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**Options before the XVI Union Finance
Commission in Fulfilling the
Constitutional Promise to Local
Governments**

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Mandate or Momentum?

Options before the XVI Union Finance Commission in Fulfilling the Constitutional Promise to Local Governments

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Abstract

Ever since local governments gained prominence as the third tier in India's federal finance structure with the 73rd and 74th Constitutional Amendment Acts (CAAs) of 1993, a large number of functions, functionaries, and finances have been devolved to local governments in most states. Starting with the 11th Union Finance Commission (hereafter UFC), the specific Terms of Reference (ToR) of the UFCs with respect to Local Governments have been following the article 280 (3) (bb) itself; *'the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State based on the recommendations made by the Finance Commission of the State.'* While UFC grants to local governments have seen a substantial increase over the period, it is also perplexing that the proportion of tied- and performance-based grants has become a core feature of the UFC recommendations. The increase in tied grants has derailed the true spirit of devolution and the essence of the 73rd and 74th Constitutional Amendment Acts, leading to a decline in the transfers to local governments. This paper critically examines the criteria, conditionalities, and the tied nature of previous UFC recommendations and suggests an overhaul to achieve local government grant devolution by the incumbent XVI UFC. Given the rising prominence of local governments in service delivery, the Union Government must devolve more funds to achieve equity and efficiency through decentralised governance. This study suggests that local governments need proper handholding to increase their efficiency through periodic training embedded with technology, but not through measures that squeeze their fiscal autonomy.

Key Words: Local Governments, Intergovernmental transfers, Finance Commission, Grants-in-aid

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Grants to Local Governments in India's Fiscal Federal Architecture

This study critically examines the frameworks of various Union Finance Commissions (UFCs) regarding grants to local governments in India, with a view to suggesting a rethink of the XVIth UFC's grant allocation to local governments in the current context. However, any analysis of devolution to local governments will be incomplete without examining the fiscal federal architecture, which is characterised by a centralised revenue structure and decentralised expenditure responsibilities. The explicit division of taxation powers within the Seventh Schedule is the primary determinant of the vertical fiscal imbalance. This constitutional arrangement systematically allocates buoyant, broad-based taxes through the Union List, whereas the States List leaves the states with less elastic and often insufficient revenue sources. States bear the majority of the expenditure responsibilities for providing essential public services that directly impact citizens' daily lives. This fundamental structural mismatch, enshrined within the Constitution, creates a persistent vertical fiscal imbalance, making intergovernmental transfers from the Union to the lower tiers an indispensable feature of India's fiscal federalism.

In the current context, the design of the transfer mechanism in India can be broadly divided into Finance Commission transfers and non-Finance Commission grants. As per Article 280, the Union Finance Commission is the crucial balancing mechanism within the Indian federal system, bridging the fiscal gap between the Union, the States, and local governments. By recommending the distribution of financial resources, the UFC aims at the "equalization of fiscal capacity" across all government tiers. These

intergovernmental transfers, aiming at vertical balance, are to be achieved mainly through the devolution of the divisible pool and Grants-in-Aid (statutory and discretionary grants). Article 270 facilitates formula-based tax devolution, providing states with untied funds to spend at their discretion, thereby enhancing fiscal autonomy. While Finance Commission transfers involve formula-based devolution — general-purpose grants and specific-purpose grants — the non-Finance Commission transfers are mainly the Central Government ministries' share of Centrally Sponsored Schemes (CSS) and other grants.

The 73rd and 74th Constitutional Amendment Acts of 1992 introduced the third tier of the federal system in India by devolving adequate power, responsibility, and finances to local bodies. However, local governments often continue to operate with huge functional domains (as listed in the 11th and 12th Schedules) and weak fiscal space. This gap between the constitutional mandate and the actual financial empowerment of Local Governments poses a challenge for them. Consequently, local bodies remain heavily dependent on intergovernmental grants.

The Union Finance Commission's mandate explicitly includes redressing "vertical imbalances between the taxation powers and expenditure responsibilities of the Center and the States" and ensuring the "equalization of all public services across the States". Thus, the Finance Commission's recommendations on tax devolution and grants-in-aid are central to India's fiscal federalism, impacting the financial health and developmental trajectory of the states and local bodies. A broad classification of the funds devolved by UFCs since the XI UFC is presented in Table 1. While allocations have substantially increased in the last

three UFCs, XV allocated Rs.42.25 lakh crore as tax proceeds and Rs.10.33 lakh crore as grants-in-aid. Although this was the highest allocation so far, the growth rate in UFC transfers has declined significantly in the last UFC (17.21%) compared to the previous UFCs, primarily due to the shrinking size of the divisible pool (from 88% to 80%). However, the proportion of grants-in-aid has risen sharply in recent periods (from 11.97% to 19.65%).

