Explanatory Memorandum as to the action taken on the recommendations made by the Eleventh Finance Commission in its Interim Report submitted to the President on January 15, 2000

1. The Eleventh Finance Commission was constituted on 3rd July, 1998 with the mandate to give its report by 31st December, 1999 covering the five year period 2000-2005. On 28th December, 1999, it was given extension of time up to 30th June, 2000 with the direction to give an interim report to enable provisional arrangements for 2000-2001. In pursuance of article 281 of the Constitution, the Interim Report of the Eleventh Finance Commission covering the one year period commencing from April 1, 2000 together with the Explanatory Memorandum on the action taken on the recommendations of the Commission is being laid on the Table of the House.

2. The Commission's interim recommendations relating to provisional arrangements in 2000-01 in respect of devolution of taxes and duties to the States, grants-in-aid under Article 275 of the Constitution and financing of relief expenditure are summarised below.

SHARES OF CENTRAL TAXES AND DUTIES

3. States' share in the net proceeds of personal Income Tax is recommended to be increased from 77.5% at present to 80% for 2000-01. States' Share in the net proceeds of Union Excise Duties is recommended to be increased from 47.5% at present to 52% for 2000-01. States' Share in the net proceeds of Additional Excise Duties is recommended to be retained at the existing level of 97.797% for 2000-01. These recommendations have been accepted by Government.

GRANTS-IN-AID OF THE REVENUES OF STATES UNDER THE SUBSTANTIVE PROVISIONS OF ARTICLE 275 OF THE CONSTITUTION

Grants-in-aid to cover non-Plan gap on Revenue Account

4. The Commission has assessed that the States' would have Revenue Deficit of about Rs. 11,000 crore on non-Plan account, which needs to be bridged through non-Plan grants from the Centre. The inter-se allocation between States has, however, not been indicated. This will be done in the final report. The Government has accepted the recommendations of the Commission for payment of Rs. 11,000 crore as grants-in-aid of the revenues of certain States under the substantive provisions of Article 275(1) of the Constitution towards meeting their non-Plan revenue gap as assessed by the Commission for the year 2000-2001 subject to stipulations in para 10 below.

Grants-in-aid for upgradation of standards of administration and specific grants to certain States for special problems

5. The Government has accepted the recommendations of the Commission for making grants-in-aid amounting to Rs. 2,000 crore to States for upgradation of standards of administration and grants to certain States for special problems for the year 2000-2001.

Financing of Relief Expenditure

6. The Government has accepted the recommendations of the Commission relating to the continuation of the existing scheme of calamity relief fund with the size of States' Calamity Relief Funds being fixed at Rs. 2,000 crore for 2000-2001 including Rs. 1,500 crore as Centre's contribution.

Grants to States for financing local bodies

7. The Tenth Finance Commission had recommended ad-hoc grants to the States for Panchayati Raj Institutions as well as for the Urban Municipal bodies. For Panchayati Raj Institutions the Tenth Finance Commission had made an ad-hoc provision at the rate of Rs. 100 per capita of rural population (1971 census) amounting to a total of Rs. 4,380.93 crore. For urban local bodies, Rs. 1,000 crore has been provided for the five year period 1995-2000 on the basis of the inter-State ratio of the slum population derived from the urban population figures as per 1971 Census. Eleventh Finance Commission has recommended a 50% increase in the grants to States for Local Bodies with 80% being earmarked for Rural and 20% for Urban Local Bodies. The Government has accepted the recommendations of the Commission.

Grants in lieu of the Repealed Tax on Railway Passenger Fares

8. Grant in lieu of tax on Railway passenger fares, which is Rs. 380 crore per annum at present, is recommended to be increased to Rs. 570 crore for 2000-2001.

