continuation of the system based on devolution NLGORR, out of the NLGORR of the State Government, and net sharing from the selected taxes.

   (b) To strike a balance in ensuring requirement of funds of local bodies and the State Government, the 2nd State Finance Commission has adopted a "Balanced Finance Allocation Approach".

   (c) Quantum of Devolution: As against 36% NLGORR recommended by the Ist State Finance Commission, as the share of the PRI's and ULB's. the 2nd State Finance Commission recommends this share to be increased to 40% of NLGORR of the State Government.

The following are the indicators and weightages.

While retaining the two indicators viz., Population and Area, the Second State Finance Comunission has formulated an Index of Backwardness

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consisting of Illiteracy Rate, Proportion of Scheduled Caste & Scheduled Tribe Population and Population per bed in Government Hospitals (5.36).

ii) Regarding weightage, second State Finance Commission has assigned a lighter weightage to Index of Backwardness by increasing it to 40 percent. This is to enable backward areas to get their due share in the allocation of State revenues. The Second State Finance Commission has assigned a weightage of 30 percent each to Population and Area (5.37 & 5.38)

iii) Considering the influence of three indicators of backwardness of educational, social and economic aspects of the society, the Second State Finance Commission has assigned weightage to the indicators of backwardness as follows: (5.53).

| Indicators of Backwardness | Weightage |
|---|---|
| 1. Illiteracy rate | 15 percentage |
| 2. SC & ST Population | 15 percentage |
| 3 Persons per hospital bed | 10 percentage |
| Total weightage for index of backwardness | 40 percentage |

(iv) The Second State Finance Commission also examined whether population below poverty line and per-capita income could be used as indicators. Due to limitations of availability of data for a divide between rural and urban, these two indicators could not be used (5.47 & 5.48)

(v) The weightages assigned to each of the indicators for the divide between Panchayat Raj Institutions and Urban Local Bodies is as follows.

| Criteria for PRIs | Weights | Criteria for ULBs | Weights |
|---|---|---|---|
| Proportion of rural population | 19.81% | Proportion of urban population | 10.19% |
| Proportion of rural area | 29.33% | Proportion of urban area | 0.67% |
| Proportion of Rural SC/ST population | 11.75% | Proportion of Urban SC/ST population | 3.25 |
| Proportion of rural illiterates | 12.03% | Proportion of urban illiterates | 2.97% |
| Ratio of rural population per hospital bed | 7.50% | Ratio of Urban population per hospital bed | 2.50% |
| Total weight | 80.42% | Total weight | 19.58% |
| Rounded off to | 80% | Rounded off to | 20% |

a) As against the allocation of 30.60 percent to Panchayat Raj Institutions and 5.40 percent to Urban Local Bodies out of NLGORR as recommended by the First State Finance Commission, the Second State Finance Commission recommends that 32 percent (i.e. 80 percent of 40 percent of NLGORR) should go to Panchayat Raj Institutions and 8 percent (i.e. 20 percent of 40 percent of NLGORR) should go to Urban LOcal Bodies out of NLGORR. This proportion is after taking into consideration the percentage increase in urban population, needs of new areas brought under Urban LOcal Bodies and the responsibilities they have for new demands such as solid waste management (6.18 &6.19)

b) As far as Grama Panchayats are concerned a fixed amount is being released as untied funds each year. The same approach should be continued. Therefore, the application of indicators and weightages is not resorted to in respect of Grama Panchayats. The State should provide a uniform rate of block grants with an incremental increase every year. In the first year, the allocation should be Rs.3.50 lakhs per Grama Panchayat and in the subsequent four years it should be increased at the rate of Rs.25,000 (Rupees twenty five thousand) per Grama Panchayat per year (6.38, 6.39 & 6.40)

c) The inter-se allocation among the Urban Local Bodies has been worked out on the basis of indicators and weightages viz., Population (67 percent weightage), illiteracy rate (33 percentage weightage). There is no justification to distribute the funds based on salary requirements and it should be done away with and individual Urban Local Bodies should be made responsible to meet the salary of their employees as a direct responsibility. (6.52)

d) In order to facilitate developing a comprehensive database, computerization, development of software required for Urban Local Bodies, training, preparation of draft documents pertaining to contracts, agreements, tenders, manuals, studies and surveys etc., the Second State Finance Commission recommends that a 'Common Purpose Fund' should be created to serve all the Urban Local Bodies. A sum of Rupees five Crore should be set apart each year out of the total share of the Urban Local Bodies as per devolution recommended by the Second State Finance Commission (6.46, 6.47 & 4.68)