UFCs	Tax devolution			Grants-in-aid			Total transfers	
	Rs. (lakh crore)	% in total	Growth rate	Rs. (lakh crore)	% in total	Growth rate	Rs. (lakh crore)	Growth rate
XI 2000-05	3.76	86.44	82.37	0.58	13.33	185.71	4.35	91.89
XII 2005-10	6.13	81.08	63.03	1.43	18.92	146.55	7.56	73.79
XIII 2010-15	14.48	84.83	136.2	2.59	15.17	81.12	17.07	125.79
XIV 2015-20	39.48	88.01	172.6	5.37	11.97	107.34	44.86	162.80
XV 2020-26	42.25	80.35	7.02	10.33	19.65	92.36	52.58	17.21

Source: XV UFC Report (2021)

S.no.	Components	XIV (2015-20)	XV (2021-26)
1	Local government grants	2.87	4.36
2	Revenue Deficit grants	1.94	2.95
3	Sector-specific grants	--	1.30
4	Disaster management grants	0.55	1.23
5	State-specific grants	--	0.50
Total	Total	5.37	10.33

Source: Various UFC Reports

As shown in Table 2, grants-in-aid have increased in recent periods. Under the XV UFC period of 2021-26, approximately 10.33 lakh crore was allocated, constituting approximately 19.65% of the total finance commission transfers. Grants-in-aid allocation under UFC XV reached a record high of approximately 10.33 lakh crore, with a growth rate of 92.25%. The components of the

grant-in-aid allocated by the XIV and XV UFCs, as shown in Table 2, reveal that the lion's share was allocated to local governments.

As seen above, while local bodies corner a significant share of grants-in-aid, Revenue Deficit Grants, Disaster Management Grants, Sector-Specific Grants and State-Specific Grants are the other types of finance commission grants. Although various UFCs have recognised that grants are essential to empower local governments to improve their functioning and have significantly increased the volume of transferable funds, their efficacy in recent years has posed severe challenges, contradicting the constitutional provision itself.

Grants to Local Governments – ‘Mandate and the Momentum’

Article 280 (3)(bb) of the Constitution vests power with the Finance Commission to provide: *‘the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State.’*

Based on this constitutional mandate, India's Union Finance Commissions (UFC), starting with the 10th, recommended grants-in-aid to local governments. Grants to local bodies are supposed to address imbalances arising from the vertical and horizontal nature of India's fiscal federal architecture. To address vertical imbalances, grants are transferred to states as Union Finance Commission grants towards the development expenditure of local governments, in line with the functions listed in the respective

Panchayat Raj and Municipal Acts of the states, as recommended by their State Finance Commissions (SFCs). In this regard, the remarks of the XIII UFC require mention. It notes that "Decentralisation results in widening the ambit and improving the quality of services being provided by the local bodies. This requires substantially larger outlays."

UFCs	Type of Grants	All States		
		Rural	Urban	Total
X		4380.93	1000.0	5380.93
XI		8000.0	2000.0	10,000
XII		20,000	5000.0	25,000
XIII	General Basic Grant	41225	15110.84	56335.4
	General Performance Grant	21826	8000.25	29826.1
	Special Area Grant	1357		1357
	Total	64408	23111.09	87518.5
XIV	Basic Grant	180262.98	69715.04	249978.02
	Performance Grant	20029.22	17428.76	37457.98
	Total	200292.2	87143.8	287436
XV (2020-21)	Basic Grant (Untied Grant)	30375.0	14625.0	45000
	Tied Grant	30375.0	14625.0	45000
	Total	60750.0	29250.0	90000
XV (2021-26)	Basic Grant (Untied Grant)	94722.0	33144.0	127866
	Tied Grant	142083.0	87911.0	229994
	Grants for the incubation of new cities		8000.0	8000
	Grants for shared municipal services		450.0	450
	Health Grant	43928.0	26123.0	70051
	Total	280733.0	155628.0	436361

Source: Various UFC reports

Various Finance Commissions, after the 73rd and 74th CAA, starting with the X, devolved grants to local governments. While grants to local governments are not allocated as a percentage of

the divisible pool ex ante, when presented as a share of the divisible pool, they have shown steady growth. At the same time, the 13th UFC recommended grants to local bodies as a percentage of the divisible pool, while the other UFCs recommended grants in absolute terms. As per the XV UFC (XV UFC Report 2021), the grants to local governments as a share of the total divisible pool have increased from 1.38% in X UFC to 3.06% in XIV UFC and are 4.31% of XV UFC (for the year 2020-21). The XV UFC recommended a release of ₹4.36 lakh crores to local bodies, which is also the highest so far in absolute terms. A detailed classification of the UFC's grants to local bodies is given in Table 3, which will be the focal point of this paper's analysis hereafter.