9. The critical challenge posed by a weakening fiscal situation must be squarely confronted and overcome. A long history of high fiscal deficit has left a legacy of huge public debt and ever-growing bill of interest payments. Although in the

current precarious fiscal situation of Centre, it would be very burdensome on Centre's finances to accept these recommendations but the States' finances are also severely strained and, therefore, in the spirit of federalism, Government has accepted these recommendations. While the need of non-Plan grants to cover the residual Revenue Deficit of States is manifest, the problems that have in the first place caused high revenue deficit need to be addressed. In this context, it is pertinent to mention that the challenge of fiscal management is not confined to the

Central Government. The financial position of the State Governments has deteriorated sharply in the last few years. Revenue deficits have widened and borrowings are being increasingly used to meet revenue expenditure. Fiscal reform at the State level has acquired great urgency. While we have gone out of our way to help State Government, the determination shown by some States to deal with these issues has also helped enormously. It will be my endeavour to take further collective measures in the next year for promoting fiscal reforms in the States. The final report of the Eleventh Finance Commission will provide valuable inputs for taking policy initiatives in this regard. The Commission has a broader mandate to look into the overall macro-economic balance. The Commission has indicated in the interim report that it is preparing a scheme of restructuring the government finances so as to restore the fiscal balance.

10. Keeping in view the difficult fiscal situation and the collective efforts of the Central and State Governments required in dealing with it, the Government has decided that the Finance Commission should draw up a monitorable fiscal reform programme for the States and the non-Plan grants to cover the assessed Revenue Deficit should be suitable tied up with the progress made in the implementation of the programme.

11. The Government's acceptance of the interim recommendations is meant to be a provisional arrangement for 2000-2001 only. Necessary provisions have been proposed in Budget 2000-2001. Government will review the decision in the light of the recommendations of the Commission in their final report and also in the light of the Parliament's decision in respect of the Constitution (Eighty Ninth Amendment) Bill , 2000 introduced in the Lok Sabha on 9th March, 2000 regarding the Alternative Scheme of Devolution recommended by the 10th Finance Commission. Under this scheme, a fixed percentage of the net proceeds of almost all Central taxes, excluding cesses and surcharges, is sought to be assigned to the States w.e.f. 1st April, 1996 in lieu of existing share in Personal Income Tax, Union Excise Duties and Grants in lieu of Tax on Railway Passenger Fares.

IMPLEMENTATION

12. The Commission's recommendations fall in three categories:

(i) Those to be implemented by an Order of the President.
(ii) Those to be implemented by Law of Parliament.
(iii) Those to be implemented by executive orders.

13. The recommendations under article 270 and 275(1) of the Constitution relating to income tax and grants-in-aid, respectively, fall in the first category and the necessary order will be submitted to the President for approval.

14. Recommendations relating to distribution of Union Excise duties including Additional Duties of Excise in lieu of Sales Tax (under Article 272 of the constitution) fall in the second category. Necessary legislation will be promoted for implementing these recommendations in a manner consistent with Parliament's decision in respect of the Constitution (Eighty Ninth Amendment) Bill, 2000 introduced in the Lok Sabha on 9th March, 2000 regarding the Alternative Scheme of Devolution recommended by the Tenth Finance Commission.

15. The recommendations relating to distribution of grants to States in lieu of tax on railway passenger fares and debt relief will be implemented by executive orders.

Sd/-

(Yashwant Sinha)
Ministry of Finance

New Delhi
March 16, 2000

Explanatory Memorandum as to the action taken on the recommendations made by the Eleventh Finance Commission in its report submitted to the President on July 7, 2000

1. The Eleventh Finance Commission was constituted by the President on July 3, 1998 to give recommendations on specified aspects of Centre-State fiscal relations during 2000-2005. The Commission submitted its Report covering all aspects of its original mandate on 7th July, 2000. Earlier, on 15th January,2000, the Commission had submitted an interim report for making provisional arrangements for 2000-01. The interim recommendations of the Commission were accepted by the Government and were laid on the Table of the House on 16th March, 2000.

2. The Report of the Eleventh Finance Commission (hereinafter referred to as the Commission) covering the five years period commencing from April 1, 2000 together with the Explanatory Memorandum on the action taken on the recommendations of the Commission is being laid on the Table of the House, in pursuance of Article 281 of the Constitution. A summary of the Commission's main recommendations relating to devolution of taxes and duties to the States, grants-in-aid under Article 275 of the Constitution, financing of relief expenditure and debt relief to the States and other matters is contained in Chapter XIV of the Report of the Commission.

