
Chapter 16

Summary of Recommendations

Plan for Restructuring Public Finances

1. By 2009-10, the combined tax-GDP ratio of the centre and the states should be increased to 17.6 per cent, primary expenditure to a level of 23 per cent of GDP and capital expenditure to nearly 7 per cent of GDP
(Para 4.52)
2. The combined debt-GDP ratio with external debt measured at historical exchange rates should, at a minimum, be brought down to 75 per cent by the end of 2009-10.
(Para 4.45)
3. The system of on-lending should be brought to an end over time and the long term goal for the centre and states for the debt-GDP ratio should be 28 per cent each.
(Para 4.45)
4. The fiscal deficit to GDP ratio targets for the centre and the states may be fixed at 3 per cent of GDP each.
(Para 4.45)
5. The centre's interest payment relative to revenue receipts should reach about 28 per cent by 2009-10. In the case of states, the level of interest payments relative to revenue receipts should fall to about 15 per cent by 2009-10.
(Para 4.54)
6. The revenue deficit relative to GDP for the centre and the states, for their combined as well as individual accounts should be brought down to zero by 2008-09.
(Para 4.51)
7. States should follow a recruitment and wage policy, in a manner such that the total salary bill relative to revenue expenditure net of interest payments and pensions does not exceed 35 per cent.
(Para 4.63)
8. Each state should enact a fiscal responsibility legislation, which should, at a minimum, provide for
 - (a) eliminating revenue deficit by 2008-09;
 - (b) reducing fiscal deficit to 3 per cent of GSDP or its equivalent, defined as the ratio of interest payment to revenue receipts;
 - (c) bringing out annual reduction targets of revenue and fiscal deficits;

- (d) bringing out annual statement giving prospects for the state economy and related fiscal strategy; and
- (e) bringing out special statements along with the budget giving in detail the number of employees in government, public sector, and aided institutions and related salaries.

(Para 4.79)

Sharing of Union Tax Revenues

9. The share of the states in the net proceeds of shareable central taxes shall be 30.5 per cent. For this purpose, additional excise duties in lieu of sales tax are treated as a part of the general pool of central taxes. If the tax rental arrangement is terminated and the states are allowed to levy sales tax (or VAT) on these commodities without any prescribed limit, the share of the states in the net proceeds of shareable central taxes shall be reduced to 29.5 per cent.

(Para 7.22)

10. If any legislation is enacted in respect of service tax after the eighty eighth Constitutional amendment is notified, it must be ensured that the revenue accruing to a state under the legislation should not be less than the share that would accrue to it, had the entire service tax proceeds been part of the shareable pool.

(Para 7.22)

11. The indicative amount of over all transfers to states may be fixed at 38 per cent of the central gross revenue receipt.

(Para 7.22)

12. The states should be given a share as specified in the following table in the net proceeds of all the shareable Union taxes in each of the five financial years during the period 2005-06 to 2009-10.

(Paras 7.35, 7.36)

State	Share (all shareable taxes excluding service tax) (per cent)	Share of Service Tax (per cent)
1	2	3
Andhra Pradesh	7.356	7.453
Arunachal Pradesh	0.288	0.292
Assam	3.235	3.277
Bihar	11.028	11.173
Chhattisgarh	2.654	2.689
Goa	0.259	0.262
Gujarat	3.569	3.616
Haryana	1.075	1.089
Himachal Pradesh	0.522	0.529
Jammu & Kashmir	1.297	nil
Jharkhand	3.361	3.405
Karnataka	4.459	4.518
Kerala	2.665	2.700
Madhya Pradesh	6.711	6.799
Maharashtra	4.997	5.063
Manipur	0.362	0.367
Meghalaya	0.371	0.376
Mizoram	0.239	0.242
Nagaland	0.263	0.266
Orissa	5.161	5.229
Punjab	1.299	1.316
Rajasthan	5.609	5.683
Sikkim	0.227	0.230
Tamil Nadu	5.305	5.374
Tripura	0.428	0.433
Uttar Pradesh	19.264	19.517
Uttaranchal	0.939	0.952
West Bengal	7.057	7.150
All states	100.000	100.000

Local Bodies

13. A total grant of Rs.20000 crore for the panchayati raj institutions and Rs.5000 crore for the urban local bodies may be given to the states for the period