Maintaining the size

To improve service delivery, local governments must sustain funding to meet rising demands. The example of the XIII UFC may be considered, wherein the UFC grants to local bodies were recommended as a share of the divisible pool (totalling 2.28% for 2010-15). Therefore, the 16 UFC should earmark ***at least 5%–7.5% of the divisible pool*** for local governments. Based on the projections by Varughese et al. (2025), this will amount to Rs.10.77-16.15 lakh crore for the 16th UFC period (2026-27–2030-31).

From Rs.4.36 lakh crore in the XV UFC, grants to local bodies more than doubled to about Rs.10.77 lakh crore in the XVI UFC, if a mere 5% of the divisible pool is calculated. As the percentage increases, the proposed grant will also increase, as depicted in Table 4.

Table 4: Year-wise Projections of the Divisible Pool for various shares (Rs. crore)					
16th FC Year	Divisible pool (GIFT)	5 % of Divisible Pool	6 % of Divisible Pool	7 % of Divisible Pool	7.5 % of Divisible Pool
2026-27	35,95,700	1,79,785.0	2,15,742.0	2,51,699.0	2,69,677.5
2027-28	39,21,237	1,96,061.8	2,35,274.2	2,74,486.6	2,94,092.8
2028-29	42,76,245	2,13,812.3	2,56,574.7	2,99,337.2	3,20,718.4
2029-30	46,63,394	2,33,169.7	2,79,803.7	3,26,437.6	3,49,754.6
2030-31	50,85,594	2,54,279.7	3,05,135.6	3,55,991.6	3,81,419.5
Total	215,42171	10,77,109	12,92,530.2	15,07,951.9	16,15,662.8

Source: Author's Calculation

Revisiting the Horizontal Devolution Criteria

UFCs are allocated to various states based on distinct criteria, with each UFC following its own formula. A summary of the criteria followed by the various UFCs since the 73rd and 74th CAA is provided in Table 5. Both the XIV and XV UFCs considered only the population (90%) and geographical area (10%) criteria for devolution.

The resultant shares of the various states are shown in Annexure Table (A1). As per the XV UFC formula, the most populous and largest states can corner a major share of the grant distribution. Therefore, states such as Uttar Pradesh (16.05%), Maharashtra (9.29%), Bihar (8.26%), West Bengal (7.26%), Madhya Pradesh (6.56%), and Rajasthan (6.2%) are recommended higher shares corresponding to their population share and geographical size as per the 15th UFC devolution (15 UFC Report, 2019). Kerala's share has been in a downward trend during the 14th (2.67%) and 15th UFC periods (2.68%).

Table 5: Criteria of UFCs							
Criteria	10 th UFC	11 th UFC	12 th UFC	13 th UFC		14 th UFC	15 th UFC
				RLG	ULG		
Index of decentralization		20		15	15		
Revenue effort		10	20				
FC local body grants utilisation index				5	5		
Index of deprivation			10				
Proportion of SC/STs in the population				10	0		
Population - () denotes Census year	100 (1971)	40 (1971)	40 (2001)	50 (2001)	50 (2001)	90 (2011)	90 (2011)
Geographical Area		10	10	10	10	10	10
Distance from the highest per capita income		20	20	10	20		
Total	100	100	100	100	100	100	100

Source: 15 FC report 2020

However, prioritising headcount alone diminishes the significance of the headcount itself. This is essential for local bodies because they provide local public goods in response to the needs of the local population. While population characteristics are not uniform, factors such as gender, aging, and materialist features—historically marginalised, urban, and rural— shape the local demand for public goods. Therefore, it is essential to include relevant population characteristics in the formula, as this is more inclusive than using the basic headcount.

