Fourteenth Finance Commission

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STUDY ON "EVALUATION OF STATE FINANCES" WITH RESPECT TO STATE OF SIKKIM

STUDY REPORT

SUBMITTED BY

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Acknowledgement

The constitutional framework of this country provides for a federal system of governance. As a result of this the states have to bear important responsibilities in the social and economic sectors, in addition to the normal governance activities entrusted to them. One of the outcomes of this federal structure is that the states have a comparatively less significant role to play vis-à-vis revenue and taxation. This has naturally resulted in the generation of a chasm between the needs and availability of resources for the states.

With the situation being as it is, the successive Finance Commissions have been set up in order to facilitate the process of revenue generation in the states thus bringing about their rapid economic growth. The Commission provides a legitimate system through which the states can put forward their views on the financial relations between the Centre and the states.

The Commission performs the important task of identifying the states that qualify for grants-in-aid out of the Consolidated Fund of India along with the equitable distribution of the same among different states. For this purpose the Commission takes into consideration not just the current requirements of the state concerned, but also those that may arise during the period for which the grant is being made. This requires the Commission to base its forecasts on a number of assumptions, variables and parameters.

This report would not have been possible without the contribution of a large number of people. It was Mr A.N.Jha, Secretary, Fourteenth Finance Commission, who wrote to the Vice Chancellor, Sikkim University, requesting the Economics Department of the University (then the Department of Economic Studies and Planning) to take up the project covering the evaluation of state finances in Sikkim. I am grateful to the Honourable Vice Chancellor for giving me the opportunity to undertake this worthy project. I am also thankful to the Registrar, Sikkim University for the kind help and support extended to me in the course of this project.

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CONTENTS

LIST OF TABLES

Evaluation of State Finances in Sikkim – A Synopsis

The federal system of governance prevalent in our country mandates that the states have to bear important responsibilities in the social and economic sectors, in addition to the normal governance activities entrusted to them. One of the outcomes of this federal structure is that the states have a comparatively less significant role to play vis-à-vis revenue and taxation. This has naturally resulted in the generation of a chasm between the needs and availability of resources for the states.

With the situation being as it is, the successive Finance Commissions have been set up in order to facilitate the process of revenue generation in the states thus bringing about their rapid economic growth. The Commission provides a legitimate system through which the states can put forward their views on the financial relations between the Centre and the states.

The Commission performs the important task of identifying the states that qualify for grants-in-aid out of the Consolidated Fund of India along with the equitable distribution of the same among different states. For this purpose the Commission takes into consideration not just the current requirements of the state concerned, but also those that may arise during the period for which the grant is being made. This requires the Commission to base its forecasts on a number of assumptions, variables and parameters.

A number of the facts have been revealed in the course of the preparation of this report. The AE/GSDP ratio of the Government of Sikkim has reduced to 36.84% in 2011-12, which represents a decrease of 24.87 % compared to 2008-09. Considering development expenditure in proportion to aggregate expenditure there has been a marginal decrease of 1.93% in 2011-12 compared to 2008-09.

The Sikkim Government is giving more importance to the social sector, as is evident from the increase in social sector expenditure as a percentage of annual expenditure by 5.61%. On the other hand, the expenditure on the capital sector has fallen by 10.8 % in 2011-12 compared to 2008-09. This suggests that State Government was not giving enough emphasis to capital expenditure during these years.

Development expenditure in case of Sikkim consists of revenue expenditure, capital outlay and loans and advances on socio-economic services. Such expenditure registered an increase from 1,135 crore in 2007-08 to 2,285.35 crore in 2011-12. In terms of percentage of total expenditure, the increase was from 72.65 per cent in 2007-08 to 73.85 per cent in 2011-12. Development expenditure for 2011-12 increased by 33.32 per cent relative to 2010-11; this was on account of increase in development loans disbursed and other components. 70 per cent of the development expenditure on an average was on revenue account. The balance was ascribed to capital expenditure including loans and advances.

