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BACKGROUND

1A.1 A few features of these Union Territories need to the kept in mind. These UTs are located in diverse far flung parts of the Indian Union. They are rather tiny in size compared to the other states in India. However due to their historical legacy they have not had administrative links with other nearby states and have been governed as separate administrative units. Daman & Diu were for centuries ruled by the Portuguese (along with Goa) and after Goa became an independent state in 1987 they continued as Union Territories. To add to the complication Daman & Diu are separated at a distance of more than 700 kms from each other. Dadra & Nagar Haveli was also liberated from Portuguese role and set up as Mukta Pradesh which became a separated Union territory in 1961. It is a tiny set-up of a mere 72 villages. The Andaman and Nicobar islands is the largest archipelago system in the Bay of Bengal and is more than a thousand kilometres from the mainland. It was initially a British penal settlement and was later upgraded in 1874 with a Chief Commissioner being appointed as the Administrator. Today it is run by an Administrator appointed by the President of India. The Lakshadweep group of Islands are in the Arabian sea and have been governed separately from the neighbouring state of Kerala (though the people of Lakshadweep have historical bonds both social and economic with people from Kerala).

1A.2 The cost of running these tiny administrative units is very high and from all parameters of good governance especially fiscal discipline it is difficult to make a case for them to have a full fledged bureaucratic paraphernalia like all State Governments. The percentage of government employees to the total population is phenomenally high. The non-plan expenditure is also very high in these UTs. Moreover the total tax and non-tax receipts on a per capita basis are abysmally low, although they are a part of the consolidated fund of the Government of India.

1A.3 Hence, a case can be made out that these administrative units are not viable and should be merged with nearby states. For instance Daman & Diu and Dadra & Nagar Haveli can be merged with Gujarat, Lakshadweep with Kerala and Andaman & Nicobar with either Tamil Nadu or West Bengal or Andhra Pradesh. However this view goes against their very origin and ethos. They have always had an independent status and to merge them with nearby States would go against their historical legacy. Having been run as independent administrative units all these years it would go against the local sentiment and tradition to merge them with the nearby larger States. The historical legacy of these territories is being preserved by keeping them as separate union territories despite their high administrative cost and also of high unit cost of provisioning of public services. These UTs are often tiny hamlets less than the size of a district in the nearby states and yet have all the bureaucratic apparatus of a State Govt, replete with a Secretariat and all others trappings.

1A.4 The Union territories of Andaman & Nicobar and Lakshadweep also need huge funds to help them in their developmental efforts. As these regions are remote and are in inhospitable terrain, the costs of construction and unit cost of providing public services are very high. All goods have to be transported from the mainland. As there is practically very little activity in the private sector the impetus is solely with the Government. Coupled with the high cost of administration it would be difficult to run these territories on the lines of other State Governments. Their sources of revenue are negligible and most of the money is provided as grant-in-aid by the Central Government. These territories are high cost economies. Government expenditure is literally propping up the economy and also providing employment. Without government support the economy would collapse. It is a classic case of market failure in some sense. Government spending injects vigour into the economy and this is its lifeblood. If merged into the nearby states, their special needs for funds and autonomy would be ignored. Their separate identity would be merged into the larger state and their unique heritage would disappear. Their need for additional funds would also be like a cry in the wilderness seldom heard and not responded to at all.

1A.5 Hence, as all these union territories have a unique historical background, their rich and distinct socio-cultural milieu needs to be preserved and protected. For this reason it is essential to maintain their unique identity despite the high cost of the administration. This is recognised by the Finance Commission and given its due importance. In attempting to fine tune fiscal managements of these UT administrations and providing for efficiency and economy in expenditure the Commission has kept the ground realities of a high cost economy and over-administration in focus.

1A.6 Another point the Finance Commission has kept in mind is that for strategic and environmental reasons the island territories of Andaman & Nicobar and Lakshadweep cannot be opened up to their full economic potential. Hence, popular projects like free trade zones, free ports and unbridled setting up of factories, extraction of timber, mining and quarrying have not been recommended. The long term development goals of these territories have been kept to a fairly modest degree, keeping in mind the fragile ecology. No radical development plan has been postulated.

1A.7 Hence, the Finance Commission has been rather sedate in its approach. It has sought to make suggestions which preserve the separate identity of the territories and yet at the same time propose development plans which blend these far flung territories with the national mainstream. The aim is to propose development plans which project a steady growth rate of the economy and yet fulfil the legitimate democratic aspiration of the people. This pre-supposes a generous dose of capital infusion from the Central government. Yet at the same time an attempt is being made by this Finance Commission so that fiscal prudence is maintained and the economy reaches its full potential within the constraints just enumerated.