- 2005-10 with *inter-se* distribution as indicated in Table 8.1.
(Para 8.38)
14. The PRIs should be encouraged to take over the assets relating to water supply and sanitation and utilize the grants for repairs/rejuvenation as also the O&M costs. The PRIs should, however, recover at least 50 percent of the recurring costs in the form of user charges.
(Para 8.40)
 15. Out of the grants allocated for the panchayats, priority should be given to expenditure on the O&M costs of water supply and sanitation. This will facilitate panchayats to take over the schemes and operate them.
(Para 8.41)
 16. At least 50 per cent of the grants provided to each state for the urban local bodies should be earmarked for the scheme of solid waste management through public-private partnership. The municipalities should concentrate on collection, segregation and transportation of solid waste. The cost of these activities, whether carried out in house or out sourced, could be met from the grants.
(Para 8.42)
 17. Besides expenditure on the O&M costs of water supply and sanitation in rural areas and on the schemes of solid waste management in urban areas, PRIs and ULBs should, out of the grants allocated, give high priority to expenditure on creation of data base and maintenance of accounts through the use of modern technology and management systems, wherever possible. Some of the modern methods like GIS (Geographic Information Systems) for mapping of properties in urban areas and computerization for switching over to a modern system of financial management would go a long way in creating strong local governments, fulfilling the spirit of the 73rd and 74th Constitutional amendments.
(Para 8.43)
 18. The states may assess the requirement of each local body on the basis of the principles stated by us and earmark funds accordingly out of the total allocation re-commended by us.
(Para 8.43)
 19. Grants have not been recommended separately for the normal and the excluded areas under the fifth and sixth schedule of the Constitution. The states having such areas may distribute the grants recommended by us to all local bodies, including those in the excluded areas, in a fair and just manner.
(Para 8.51)
 20. The central government should not impose any condition other than those prescribed by us, for release or utilization of these grants, which are largely in the nature of a correction of vertical imbalance between the centre and the states.
(Para 8.52)
 21. The normal practice of insisting on the utilization of amounts already released before further releases are considered, may continue and the grants may be released to a state only after it certifies that the previous releases have been

- passed on to the local bodies. The amounts due to the states in the first year of our award period i.e. 2005-06 may be released without such an insistence.
(Para 8.52)
22. State governments should not take more than 15 days in transferring the grants to local bodies after these are released by the central government. The centre should take a serious view of any undue delay on the part of the state.
(Para 8.53)
23. The central government should take note of our views on the issues listed in para 8.23, while formulating or revising various policy measures. In particular, action may be taken to raise the ceiling on profession tax.
(Para 8.23)
24. The state should adopt the best practices listed in para 8.19 to improve the resources of the panchayats.
(Para 8.19)
25. The suggestions made by us in respect of state finance commissions in paras 8.29 to 8.37 and 8.54 should be acted upon with a view to strengthening the institution of SFCs, so that it may play an effective role in the system of fiscal transfers to the third tier of government.
(Paras 8.29 to 8.37, 8.54)
27. The size of the CRF for our award period is worked out at Rs.21333.33 crore.
(Para 9.11)
28. The scheme of NCCF may continue in its present form with core corpus of Rs.500 crore. The outgo from the fund may continue to be replenished by way of collection of National Calamity Contingent Duty and levy of special surcharges.
(Paras 9.16, 9.17)
29. The definition of natural calamity, as applicable at present, may be expanded to cover landslides, avalanches, cloud burst and pest attacks.
(Para 9.12)
30. The centre may continue to make allocation of foodgrains to the needy states as a relief measure, but a transparent policy in this regard is required to be put in place.
(Para 9.18)
31. A committee consisting of scientists, flood control specialists and other experts be set up to study and map the hazards to which several states are subject to.
(Para 9.14)
32. The provision for disaster preparedness and mitigation needs to be built into the state plans, and not as a part of calamity relief.
(Para 9.14)

Calamity Relief

26. The scheme of CRF be continued in its present form with contributions from the centre and the states in the ratio of 75:25.
(Paras 9.10, 9.11)

Grants-in-aid to States

33. The system of imposing a 70:30 ratio between loans and grants for extending plan assistance to non-special category states (10:90 in the case of special

category states) should be done away with. Instead, the centre should confine itself to extending plan grants to the states, and leave it to the states to decide how much they wish to borrow and from whom.

(Para 10.4)

34. A total non-plan revenue deficit grant of Rs.56855.87 crore is recommended during the award period for fifteen states (*vide* Table 10.4).

(Paras 10.12, 10.13)

35. Eight states have been recommended for grants amounting to Rs.10171.65 crore over the award period for the education sector, with a minimum of Rs.20 crore in a year for any eligible state (*vide* Table 10.5).

(Para 10.17)

36. Seven states have been recommended for grants amounting to Rs.5887.08 crore over the award period for the health sector (major heads 2210 and 2211), with a minimum of Rs.10 crore a year for any eligible state (*vide* Table 10.6).