Development revenue expenditure in 2011-12 consisted of inter alia expenditure on salary (874.83 crore), subsidy (7.10 crore) and financial assistance to local bodies and other institutions (252.39 crore).

It is rare to find a balanced budget in an emerging economy. In such a situation the government uses borrowings to reduce the gap between expenditure requirements and inadequate non-debt receipts.

In case of Sikkim the main fiscal parameters like revenue surplus, fiscal deficit and primary deficit indicate that the State had been able to maintain revenue surplus over a period of ten years due to increase in revenue receipts. The share of committed expenditure in the NPRE was 74.14 percent which did not leave many funds for developmental purposes. Capital expenditure increased by 164.69 crore over the previous year. The fiscal deficit demonstrated a decrease from 316.25 to 180.15 crore in 2011-12. The primary deficit decreased by 118.80 crore during 2011-12. Grants-in-aid, which were 59.97 % of the State's revenue receipts in 2011-12, increased by Rs 617.48 crore. The continued dependence of the State on central transfers and grants-in-aid was suggested by the fact that 81.26 % of the revenue receipts during the year came from the Government of India. The social sector and economic sector witnessed growth in revenue expenditure of 26.36 and 23.39 % over 2010-11. In case of general services growth in revenue expenditure was 9.85%.

Committed expenditure on salaries, pension, interest payments and subsidies formed 51.3% of revenue expenditure.

Capital expenditure which formed nearly 20 % of total expenditure underwent an increase of 164.69 crore or 36.51% over the value in 2010-11.

Funds amounting to Rs 180.53 crore remained blocked (as of 31 March 2012) in incomplete projects.

There was a decrease in debt-GSDP ratio from 39.16 in 2010-11 to 37.63 in 2011-12, which was much below the normative assessment made by the XIII Finance Commission for the current year. The fiscal liabilities stood at nearly 1.10 times of the revenue receipts and 5.88 times of the State's own resources. The buoyancy of these liabilities with respect to GSDP during the year was 0.07. This would suggest that for each one unit increase in GSDP, fiscal liabilities grew by 0.07.

The return from investment was 'Nil' and some of the Companies/Corporations were under perennial loss.

Coming to tourism and other related activities, these have assumed a significant part of the state economy since 2007. The number of tourists, both domestic and foreign, has been continuously increasing in the period between 2005 and 2012, though after 2010 the total number of tourists as well as the number of domestic tourists has decreased. The compound annual rate of growth for tourists has been found to be 7.46 %. During the same period domestic and foreign tourists grew at an annual compound rate of 7.50 per cent and 6.26 per cent respectively. As mentioned earlier, between 2010 and 2012, there was an overall slowing down in tourists' arrival, and tourism was mostly domestic in nature. In fact, in 2009, the number of foreign tourists decreased and the inflow of foreign tourists registered a negative growth. Between 2010 and 2012 growth rate of foreign tourist demonstrated a decrease. The growth of domestic tourists had registered an all time low.

If the variables like transport and communication, trade, hotels and restaurants, and banking and insurance are considered as proxy for the growth of tourism, then the contribution of these sectors to GSDP will partly explain the contribution of tourism towards revenue generation in the state. Average contribution of these three sectors account for 11.89 per cent of GSDP (in 2005). However, trade, hotels and restaurants have reduced their contribution with an average contribution of 2.27 percent in 2012-13. Transport and communication, and banking and insurance in average are contributing 3.02 per cent and 3.19 per cent respectively.