1A.8 A vital feature that the Finance Commission has kept in the backdrop while preparing this report is that the Panchayats and Municipalities are the only democratic forum in these Union Territories (apart from providing a representative in the Lok Sabha). Hence, it is essential that these institutions of local self-government being of rather nascent origin have to be given due importance by providing funds, functions and functionaries so that they are able to discharge their obligatory functions to the desired satisfaction level of the people. The democratic aspirations of the people have to be fulfilled. These forums have to address the genuine requirements of the people and have to perform their tasks in a harmonious manner with the bureaucratic set-up in the Union Territories.

1A.9 This is the Third Finance Commission to be set up by the Home Ministry. The First Finance Commission submitted its report in 1998. The Second Finance Commission submitted its report in 2002. A summary of their recommendations pertaining to the local bodies, resources of the UTs and administrative set-up is given below. The detail can be seen in the Annexure to this report.

Recommendations of First Finance Commission

1. Recommendations Related to Local Bodies

Assets: the First Finance Commission recommended that transfer of assets should be done on priority basis. Assets creation by local bodies should emphasise durability and generation of surplus for further investment. These assets should not remain undisposed for long period.

Devolution of Functions and Functionaries: Commission recommended that UT administration should immediately transfer all implementation, regulatory, advisory and other functions to the local bodies as envisaged in the Constitutional provisions for the functions to be devolved to the local bodies. UTAs should also ensure availability of minimum staff strength for which they will either bear the expenditure or transfer adequate funds. Control of staff should vest in local bodies.

The responsibility for planning and implementation of schemes under ACA and CSS should be transferred along with funds and staff to local bodies.

Resources: Commission recommended that 20 % of annual plan outlay of UTA should be earmarked for the local bodies. Each GP, PS and ZP may be considered entitled to annual grant of Rs. 3, 5, and 10 1akh per annum respectively. They are also entitled to a fixed grant of Rs. one lakh for GP, Rs. three lakh for PSs and Rs. five lakh for ZP/MC for efficient utilization bi-annually.

The Net proceeds collected by Zilla Parishad should be distributed annually among the gram Panchayats. Local bodies should consider generating income from activities such as garbage collection. The Commission also recommended ad-hoc amount for rural infrastructure and Municipal Development Fund for urban sectors.

Decision of the Government: All recommendations were accepted by the ministry. Government decided that at least 5% of total funds should be earmarked for Panchayats and this fund should be untied.

Direction issued to UTs: The Union Territory Administrations were directed to take note of decision taken on recommendations.

2. Recommendations Related to Resources of UT

The Commission recommended to the UT administrations to achieve a positive balance on revenue account by reduction on non-plan allocation and stepping up their collection of tax and non tax revenue. It recommended a 10% annual reduction in the non plan allocation of the UTs till the gap between receipts and Non-Plan expenditure is reduced in real term to 60% of the total allocation. To raise resources apart from widening of the tax net, it suggested a review of tax laws and better intelligence sharing between different departments. The Commission also suggested that maximum tax rate may be done away. The Levy of some taxes such as property tax should be made compulsory. Revenue eroding exemptions should be reviewed and authority to decide exemptions should vest in the local bodies. A corpus of development fund should be created at the level of MHA for financing remunerative projects in the UTs.

Decision of the Government: Except reduction in the non plan allocation of the UTs and creation of corpus of development fund at the level of MHA all recommendations were accepted.

Government rejected the 10% annual cut in the non-plan allocation of the UTs citing steep rise in inflation and additional burden of service and maintenance of assets created under plan. Since plan and non-plan expenditure of UTs is met from consolidated fund of India therefore government rejected a separate corpus of development fund.

Direction issued to UTs: The Union Territory Administrations were directed to take note of decision taken on recommendations.

3. Recommendations Related to Administrative Reforms

The Commission recommended UT administration should complete review, updating and framing of subordinate legislation which would provide the local bodies with enabling rules and by-laws. It also recommended that discretionary powers must be curbed or minimized at all levels and information regarding spending of mobilized resources should be shared with citizens.

Decision of the Government: All recommendations were accepted by the ministry.

Direction issued to UTs: The Union Territory Administrations were directed to take note of decision taken on recommendations.

As mentioned earlier, the second Finance Commission submitted its recommendations in 2002. A summary of its recommendations focusing on revenue augmentation, devolution mechanism from the UTs to the Panchayati Raj Institutions, focus on administrative reforms and path for future development is given below. The complete details are in the Annexure of the Report.