In addition, giving the population a major role as a criterion can disincentivize states that have taken measures to control the population and thus have low fertility rates. Therefore, a better

measure must be adopted. It will be worthwhile to consider the ***proportion of the aged in the state's population*** as a criterion for devolution, given the unfavourable economic implications of aging, which warrant greater local government intervention. States such as Kerala, which have a higher proportion of senior citizens (UNFPA, 2023), stand to gain from this scenario. It is also of utmost importance to include the most deprived members of the population, as their developmental needs are more acute than those of the rest. Therefore, the ***proportion of SC and ST populations*** is also suggested for inclusion as a criterion for deprivation.

It is also essential to include criteria to improve local governance efficiency. Taking a cue from earlier UFCs (XI, XII, and XIII) regarding ***equity and efficiency***, the index of devolution and revenue effort should be considered when formulating the criteria. All these criteria are more inclusive and make economic sense, especially as they are crucially linked to the performance of local bodies. As followed by the XII UFC, the ***index of devolution*** should be considered a criterion for incentivising achievement and motivating states to devolve functions, functionaries, and finances to local governments. It must be acknowledged that states like Kerala are devolving substantial power to local governments. Gupta and Chakraborty (2019) note that while Kerala devolved about 20% of Own tax revenue (during 2016-219) to Local governments, the corresponding share of the Union government was only about 9%. Banking solely on the population and size criteria might deprive states that have made progress in devolving functions to local governments.

The OSR of local governments might be a good indicator for promoting efficiency by rewarding performers in Own Source

mobilisation. Thus, revenue effort can be a crucial criterion for devolving funds to local governments. As suggested by various UFCs, property tax has been identified as a major source of own-source revenue. The own source of revenue is slated to increase with the recent hike in property taxes. Based on the above discussion, the new formula for determining the horizontal share of grants to local governments within states is shown in Table 6.

SL No	Criteria	XVI UFC
1.	Index of devolution	10
2.	Revenue effort	15
3.	Aged in population (2011 Census)	10
4.	SC/STs in population (2011 Census)	5
5.	Population (2011) *	50
6.	Geographical Area	10
7.	Total	100

Source: Authors

Notably, Kerala's share, as per the recommendations of the XI, XII, and XIII UFCs, was 4.0%, 4.54%, and 3.11%, respectively. The criteria proposed in Table 6 are similar to the XI, XII, and XIII UFCs, and we have included indicators such as the index of devolution, revenue effort, proportion of SC and ST population, and proportion of the aged population for the reasons mentioned in the above sections. The figures for the 2026 census may be updated as they become accessible. Based on the above criteria and their weights, the state shares are constructed and provided in Table 7. States like Kerala, which are at the forefront of decentralisation, will see a rise in their share (4.61%), improving from 2.5% in the XIV and XV UFC to levels seen in the XII UFC.

Table 7: Proposed share of states							
State	Population	Size	SC/ST Population	Aged Population	Index of Devolution	Revenue Effort (PRI)	Total
Weight (percent)	50	10	5	10	15	10	100
Andhra Pradesh	2.1	0.53	0.1	0.3	0.61	0.05	3.69
Arunachal Pradesh	0.06	0.27	0.36	0.21	0.11	0	1.02
Assam	1.32	0.26	0.11	0.29	0.39	0.65	3.02
Bihar	4.42	0.31	0.1	0.31	0.57	0.71	6.42
Chhattisgarh	1.08	0.44	0.24	0.34	0.5	0.25	2.86
Goa	0.06	0.01	0.04	0.44	0.07	0.2	0.83
Gujarat	2.56	0.64	0.11	0.34	0.83	0.32	4.8
Haryana	1.08	0.14	0.09	0.36	0.7	0.08	2.45
Himachal Pradesh	0.29	0.18	0.18	0.46	0.5	0.45	2.07
Jharkhand	1.4	0.26	0.21	0.28	0.55	0.39	3.1
Karnataka	2.59	0.63	0.11	0.39	0.92	0.77	5.41
Kerala	1.42	0.13	0.04	0.58	1.33	1.11	4.61
Madhya Pradesh	3.08	1.01	0.2	0.34	0.65	0.14	5.42
Maharashtra	4.77	1.01	0.09	0.44	1	0.37	7.68
Manipur	0.12	0.07	0.19	0.3	0.22	0.3	1.2
Meghalaya	0.13	0.07	0.46	0.21	0	0	0.87
Mizoram	0.05	0.07	0.29	0.26	0	0.05	0.72
Nagaland	0.08	0.05	0.42	0.26	0	0	0.82
Orissa	1.78	0.51	0.23	0.42	0.46	0.62	4.02
Punjab	1.18	0.16	0.15	0.46	0.28	0.11	2.33
Rajasthan	2.91	1.12	0.17	0.32	0.63	0.36	5.51
Sikkim	0.03	0.02	0.19	0.27	0.76	0.68	1.95
Tamil Nadu	3.06	0.43	0.09	0.44	0.87	0.61	5.5
Telangana	1.49	0.37	0.16	0.54	0.7	0.21	3.46
Tripura	0.16	0.03	0.27	0.37	0.55	0.17	1.55
Uttar Pradesh	8.48	0.79	0.12	0.34	0.52	0.3	10.54
Uttarakhand	0.43	0.18	0.11	0.38	0.54	0.06	1.69
West Bengal	3.87	0.29	0.15	0.36	0.74	1.05	6.47