Sikkim declared tourism as an industry during the 10th Five Year plan (2002-07). In addition, development of basic infrastructure, handloom & handicrafts, human resources etc. have been put on the priority list. The Rangpo-Gangtok, Melli- Jorethang and Jorethang-Reshi roads were declared as industrial corridors whereby land would be acquired by the government and leased out on a long term basis to the investors. The strategy in the 10th Five Year Plan for implementation of Centrally Sponsored Scheme was to identify the various tourism projects like Tourism Information Centres, tourist lodges, yatri niwases, public conveniences, wayside amenities, trekking trails, water sports activities, publicity brochure, adventure sports equipment, tourist circuits, etc to meet the requirements and needs of tourists. Existing attraction centres will be provided with upgraded facilities on phased manner over the five-year period duly prioritising the schemes requiring immediate upgradation based on tourist flow to destinations.

While it is a well known fact that the Government of Sikkim is trying its best to promote Sikkim as one of the best tourist destinations at national and international levels, it would be better to take a closer look at the relevant facts. This can be done by considering the figures of plan expenditure on tourism in Sikkim in different plan periods. Additionally, plan expenditure on road transportation and roads and bridges should also be taken into consideration because expansion of tourism is positively correlated with the expansion of road transportation and roads and bridges. Increases in plan expenditure on tourism by 39.9% and from 2002-03 to 2011-12 and in the transport sector increases by 20.46% in the same period would tend to confirm this. In contrast, plan allocation on roads and bridges has been receiving much higher emphasis and the amount is also quite substantial in absolute terms. Again, plan allocation on road transport is not showing much improvement over the periods. While the State has been vigorously pursuing tourism policy, it should perhaps have higher plan allocation in the sectors of tourism and road transport.

Many studies to assess feasibility and prepare perspective plans were commissioned by the State of Sikkim. The Tata Economic Consultancy Services had prepared the Tourism Master Plan and Policy document for the period 1997-2011 for the State of Sikkim in 1997. As a part of this policy short, medium and long term strategies were formulated for district wise tourism development in the State. In 2002, the Horizon Industrial Consultancy Services had prepared a 20-Year Perspective Plan for Sustainable Development in Sikkim under the aegis of the Ministry of Tourism and Culture, Government of India. The same organisation was also entrusted to prepare Sikkim Tourism Vision 2020, which set the following targets:

1) To increase earnings from tourism at least at the rate of 10 per cent per annum.
2) To achieve an annual growth rate of 10 per cent in foreign tourist arrivals during the period 2015-16 and 15 per cent during the subsequent period of the perspective plan.
3) To create employment opportunities for 1500 persons per annum.
4) To add 200 quality accommodations spread over in the four districts of the state except Gangtok, and
5) To innovate and promote at least one new tourism product (eco/adventure tourism) and new destination every year.

The Sikkim Tourism Development Corporation has also commissioned a Master Plan for Trekking in Sikkim. The Forest Department of Sikkim has initiated some projects like the Bird Park (including Walk Through Aviary) at Rabdentse, West Sikkim; Butterfly Park at Rangrang, North Sikkim; Himalayan Zoological Park (Including Night Safari/Nocturnal House) at Gangtok, East Sikkim. The department has introduced bans on grazing, cutting of trees, use of plastics, smoking etc. in the forest areas. It also has taken up awareness and capacity building programmes for the local communities who are settled in the vicinity of the National Park.

Of late many NGOs in Sikkim are working towards promoting ecotourism and village tourism in various remote places in Sikkim and it is also partially helping rural people to take up tourism-related activities as a better alternative to agriculture. This is in conjunction with the changing global tourism scenario which has undergone a major transformation over the past 30 years. In 1980s the international focus shifted from “beach tourism” to “cultural tourism”, which involves visits to historical sites and cultural spots. Then the focus shifted to “ecotourism”. Due to consistent efforts of environmentalists coupled with growing concern of various stakeholders in tourism development, including NGOs, this focus on eco-tourism has gained importance, particularly because of its relevance and imperative need for protecting the fragile character of the environment in its specific stations like mountains and hills. This scenario is rightly pronounced in the case of Sikkim due to its fragile ecology.