e) The Second State Finance Commission is not in favour of writing-off of any part of the dues with a view to ensuring financial responsibility on the part of the Urban Local Bodies. The allocation recommended by the Second State Finance Commission will result in significant improvement in the financial position of Urban Local Bodies, in addition to capital value based taxation system due for implementation by Urban Local Bodies. The Second State Finance Commission recommends that as an incentive for regular repayment of loan

installments, the State Government should give the interest part of the loan installments due as subsidy. This should be outside the devolution recommended for Urban Local Bodies. The subsidy towards interest should be given only to those Institutions who make regular repayment of loan installments. The LIC and HUDCO loan installments may also be paid by Government by adjusting the same from the devolution of funds to individual Urban Local Bodies in respect of those who are not paying installments regularly. (7.9 & 7.10)

f) Incentive scheme is designed to encourage Grama Panchayats to maximize their revenue mobilization. An amount of Rs. 10 crore should be earmarked during each year for the incentivisation scheme to Grama Panchayats. The incentive fund may be increased after two years if the State Government finds that this scheme has had the desired impact on the performance of Grama Panchayats. Incentive fund should not be diverted for any other purpose. Incentive fund should be allocated among all the districts in proportion to the number of Grama Panchayats in each district. Amount under the incentive fund should be released directly to Zilla Panchyats. For Urban Local Bodies, an Incentive scheme should be formulated by the Government, on similar lines as recommended by the Second State Finance Commission for Grama Panchayats, after two years of implementation of the capital value based taxation system (9.20).

Views of RDPR and Urban Development Department were taken on Recommendations of Second State Finance Commission. After examining the same in detail Government is pleased to order as follows:-

GOVERNMENT ORDER NO. FD 338 Exp-9/2006 DATED 29-06-2006.

Government are pleased to order the following:-

1) Instead of using NLGORR as basis for devolution, Non-Loan Net Own Revenue Receipts (NLNORR) i.e. NLGORR net of non-plan cost of revenue collections, and cesses should be used as a basis for devolution.

2) As PRI share in case SSFC recommendations are accepted is likely to be lower than the current devolution, the formulation proposed by SSFC is restricted to the ULB share only. Here too, 20% share should be achieved in a graduated fashion starting from 2005-06 financial year as was the decision on the first SFC's recommendation.

| ULB share | Y1 | Y2 | Y3 | Y4 | Y5 |
|---|---|---|---|---|---|
| % of NLNORR | 6.00% | 6.5% | 7.0% | 7.5% | 8.0% |

3) The PRI's will continue to receive untied developmental grants at current levels subject to prompt to clearance of user charges levied by public utilities. As the current levels of grants are much higher than that

installments, the State Government should give the interest part of the loan installments due as subsidy. This should be outside the devolution recommended for Urban Local Bodies. The subsidy towards interest should be given only to those Institutions who make regular repayment of loan installments. The LIC and HUDCO loan installments may also be paid by Government by adjusting the same from the devolution of funds to individual Urban Local Bodies in respect of those who are not paying installments regularly. (7.9 & 7.10)

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3) The PRI's will continue to receive untied developmental grants at current levels subject to prompt to clearance of user charges levied by public utilities. As the current levels of grants are much higher than that

recommended by the SSFC, no increases would be made for the SSFC period and any incentivisation would have to be fashioned within the existing level of grants.

4) Urban Development Department vide its G.O. No.UDD 121 SFC 2005, dated 12.4.2006 has indicated a formula for inter-se allocation of untied funds among ULB's, the same would be used for inter-se allocation of untied funds.

By order and in the name of
Governor of Karnataka

(V.VENKATESHA MURTHY).
Under Secretary,
Finance Department (Exp.3&9).

To:

1. The Accountant General, Karnataka, Bangalore,
2. The Commissioner, Bangalore Mahanagara Palike, Bangalore.
3. The Director, Municipal Administration, Bangalore.
4. The Director o Treasuries, Bangalore,
5. The Comptroller, State Accounts Department, Bangalore,
6. The Deputy Commissioner's of all Districts,
7. The District Treasury Officers of all Districts,
8. The Commissioner's of Mahanagara Palike, Hubli-Dharwad, Mysore, Mangalore, Gulburga, Belgaum and Bellary.
9. The Commissioner's of All CMC's.
10. The Chief Officer's – all TMC/TPS.
11. The Principal Secretary to Hon'ble Chief Minister,
12. The Principal Secretary to the Govt, RDPR,
13. The Private Secretary to Chief Secretary
14. The Private Secretary to Principal Secretary, Finance Department,
15. The Private Secretary to Principal Secretary, Urban Development Department
16. The Private Secretary to Secretary (exp) Finance Department.
17. The Private Secretary to Secretary, Urban Development Department
18. The P.A to Deputy Secretary (B&R) Finance Department
19. The PA to Dy.Secretary-III, Finance Department
20. Cabinet Section, No.C.59/2006.