3. The Finance Commission are constituted by the President after every five years or earlier under Article 280 of the Constitution to give recommendations on specified aspects of Centre-State fiscal relations. The recommendations of these Commissions are based on a detailed assessment of the financial position of the Central and State Governments and wide consultation with almost all sections of stakeholders. The Commissions usually visit the States, sponsor studies, hold consultations with experts and their recommendations are usually backed up by detailed reasons disclosing methodology adopted by them. The Government has carefully considered some of the main recommendations contained in the above mentioned Report of the Commission and the action proposed to be taken on these recommendations is detailed below.

DEVOLUTION OF SHARE IN CENTRAL TAXES AND DUTIES TO STATES

4. Under Article 270 of the Constitution, as amended w.e.f. 1st April, 1996 by the Constitution (Eightieth Amendment) Act, 2000, a prescribed percentage of the net proceeds of all Central taxes and duties (except Union surcharge, cess levied for specific purposes under any law made by Parliament and the duties and taxes referred to in articles 268 and 269) is to be assigned to the States within which that tax or duty is leviable in that year and distributed among those States in terms of Orders issued by the President on the recommendations of the Finance Commission. For the period of five years commencing from April 1, 2000, the Commission has recommended that 28% of the net proceeds of shareable Central taxes/duties may be distributed amongst all such States' where the Central tax/duty is leviable. If in any year during 2000-05, a Central tax/duty is not leviable in a State, the share of that State in that tax/duty should be put to zero and the entire proceeds should be distributed among the remaining States by proportionately adjusting their shares. In addition, 1.5% of the net proceeds of shareable Central taxes/duties in a year may be distributed amongst such States which do not levy sales tax on sugar, tobacco and textiles during that year. The Commission has recommended percentage share of each State in the share of all States and indicated the criteria adopted by them in arriving at those percentage shares in Chapter VI of their Report.

5. The Government has accepted the above recommendations of the Commission.

GRANTS-IN-AID OF THE REVENUES OF STATES UNDER THE SUBSTANTIVE PROVISIONS OF ARTICLE 275 OF THE CONSTITUTION

Grants-in-aid to cover non-Plan gap on Revenue Account

6. The Commission has recommended grants-in-aid to be give under Article 275(1) of the Constitution, other than those under the proviso to Article 275(1),

equal to the amount of deficits assessed for each year during the period 2000-05. The amount of the grant for each State, having non-Plan deficits is indicated in Chapter X of their report. The Government has accepted these recommendations. In view of the coverage of non-Plan revenue deficit of States by these grants, Central Government's total budgetary support on revenue account for meeting the States' non-Plan requirements will be limited to the grants-in-aid recommended by the Commission. The release of these grants will be made in accordance with the next Report of the Commission due to be submitted by 31st August, 2000. Action is, however, being taken to release a part of these grants on an ad-hoc, provisional basis to mitigate hardship to the concerned States.

Grants-in-aid for upgradation of standards of administration and specific grants to certain States for special problems

7. The Commission has recommended grants totalling to Rs. 4,972.63 crore towards upgradation of standards of administration and special problems of States. The State-wise, year-wise, purpose-wise details of these grants are given in Chapter VII of their Report. The Government has accepted the recommendations of the Commission for making grants-in-aid to States for upgradation of standards of administration and specific grants to certain States for special problems for the five year commencing from April 1, 2000 as recommended by the Commission.

Grants to States for financing local bodies

8. The Commission has recommended grants totalling Rs. 10,000 crore for local bodies during 2000-05, to be utilised (except the amount earmarked for maintenance of accounts & audit and for development of database) for maintenance of civic services (excluding payment of salaries and wages). Of this, Rs. 1600 crore p.a. is for rural local bodies and Rs. 400 crore p.a. is for urban local bodies. The inter-State distribution, criterion adopted in arriving at the proposed distribution are given in Chapter VIII of their Report. Of the total grants for local bodies, the Commission has emphasised earmarking of funds in two areas: Rs. 200 crore for development of database on the finances of the panchayats and municipalities and Rs. 98.61 crore for maintenance of accounts of panchayats as the first charge on these grants, to be released by the concerned Ministries of the Government of India, after the arrangements suggested by the Commission have become operational. The Commission has also suggested several measures for strengthening of arrangements for maintenance of accounts and audit of local bodies.