Source: Author's Calculation

Rural-Urban fund distribution

One notable feature of the UFC grants to local governments is the division of funds for rural local governments (ULGs) and urban local governments (ULGs). This inter-se bifurcation is arrived at after earmarking funds for local governments. Given the rising prominence of urbanisation in India, it is essential to revisit the inter-se distribution between rural and urban local

governments by past UFCs to propose a new ratio. While the inter-se distribution among rural and urban local bodies was about 82:18, heavily loaded in favor of rural local governments by the X UFC, the ratio has tilted towards the urban in recent periods. By XV UFC, the rural-urban division was to progressively improve from 67:23 in 2021-22 to 65:35 by 2025-26. The amounts allocated by the XVth UFC for various components, as shown in Table 3, indicate that, apart from grants to RLGs and ULGs, the XVth UFC has also allocated grants for improving health services, setting up new cities, and sharing municipal services.

Given the rise in urbanisation and urban sprawl across the country, it is imperative that the ***RLG:ULG ratio be revised to 60:40***, or gradually increased from 65:35 in 2026-27 to 60:40 in 2030-31. Table 8 presents projections based on this ratio for various shares of the divisible pool (5% to 7.5%), as explained in the first section. The projections earmark a considerable increase in grants to urban local governments, which is necessary to fulfil the tag of ‘engines of growth.

	Grants	2026-27	2027-28	2028-29	2029-30	2030-31	Total
Share of Divisible Pool	Inter-se distribution of grants at (b) above between RLB and ULB	65:35	65:35	62:38	62:38	60:40	
5%	Grants for RLBs	116860	127440	132564	144565	152568	673997
	Grants for ULBs	62925	68622	81249	88604	101712	403111
	Grand Total	179785	196062	213812	233170	254280	1077109
6%	Grants for RLBs	140232	152928	159076	173478	183081	808797
	Grants for ULBs	75510	82346	97498	106325	122054	483734
	Grand Total	215742	235274	256575	279804	305136	1292530
7%	Grants for RLBs	163604	178416	185589	202391	213595	943596
	Grants for ULBs	88095	96070	113748	124046	142397	564356
	Grand Total	251699	274487	299337	326438	355992	1507952
7.50%	Grants for RLBs	175290	191160	198845	216848	228852	1010996
	Grants for ULBs	94387	102932	121873	132907	152568	604667
	Grand Total	269678	294093	320718	349755	381420	1615663

Source: Author's Calculation

Scholars studying Indian cities have noted that insufficient investment in urban infrastructure and institutional fragmentation have contributed significantly to this cycle (Harari, 2020; NIUA, 2022). As a result, Indian cities fared much worse than other cities. The recent Oxford Economics Global City Index (2024; 2025) ranking of the top 1000 cities worldwide paints a dismal picture of Indian cities. The latest figures are presented in Table 9.

City	Rank in Country 2025	Global Rank 2025
Delhi	1	273
Mumbai	2	330
Bengaluru	3	331
Chennai	4	360
Pune	5	390
Hyderabad	6	410
Kolkata	7	416
Kochi	8	419
Thrissur	9	427
Tiruchirappalli	10	496
Kozhikode	11	497
Chandigarh	12	513

Source: Oxford Economics Global City Index 2025

In the absence of sufficient intergovernmental transfers that match the changed geography, cities are in a state of suffocation. Therefore, the need of the time is more funds for our cities. However, there is more to urban transformation in India. Considering the prominence of cities in India's total urban population, the XV UFC classified the urban areas again into two broad categories for grant recommendations: (1) one million-plus cities and (2) less than one million-plus cities. The XVth UFC also recommended (Rs.8000/- crore) funds to states for the incubation of new cities. All these belong to purpose-oriented tied funds, for

which there has been an increasing tendency since the XIV UFC, which will be discussed in detail below.