(Para 10.18)

37. The grants for the education and health sectors are an additionality, over and above the normal expenditure to be incurred by the states in these sectors. These grants should be utilised only for the respective sectors (non-plan), i.e., major head 2202 in the case of education and major heads 2210 and 2211 in the case of health. Conditionalities governing the releases and utilisation of these grants have been specified in annexures 10.1 to 10.3. No further conditionalities should be imposed by the central or the state

government for the release or utilisation of these grants. Monitoring of the expenditure relating to these grants will rest with the state government concerned.

(Para 10.19)

38. A grant of Rs.15,000 crore over the award period is recommended for maintenance of roads and bridges. This amount will be in addition to the normal expenditure which the states would be incurring on maintenance of roads and bridges. This amount will be provided in equal instalments over the last four years (i.e., 2006-07 to 2009-10) of the award period, so that the states get a year for making preparations to absorb these funds.

(Para 10.21)

39. An amount of Rs.5000 crore is recommended as grants for maintenance of public buildings.

(Para 10.22)

40. The maintenance grants for roads and bridges, and for buildings, are an additionality, over and above the normal maintenance expenditure to be incurred by the states. These grants should be released and spent in accordance with the conditionalities indicated in annexures 10.4 to 10.6.

(Para 10.23)

41. A grant of Rs. 1000 crore spread over the award period 2005-10 is recommended for maintenance of forests. This would be an additionality over and above what the states would be spending through their forest departments. It should also result in increased expenditure to the extent of this grant, in addition to the

normal expenditure of the forest department.

(Para 10.25)

42. A grant of Rs.625 crore spread over the award period is recommended for heritage conservation. This grant will be used for preservation and protection of historical monuments, archaeological sites, public libraries, museums and archives, and also for improving the tourist infrastructure to facilitate visits to these sites.

(Para 10.26)

43. An amount of Rs.7100 crore has been recommended as grant for state specific needs. While these grants have been phased out equally over the last four years, this phasing should be taken as indicative in nature. The states may communicate the required phasing of grants to the central government (*vide* Table 10.11).

(Para 10.28)

Fiscal Reform Facility

44. The scheme of Fiscal Reform Facility may not continue over the period 2005-10, as the scheme of debt relief, as described in chapter 12 obviates the need for a separate Fiscal Reform Facility.

(Para 11.25)

Debt Relief and Corrective Measures

45. Each state must enact a fiscal responsibility legislation prescribing specific annual targets with a view to eliminating the revenue deficit by 2008-09 and reducing fiscal deficits based on a path for reduction of borrowings and guarantees. Enacting

the fiscal responsibility legislation on the lines indicated in chapter 4 will be a necessary pre-condition for availing of debt relief.

(Para 12.36)

46. Debt relief may not be linked with performance in human development or investment climate.

(Para 12.38)

47. The central loans to states contracted till 31.3.04 and outstanding on 31.3.05 (amounting to Rs 128795 crore) may be consolidated and rescheduled for a fresh term of 20 years (resulting in repayment in 20 equal instalments), and an interest rate of 7.5 per cent be charged on them. This will be subject to the state enacting the fiscal responsibility legislation and will take effect prospectively from the year in which such legislation is enacted.

(Para 12.42)

48. A debt write-off scheme linked to the reduction of revenue deficit of states may be introduced. Under the scheme, the repayments due from 2005-06 to 2009-10 on central loans contracted up to 31.3.04 and recommended to be consolidated will be eligible for write off. The quantum of write off of repayment will be linked to the absolute amount by which the revenue deficit is reduced in each successive year during the award period. The reduction in the revenue deficit must be cumulatively higher than the cumulative reduction attributable to the interest relief recommended by us. Also, the fiscal deficit of the state must be contained at least to the level of 2004-05. In effect, if the revenue deficit is brought

down to zero, the entire repayments during the period will be written off. The enactment of the fiscal responsibility legislation would be a necessary pre-condition for availing the debt relief under this scheme also with the benefit accruing prospectively. Details of the scheme have been outlined in para 12.44.

(Para 12.43)

49. The central government should not act as an intermediary for future lending and allow the states to approach the market directly. If some fiscally weak states are unable to raise funds from the market, the centre could borrow for the purpose of on lending to such states, but the interest rates should remain aligned to the marginal cost of borrowing for the centre.

(Para 12.46)

50. External assistance may be transferred to states on the same terms and conditions as attached to such assistance by external funding agencies, thereby making government of India a financial intermediary without any gain or loss. The external assistance passed through to states should be managed through a separate fund in the public account.

(Para 12.49)

51. The moratorium on repayments and interest payments on the outstanding special term loan amounting to Rs. 3772 crore as on 31.03.2000 given to Punjab may continue for another two years i.e. up to 2006-07, by which time the central government must finalize the quantum of debt relief to be allowed in terms of the recommendations of the EFC.