9. The Government has accepted these recommendations subject to the following caveats:-

(i) The local bodies should be required to raise suitable matching resources.

(ii) In cases where elected local bodies are not in place, the Central Government shall hold the share of such bodies in trust on a non-lapsable basis during 2000-05. Central Government may also similarly hold back a part of the recommended share in case of such bodies to whom functions and responsibilities have not been devolved.

(iii) Earmarking of funds for maintenance of accounts, within the overall recommended level of grants, may be increased to the extent necessary in consultation with the C&AG.

(iv) Measures to strengthen accounts and audit of local bodies have been accepted in principle. Details will be worked out in consultation with the C&AG.

Financing of calamity relief expenditure

10. The Commission has recommended the continuance of the existing scheme of Calamity Relief funds in States with an aggregate size of Rs. 11007.59 crore during 2000-05. This includes the Centre's share of Rs. 8255.69 crore, and the States' share of Rs. 2751.90 crore, worked out in the ratio of 75:25. The State-wise distribution and the criterion adopted by the Commission is indicated in Chapter IX of their Report.

11. The Commission has recommended the discontinuation of the existing National Fund for Calamity Relief because a calamity of rare severity is conceptually of such a nature that the intensity and magnitude cannot be anticipated and provided for in advance through the CRF or regular budgetary mechanism. The Central Government's responsibility does not get restricted to the availability of the amount in the Fund as indeed has been shown during 1995-2000 when Central Government released Rs. 2555 crore from NFCR set up with a corpus of only Rs. 700 crores. Instead, the Commission has recommended that the Central assistance to the States in national calamities should be financed by levy of a special surcharge on the Central taxes for a limited period. A surcharge can also instil a feeling of national participation for a national cause. Collection from such surcharge should be kept in a separate fund, to be known as National Calamity Contingency Fund (NCCF), created in the public Account of the Government of India. The Commission has also recommended that Government of India should contribute an initial core amount of Rs. 500 crore to this fund so that funds for initial operations are readily available. However, drawls from the fund should be accompanied by imposition of the special surcharge so that it is immediately recouped. Any balance left from the collection of the surcharge, after meeting the exigency for which it was collected, should be credited to the fund and not treated as a resource for meeting the budgetary expenditure. In order to ensure that there is no delay in the flow of funds to the States for administration of relief, a legislation enabling the Central Government to levy surcharge may be enacted.

12. The Government has accepted the above recommendations of the Commission. The recommendation concerning National Calamity Contingency Fund will be implemented after necessary legislation is enacted.

Debt relief to States

13. The Commission has proposed to continue the existing debt relief scheme, linked to improvement in the ratio of revenue receipts of a State to its total revenue expenditure, with enhanced incentive. Details are given in Chapter XI of their report. Besides, the Commission has recommended a moratorium on the payment of instalments of debt and interest on the special loans given to Punjab during 1984-94 for combating insurgency and militancy due for repayment from the State of Punjab during the period 2000-05. The Commission has further recommended debt relief to Punjab and Jammu & Kashmir on the basis of specified expenditure incurred on security.

14. The Government has accepted the above recommendations of the Commission.

Miscellaneous

15. While working out the total quantum of devolution of share in Central taxes/duties to States and grants-in-aid to States, the Commission has considered the trends in total transfers from the Centre to the States on Revenue account and given its recommendations on the basis of the premise that tax devolution and Plan/non-Plan grants from the Centre to the States should not exceed 37.5% of total Centre's revenues, both tax and non-tax. The Government has accepted this ceiling on total Revenue account transfers from the Centre to the States. However, the acceptance does not imply the establishment of a principle of mandatory sharing of a fixed percentage of Centre's revenue receipts with the States.

IMPLEMENTATION

16. The Commission's recommendations fall in four categories:

(i) Those to be implemented by an Order of the President.
(ii) Those to be implemented by Law of Parliament.
(iii) Those to be implemented by executive orders.
(iv) Those to be examined further.

17. The recommendations under articles 270 and 275(1) of the Constitution relating to share in Central taxes and duties and grants-in-aid, respectively, fall in the first category and the necessary order will be submitted to the President for approval.