According to the 2011 census, urbanisation is driven by rural areas with urban characteristics. These RLBs, lying on the periphery of cities, have areas that exhibit urban features but are not considered ULBs and lack the much-needed urban amenities. The XIII UFC had, in fact, recognised these entities as ‘nagar panchayats’ while highlighting the deprivations these entities face. Therefore, these “urban’ RLBs or census towns must be ***given fiscal assistance by the XVIth UFC***. It is also suggested that ***all states should be provided with grants for the incubation of new cities to the tune of Rs.1000/- crores***.

With respect to the three tiers of the RLGs, that is, Grama Panchayat (GP), Block Panchayat (BP), and District Panchayat (DP), the ***shares may be decided by the respective State Finance Commissions (SFCs)***, as the requirements of the various tiers in various states can vary across the states. 15 UFC (2019) recommended a maximum-to-minimum range for fund distribution.

Entry conditions for availing grants

A glaring aspect of grants to local governments has been the growing stringency of the conditionalities. Entry conditionalities have existed since the X UFC, which mandated three requirements for state governments: preparing guidelines, matching grants, and non-use of grants for salary purposes. The XI UFC stipulates that grants must be used for account maintenance, audits, and financial database development. Primary education, healthcare, water supply, lighting, sanitation, burial

grounds, and public conveniences were designated as core services. For the XII UFC, the entry conditions were the creation of databases of LSG finances and the maintenance of accounts using modern technology and management systems. While XIII UFC continued the idea of finetuning audited LG finances, it also made the Constitution of SFC an entry condition, while formulating separate conditions for rural local bodies (six) and urban local bodies (nine) that had to be met in each year of award.

By the time of the XIV UFC, the number of conditions had reached an all-time high. Apart from the SFC constitution and audited accounts, it also mandated a systemic increase in own-source funds, as well as innovations in local governance, such as expenditure display dashboards and scores based on revenue growth, the yearly publication of urban service benchmarks, ODF status, and immunisation levels. At the XV UFC, the Constitution of the SFC was an entry condition for availing any grants. In contrast, other conditions included publishing online accounts (unaudited for the previous year, audited for the year before) to qualify for UFC grants. To rely on property taxes as the primary source of income for local governments, urban governments must set floor rates for property taxes and demonstrate consistent growth rates in line with the SGDP to receive grants.

Given the importance of proper accounting for public funds, all local bodies must have their accounts audited and made available online to the public. The authors believe that certain basic conditions are essential to safeguard public funds and promote transparency in local-level revenue mobilisation and expenditure.

Increasing nature of Tied grants

Another aspect that hampers the autonomy of local governments is the increasing nature of tied funds. Similar to the conditionalities, various UFCs have recommended grants tied to the performance of local bodies. Alarming, the quantum of these funds increased from 10% (RLGs) and 20% (ULGs) in the XIV UFC to 60% in the XV UFC. A summary of the UFC's recommendation to tie funds to certain functions of rural and urban local governments is presented in Table 10.

Table 10: Increasing nature of Tied funds across UFC grants		
UFCs	Tied and Untied Grants for RLGs	Tied and Untied Grants for ULGs
XI	Provision of civic services	
XII	Priority to water supply and sanitation	
XIII	Six conditions to access the performance grant	Nine conditions to access the performance grant
XIV	Unconditional basic grant (90%) for improving the status of specified basic civic services. Conditional performance grant (10%) for revenue improvement.	Unconditional basic grant (80%) and a conditional performance grant (20%). Municipalities need to publish the service-level benchmarks for basic urban services each year.
XV	60 per cent grants tied to be spent on water and sanitation	For one million-plus cities, the recommended funds were fully tied to improving ambient air quality and to conservation, water supply and management, and efficient solid waste management. For non-one million urban agglomerations, 60 percent of the grants were tied to (a) drinking water (including rainwater harvesting and recycling) and (b) solid waste management.