(Para 12.51)

52. In respect of relief and rehabilitation loans given to Gujarat from ADB and World Bank through the central government, the central government may, if the government of Gujarat so desires, alter the terms and conditions of these loans, so that these are available to Gujarat on the same terms on which the external agencies have extended these loans.

(Para 12.55)

53. All states should set up sinking funds for amortization of all loans including loans from banks, liabilities on account of NSSF etc. The fund should be maintained outside the consolidated fund of the states and the public account and should not be used for any other purpose, except for redemption of loans.

(Para 12.59)

54. States should set up guarantee redemption funds through earmarked guarantee fees. This should be preceded by risk weighting of guarantees. The quantum of contribution to the fund should be decided accordingly.

(Para 12.60)

Profit Petroleum

55. The Union should share the profit petroleum from NELP areas with the states from where the mineral oil and natural gas are produced. The share should be in the ratio of 50:50.

(Para 13.31)

56. There need not be sharing of profits in respect of nomination fields and non-NELP blocks.

(Para 13.32)

57. The revenues earned by the central government on contracts signed under the coal bed methane policy may be shared with the producing states in the same manner as profit petroleum.

(Para 13.33)

58. In respect of any mineral, if a loss of revenue is anticipated for a state in the process of implementation of a policy, which involves production sharing, a similar compensation mechanism should be adopted by the central government.

(Para 13.34)

A Permanent Secretariat for the Finance Commission

59. The finance commission division of the Ministry of Finance should be converted into a full-fledged department, serving as the permanent secretariat for the finance commissions. This secretariat should be vested with the powers of a full-fledged department of the government, with Ministry of Finance only as its nodal ministry for the purpose of linkage with the Parliament.

(Paras 14.6, 14.7)

60. The expenditure of finance commissions should be treated as expenditure “charged” on the consolidated fund of India.

(Para 14.9)

61. A research committee should be set up with adequate funding to organize studies relevant to fiscal federalism.

(Para 14.8)

62. The finance commissions should have a tenure of at least 3 years to

enable them to do their work adequately.

(Para 14.8)

63. The Thirteenth Finance Commission should be set up at the beginning of 2007 and appropriate and adequate arrangements for the office and residence of the chairman and members of the Commission must be made before the appointment of the Commission, so that Commission’s time is not wasted in routine administrative matters.

(Para 14.8)

Monitoring Mechanism

64. Every state should set up a high level monitoring committee headed by the Chief Secretary with the Finance Secretary and the Secretaries / heads of departments as members for monitoring proper utilization of finance commission grants.

(Paras 14.11, 14.12)

65. The monitoring committee should meet at least once in every quarter to review the utilization of the grants and to issue directions for mid-course correction, if considered necessary.

(Para 14.12)

66. The monitoring committee should be responsible for monitoring both financial and physical targets and for ensuring adherence to the specific conditionalities in respect of each grant, wherever applicable.

(Para 14.11)

67. In the beginning of the year, the monitoring committee should approve finance commission assisted projects to be undertaken in each sector,

quantify the targets, both in physical and financial terms and lay down the time period for achieving specific milestones.

(Para 14.11)

Accounting Procedure

68. Central government should gradually move towards accrual basis of accounting.

(Para 14.16)

69. In the interim period, additional information in the form of statements should be appended to the present system of cash accounting to enable more informed decision making. The additional information may relate to subsidies, expenditure on salaries,

expenditure on pensions, committed liabilities, maintenance expenditure, segregation of salary and non-salary portions and liabilities and repayment schedule on outstanding debts.

(Para 14.16)

70. The definition of revenue and fiscal deficits be standardized and instructions for a uniform classification code down to the object head may be issued to all the states.

(Para 14.17)

71. A National Institute of Public Financial Accountants be set up by the government of India and its charter be decided in consultation with the Comptroller and Auditor General.

(Para 14.18)

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New Delhi
November 30, 2004

I am happy to record my deep appreciation of the unstinted cooperation and support provided by Members of the Commission. The Report is a joint effort and has benefited from the wealth of knowledge and experience brought to bear on it by each Member. I also wish to thank Shri Som Pal, who was a Member of the Commission till May, 2004. He articulated his views with great clarity and sincerity in the various discussions that the Commission had. I must place on record the exemplary services rendered by the Member Secretary, Dr. G.C. Srivastava, who, besides making a substantive contribution to the Report, provided effective leadership to the Secretariat and organized meticulously the multifarious work related to the Commission. His experience at the various levels of government was a great asset to the Commission.

New Delhi
November 30, 2004

C. Rangarajan
Chairman