18. Recommendations relating to setting up of a National Calamity Contingency Fund (NCCF) and enabling the Central Government to levy surcharge for national calamities fall in the second category. Necessary legislation will be proposed for implementing these recommendations.

19. The recommendations relating to debt relief will be implemented by executive orders.

20. Other recommendations of the Commission will be considered in due course.

Sd/-
(Yashwant Sinha)
Minister of Finance

New Delhi
July 27, 2000.

Explanatory Memorandum as to the action taken on the recommendations made by the Eleventh Finance Commission in its Report submitted to the President on 30th August,2000

1. The Eleventh Finance Commission was constituted by the President on July 3, 1998 to give recommendations on specified aspects of Centre-State fiscal relations during 2000-05. The Commission submitted its Report covering all aspects of its original mandate on 7th July,2000. Earlier, on 15th January, 2000, the Commission had submitted an interim Report for making provisional arrangements for 2000-2001. The interim recommendations of the Commission were accepted by the Government and were laid on the Table of the House on 16th March, 2000. The Commission was asked (vide President's order dated 28th April, 2000) to "draw a monitorable fiscal reforms programme aimed at reduction of revenue deficit of the States and to recommend the manner in which the grants to States to cover the assessed deficit in their non-plan revenue account may be linked to progress in implementing the programme." On 7th July, 2000, the Commission submitted its report covering all aspects of its original mandate except in respect of the additional mandate assigned to it under the President's order dated 28th April, 2000. This report of the Eleventh Finance Commission was laid on the Table of the House on 27th July, 2000 together with an explanatory memorandum as to the action taken by the Government on the recommendations of the Commission.

2. The Commission has now submitted a supplementary report on 30th August, 2000 purpotedly under the additional mandate assigned to it under the President's order dated 28th April, 2000. This Report together with the Explanatory Memorandum on the action taken on the recommendations of the Commission is being laid on the Table of the House, in pursuance of Article 281 of the Constitution.

3. This report mainly deals with grants to States in the context of revenue deficit in the accounts of the States. In respect of revenue deficit grants to States, the Commission's recommendations in their three Reports are summarised below:-

* In the Interim Report submitted on 15th January, 2000, the Commission had recommended a lumpsum provision of Rs. 11000 crore in the Central Budget 2000-01 for revenue deficit grants to States without giving State-wise break-up.

* In the Main Report submitted on 7th July, 2000, the Commission recommended revenue deficit grants of Rs. 35359 crore for 15 States during 2000-2005. The remaining 10 States were revenue surplus in the Commission's assessment. The Commission was asked to draw up a monitorable fiscal reforms programmes and to recommend how to link the release of revenue deficit grants to progress in implementing the programme.

* Since only 15 States were assessed to be in revenue deficit, the fiscal reforms programme should have normally covered only the 15 States assessed to be in revenue deficit. Instead, in the Supplementary Report submitted on 30th August, 2000, the majority view in the Commission has recommended monitorable fiscal reforms programmes for all States. It has been recommended that 15% of the revenue deficit grants meant for 15 States during 2000-05 and a matching contribution by Central Government be credited into an Incentive Fund from which fiscal performance based grants should be made available to all 25 States. Release of performance based grants from an Incentive Fund to be set up by withholding 15% of the Rs. 35359 crore deficit grants for 15 States and an equal matching contribution by Government of India with year-wise phasing as follows:

Composition of the Incentive Fund

(Rs. In crores)

Year	Withheld portion of theRevenue deficit grants	Contribution of the Centre	Total Fund
2000-01	1523.06	598.48	2121.54
2001-02	1080.43	1041.11	2121.54
2002-03	994.64	1126.91	2121.55
2003-04	861.74	1259.81	2121.55
2004-05	843.99	1277.55	2121.54
Total	5303.86	5303.86	10607.72

* The Commission has also recommended that the grants for specific purposes like upgradation, special problems and local bodies, which remain unutilised due to

non-observance of conditionalities attached to the release of these grants may also be credited to the Incentive Fund during 2004-05.

4. Important features of the scheme proposed by the Commission in the Supplementary Report are summarised below.

(i) A group designated as Monitoring Agency may be constituted by the Government of India for drawing up State-specific monitorable fiscal reforms programmes for all States in the context of the broad parameters suggested by the Commission and as accepted by Government of India. The group may include, among other, representatives of Planning Commission, the Finance Ministry of the Government of India and the representative of the State Government concerned.