Source: Various UFC reports

This is a form of centralisation in which the UFC decides how local governments should use the funds, and if targets are not

met, the funds are lost in subsequent years. This is against the spirit of decentralised planning and devolution. This is also a bane for local bodies that have already achieved the amenities mentioned above. Therefore, to uphold the spirit of decentralisation and devolution, interventions should be minimised. ***Therefore, the UFC grants to local bodies should not be tied too closely, and local bodies should be permitted to use funds suited to their developmental requirements, as enshrined in the Eleventh and the Twelfth Schedules of the Constitution.***

In fact, the XVth UFC excluded the state of Kerala from the performance-based grant for ambient air quality, as its million-plus cities have comparatively higher air quality. Therefore, the XVth UFC allowed ULBs to divert grants under the 18 subjects enshrined in the Twelfth Schedule. It is therefore imperative that this ***freedom of fund use be granted to local governments if their requirements do not align with UFC's recommendations.***

Grants Release Versus Recommended

UFCs	% Released for RLGs	% Released for ULGs
X	81.6	83.4
XI	82.5	87.6
XII	94.6	89.4
XIII	90.7	82.1
XIV	89.6	85.2

Source: XV FC Report 2020

Various UFCs have highlighted that the actual UFC grant release to local bodies is not in line with the recommended. A summary provided by the XV UFC, indicates unimpressive fund releases to

local governments, which violate the constitutional mandates (Table 11).

There is a shortage of approximately 5% and 18% for RLGs and between 10% and 18% for ULGs, respectively. The XV UFC itself admits that this is *“because of failure of the local governments to meet the conditionalities attached to the performance grants by the Commissions. Sometimes the concerned Union ministries had also added to these conditionalities.”* It should be noted that the actual utilisation will also not be fully achieved in realistic terms. Based on the previous discussion, minimal conditions must be fixed for local governments to adhere to the spirit of participatory planning, decentralised governance, devolution, and even the ideals of equity and efficiency.

Conclusion

Given the rising importance of local governments in local service delivery in the present context, it is pertinent to increase overall funding for both rural and urban local governments in India. Funds to the tune of 5–7.5% of the divisible pool should be earmarked for local governments for the XVI UFC period. The evaluation of the criteria guiding the devolution of grants-in-aid to local governments necessitated expanding the formula to include the devolution index, the proportion of the population aged 65 or older, and revenue effort, as these are more inclusive than relying solely on population headcount and land area. Considering the rising urbanisation and urban sprawl across the country, it is essential to update the inter-se distribution between rural and urban governments to 60:40, or gradually increase it from 65:35 in 2026-27 to 60:40 in 2030-31. The UFC grants to local bodies should not be extensively tied, and local bodies should be

permitted to use funds suited to their developmental requirements, as per the Eleventh and Twelfth Schedules of the Constitution. To adhere to the spirit of participatory planning, decentralised governance, devolution, and even the ideals of equity and efficiency, minimal conditions must be imposed on how local governments spend UFC grants. Local governments require handholding to improve their efficiency, and the XVI Union Finance Commission can mandate continuous training in this regard while leveraging innovations in governance. In fact, some of the conditions laid out by the XIV UFC are worth mentioning. Training is needed to update staff on accounting standards, make them available online, and introduce innovations in local governance, such as expenditure display dashboards and scores based on revenue growth, and the yearly publication of urban service benchmarks.

It is also essential to increase the own-source mobilisation of local governments, given that their revenue sources are the most buoyant. To this end, it is imperative to move beyond the current methods for arriving at the tax demand to state-of-the-art methods based on spatial and digital technologies to improve the base. A crucial aspect is the use of GIS technology to increase property taxes. Another aspect would be to collect more from the profession tax, which, however, is beyond the ambit of the Union Finance Commission. They can, in fact, initiate the Union government to expedite the constitutional amendments to revise professional taxes, as the Union government is already involved in a constitutional amendment.

States like Kerala, which have made a mark in decentralised governance and the transfer of functions, functionaries, and finances, are to be seen as role models of local governance in

India. This was achieved by providing autonomy in terms of word and deed. It is imperative that, to raise the bar for local governments in India, UFC funds be increased for both rural and urban local governments. Regular and generous fiscal support is necessary, but local governments need to be guided to increase innovation and transparency.

In summary, in the context of rising conditions and performance-based grants-in-aid to local government institutions, the constitutional provision governing local government institutions must be adhered to. A summary of recommendations regarding grants-in-aid to local bodies is provided below.