Revenue Augmentation

The Commission suggested an approach of "Normative Assessment for Fiscal Needs" in terms of provision of core civic services like water supply, sanitation, waste disposal and sewerage facilities, roads and streetlights and the maintenance of these in order to arrive at the actual necessities of the local bodies. To augment the revenue resources of the Local Bodies, the Commission recommended that taxes on professions, trade and calling should be assigned to the local bodies and the the local bodies should be made autonomous in regard to any new tax they want introduce or for revising the existing tax rates.

The Home Ministry accepted most of these proposals and asked the UT administration to take necessary action. With regard to property tax, the Commission recommended the use of Unit Area Method (UAM) to determine the Annual Ratable Value (ARV) for imposition of Property Tax. Each UT administration should set up a Central Property Tax Valuation Cell staffed with experts for evaluation of properties and determination of tax rates. The UT administration was also envisaged to play a proactive role in assisting local bodies to collect accumulated arrears.

Devolution Mechanism

The Commission recommended that net proceeds from tax receipts of UT administration should be shared with the local bodies, along the lines it is shared by the State Governments with local bodies. The Commission however did not spell out specific proportion of net tax proceeds that should be shared with local bodies.

The inter se distribution of resources between the Village Panchayats (VPs) and District Panchayat (DPs) should be in the ratio of 75:25. The devolution of grants should be utilized for payment of salaries and wages, maintenance of core civic services and execution of statutory obligation (public health, hygiene etc.) by the local bodies.

The recommendations were accepted by the ministry and UT administration was directed to work accordingly. Necessary funds are to be arranged by the UT administration to avoid a deficit in the budgetary provision of the Panchayati Raj institution.

Accounting System

The Commission stressed that audit and account procedures of the UTs need to be strengthened at least at comparable levels those exercised in States. Government transactions and receipts should be recorded according to a common budget format and the coding mechanisms of accounting heads by central and state government should be followed by local bodies as well.

The recommendations were accepted by the ministry and UT administrations were directed to work accordingly. The audit of local bodies is being carried out by the internal audit wing of the Pay and Account Office.

Administrative Reform

The Commission recommended the setting up of an Administrative Reforms Commission to deliberate on the administrative structure of the UT Administrations and find ways of making the administrations leaner and more responsive and also cater to the emergent demands of local bodies for more staff.

The recommendations were accepted by the ministry and UT administration was directed to work accordingly.

Future development

The 2nd Finance Commission is of the view that the guidelines laid down by the Expert Group 'Island Development Possibilities' for Andaman & Nicobar Islands and Lakshadweep has not translated into actionable points and recommends that the guidelines be adopted as was originally intended. Moreover, the Commission also recommended that although Daman & Diu and Dadra & Nagar Haveli are not island territories but they should come under the ambit of island Development Authority (IDA).

The recommendation of IDA are implemented in letter and spirit however administration declined to comment on bringing the non-island territories within the ambit of IDA.

It can be seen that only some headway has been made in devolution of funds, functions and functionaries to the institutions of local self government in the Union Territories. However, the progress has been rather slow and often tardy. This process on paper gathered momentum in 2006 when administrative orders were issued to transfer constitutionally mandated twenty nine functions to these institutions. The process has now been set in motion. However, even today this administrative fiat has not been translated into action at the ground level in letter and spirit. In many cases the devolved functions are still being done by the administrative departments. The funds for all these functions have not been fully devolved and the Panchayati Raj institutions are starved for funds. All officials have also not been sent to the local bodies and those that are transferred, in most cases are controlled by their respective administrative departments. The bulk of the expenditure in the UTs is still done by the Government departments and grants-in-aid for the Panchayati Raj institutions though gradually increasing over the years have still not reached the level recommended by earlier Finace Commissions. The Third Finance Commission has been appointed at this juncture and it would be its endeavor to implement its mandate judiciously.

The Commission is of the view that in the absence of fiscal autonomy, there can be no autonomy in functioning. However, since the own resource base of local bodies is low, revenue transfers from the UT administration is a must to enable them to become truly the institutions of local self governments. In this context, it needs to be mentioned that our objective is two fold: (a) to decide the quantum of transfers and (b) also the nature of transfers to be devolved to the local bodies. The nature of transfers is as important as the quantum; it has to be a combination of both untied and tied funds. The untied funds should give sufficient autonomy to the local bodies to carry out its constitutionally mandated functions in an independent manner and limited tied funds can help the local bodies to achieve certain key objectives having intejurisdictional ramifications.