(ii) Eighty five per cent of the revenue deficit grant recommended by the Commission and accepted by the Government of India may be released to the relevant States without linking it to performance under the monitorable fiscal reforms programme. Only 15 per cent of the revenue deficit grant to which a State is entitled may be withheld and linked with the progress in performance.

(iii) The monitorable programme should give equal weight to the raising of revenue and control of expenditure. The areas indicated by the Commission for monitoring are only suggestive; so are the weights. These can be suitably modified while drawing the State specific programme. However, the broad contents of the reform indicated in the Main Report should be kept in view as the ultimate objective is to bring the revenue deficit of the States to zero, in the aggregate, by 2004-05.

(iv) The Incentive Fund should be set up comprising of two parts. The first part of the Fund would comprise 15 per cent of the withheld part of the grants recommended to cover the deficit of the States on non-plan revenue account. Depending on the performance of a State in the implementation of the monitorable programme, the withheld amount would be released to it on a proportionate basis. The second part of the Fund would be created by contribution from the Central Government, equivalent to 15 per cent of the revenue deficit grants recommended by the Commission.

(v) The incentive component is recommended to be provided to all the States. The initial eligibility of the States has been worked out on the basis of the population as per the 1971 Census. The amount will be available to a State in proportion to the level of performance in the implementation of the monitorable fiscal reforms programme for each year.

(vi) If any State is unable to get the full amount initially earmarked for it in any year, such amount will not lapse but will continue to be available in subsequent years to the same State. During the first four years, no amount of this Fund earmarked for assistance/incentive to a State, would be transferred to another State. However, if any State is not able to draw the amount indicated on the basis of the performance of the first four years, the amount undisbursed to a State would form part of the common pool and would be distributed to the performing States in the fifth year on a pro-rata basis in addition to the amounts to which they are initially entitled. The same would apply to the undrawn amount of the withheld portion of the grants to cover non-plan revenue deficit. Every State irrespective of the assessed deficit or not would be entitled to get the assistance on a pro-rata basis related to performance from the additions to the Fund. This additional entitlement can go up to 100 per cent of their initial eligibility indicated for the State concerned. The Fund may be kept separately, preferably in public account.

(vii) The withheld amount of grants releasable in 2004-05 may be released to the concerned assessed State on the basis of a review of their performance. In case any amount remains unreleased to a State, it would be added to the Fund and would be available to the remaining States. The balance amount in the fund at the end of 2005-06 will lapse to the Central Government.

(viii) The Commission had recommended grants for specific purposes like upgradation, special problems and local bodies in the Main Report. There are certain specific conditionalities for releasing these grants. The progress in the implementation of the identified schemes may be reviewed by the Monitoring Agency. If the Agency is satisfied that a State has not taken effective steps to implement these in the first four years, and is not in a position to utilise the amount either in full or in part, the same may be added to the Incentive Fund in the fifth year.

(ix) In addition to the incentives for better performance, Central Government may also consider the fiscal reforms programme linked assistance by way of extended ways and means advance and additional open market borrowings. The scope and dimension of such facilities should be drawn up by the Central Government bearing in mind the Centre's fiscal position and the macro-economic implications of this facility. This facility should also be extended to all States linked to monitorable fiscal reforms programme drawn up for the State.

(x) The disbursements from the Incentive Fund as well as the utilisation of the grants recommended by the 11th Finance Commission in the Main Report will be subject to review by the 12th Finance Commission.

5. The above recommendations of the Commission have been accepted by the Government in the interest of furthering the cause of fiscal reforms in the States.

6. The recommendations relating to regulation of grants-in-aid under article 275(1) of the Constitution are required to be implemented by an Order of the President and the necessary order will be submitted to the President for approval.

7. The above recommendations of the Commission substantially alter the recommendations already made in the Main Report and accepted by the Government. Nevertheless, the recommendations have been accepted by the Government in the interest of furthering the cause of fiscal reforms in the States.

Sd/-

(Yashwant Sinha)
Minister of Finance

New Delhi
19th December, 2000