Summary of Suggestions

- 1) The XVI UFC should earmark grants amounting to 5% - 7.5% of the divisible pool for local governments.
- 2) The proportion of the elderly in the state's population should also be considered a criterion for devolution, given the unfavourable economic implications of aging, which warrant greater government intervention at the local level. Taking a cue from earlier UFCs (1XI, XII, XIII) on equity and efficiency, the index of devolution and revenue effort should be considered, as it is crucially linked to the performance of local bodies (LBs).
- 3) The Inter-se distribution of grants between RLGs and ULG may be in the ratio of 60:40, or gradually increase from 65:35 in 2026-27 to 60:40 in 2030-31.
- 4) It is important to consider the importance of urbanised RLGs (called Nagar Panchayats by the 13th UFC). Therefore, these "urban" RLBs must be given fiscal assistance by the XVIth UFC.

- 5) Elaborating on the suggestions of the 15th UFC regarding the incubation of new cities, it is suggested that all states be provided with grants of Rs.1000/- crore for the incubation of new cities.
- 6) With respect to the three tiers of the RLGs — Grama Panchayat (GP), Block Panchayat (BP), and District Panchayat (DP) —the shares may be determined by the respective State Finance Commissions (SFCs).
- 7) The XVIth UFC can assign a grant component for training to enhance OSR using technology.
- 8) The requirement to make local governments accounting data available online in the public domain should be insisted upon, however, with a one-year lag to allow ample time for the local bodies to collect, audit, and enter the data in the prescribed format.
- 9) The XVI UFC may recommend to the Union government the urgent need to expedite the Constitutional Amendment to revise the profession tax. Otherwise, there should be a recommendation to supplement local governments with additional funds until their enactment.
- 10) To uphold the spirit of decentralisation and devolution, interventions should be minimised. Therefore, the UFC grants to local governments should not be extensively tied, and local bodies should be permitted to use funds suited to their developmental requirements, as listed under the subjects enshrined in the Eleventh and Twelfth Schedules.
- 11) If local governments already meet the UFC's recommendations for specific functions, states may be granted the freedom to use funds.
- 12) Urban Local governments should be given the necessary direction and training to initiate large infrastructure projects, such as rail transit systems, and to develop solid

and liquid waste management infrastructure. To this end, urban local governments may be allowed to access interest-free CAPEX loans from the Union Government.

Annexure

Table A 1: Share of States in UFC Grants to Local Bodies						
State	X th UFC	11 th UFC	12 th UFC	13 th UFC	14 th UFC	15 th UFC
Andhra Pradesh	7.93	9.20	7.84	8.29	4.28	4.32
Arunachal Pradesh	0.09	0.30	0.28	0.35	0.37	0.38
Assam	2.74	2.50	2.32	2.13	2.22	2.64
Bihar	10.67	8.80	7.06	6.59	8.24	8.26
Chhattisgarh			2.81	2.42	2.38	2.39
Goa	0.11	0.10	0.12	0.20	0.12	0.12
Gujarat	4.82	4.80	5.38	4.22	5.23	5.26
Haryana	1.84	1.80	1.92	1.77	2.08	2.08
Himachal Pradesh	0.64	0.70	0.62	0.74	0.70	0.71
Jammu & Kashmir	0.92	0.90	1.28	1.30	1.66	
Jharkhand			2.32	2.25	2.77	2.78
Karnataka	5.43	5.20	4.84	7.54	5.27	5.29
Kerala	3.80	4.00	4.54	3.11	2.67	2.68
Madhya Pradesh	7.63	8.70	8.10	6.51	6.52	6.56
Maharashtra	8.92	9.70	11.10	10.07	9.55	9.59
Manipur	0.21	0.20	0.22	0.35	0.13	0.29
Meghalaya	0.19	0.30	0.23	0.46	0.01	0.30
Mizoram	0.06	0.10	0.12	0.34	0.04	0.15
Nagaland	0.10	0.10	0.18	0.44	0.04	0.21
Odisha	4.09	3.90	3.63	3.58	3.70	3.72
Punjab	2.49	2.10	1.98	2.04	2.28	2.29
Rajasthan	4.75	5.90	5.80	5.96	6.31	6.36
Sikkim	0.05	0.10	0.06	0.22	0.07	0.07
Tamil Nadu	7.49	6.60	5.77	6.33	5.92	5.94
Telangana					3.05	3.04
Tripura	0.28	0.30	0.26	0.41	0.19	0.31
Uttar Pradesh	16.37	15.70	13.78	14.79	16.01	16.05
Uttarakhand			0.78	0.91	0.94	0.95
West Bengal	8.43	7.80	6.66	6.68	7.25	7.26

Source: XV UFC Report 2020

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