Taking the case of the power sector, there was a deficit in this sector up to 2006-07. In 2004-05 the deficit was Rs. 17.11 lakh. Since then the gap has decreased. From 2007-8 to 2010-11 Sikkim has enjoyed a revenue surplus in power generating sector. Between 2002-03 and 2011-12 revenue earned from power sector grew on an average by 33.74% while the expenditure has shown a declining trend of 7.83%.

It is a well-known fact that Sikkim has tremendous hydroelectric power potential. This potential has been worked out to 8000 MW Peak with a firm base of 3000 MW. Approximately seventy miles North East stretch of Sikkimese territory possesses a land gradient that lies roughly between 500 feet to 28,000 feet above mean sea level. Because of such terrain Sikkim has some of the most turbulent and swiftest rivulets in the world that is best suited for harnessing hydel power potential.

All the hydel projects in the state being run consist of the river ones. There is no room for spinning reserve, which means the generation capacity during the winter months cannot be raised more than half the generation capacity. Besides like the Diesel Engines, where the decompression due to wear and tear causes de-ration of capacity, hydro-turbines also follow the same rule and unless these machines are maintained as per set routine, they become sluggish [xiii] affecting the generation capacity adversely. As such, it is very important that all the civil structures right from intake weir to tailrace including hydro-mechanical parts are maintained and re-strengthened periodically thereby giving them a new lease of life.

The state manages to meet its base load demand only partially from its run-of-the-river hydel power plants. Unlike other mode of generating stations like thermal, diesel, gas or nuclear, which run on fuel, the hydro generating stations run on availability of water. Quality and quantity of water running the turbines play an important role on its life and output of the machine respectively. As for example, a diesel engine requires more fuel to run on higher load than at lesser load, the hydro generating sets also require more water to run the turbine at higher load profile.

But the department is not in a position to attend to the routine maintenance and periodical renovation on all the installations owned by the department due to the reasons like unproductive expenses on wages and salaries and huge pending liabilities, which has been brought to the knowledge of the Government.

Salaries and pension payments constituted 30.45 % and 6.04 % of the revenue receipts of the State, respectively. Pension payment increased as a result of the increase in the number of pensioners in the state. There was also an increase in interest payments.

The major proportion of subsidies was taken up by the subsidies on food. This in turn was increased due to the introduction of a new scheme by the government.

Subsidies were also a major component of the horticulture sector. The cooperative sector witnessed subsidies for transport and marketing. While there has been a cumulative investment of 2.20 lakh in Multi-Purpose Co-operative Societies, no dividend had accrued to the Government till 2011-12.

Financial assistance provided to local bodies increased by 1.83 % by the end of 2011-12; the major beneficiaries of such assistance were farmers, local bodies, corporations and urban development. There was a 12.99 % in fiscal liabilities of the state from 2010-11 to 2011-12. The main components of these were public account liabilities, internal debt and loans and advances. Fiscal deficit continued to be at 2.14 % of the GSDP.

Government had guaranteed loans raised by State Finance Corporation to the tune of 128.79 crore and other Institutions to the extent of 34.93 crore. The Government had received 2.85 crore and 0.25 crore in the form of guarantee commission or fee during the current year.

CHAPTER 1

Introduction

The Finance Commission of India came into existence in 1951. It was established under Article 280 of the Indian Constitution by the President of India. It was formed to define the financial relations between the centre and the state. The Finance Commission Act of 1951 states the terms of qualification, appointment and disqualification, the term, eligibility and powers of the Finance Commission. As per the Constitution, the commission is appointed every five years and consists of a chairman and four other members. Since the institution of the first finance commission, stark changes have occurred in the Indian economy causing changes in the macroeconomic scenario. This has led to major changes in the Finance Commission's recommendations over the years. Till date, Thirteen Finance Commissions have submitted their reports.

Functions of the Finance Commission can be explicitly stated as:

1. Distribution of net proceeds of taxes between Centre and the States, to be divided as per their respective contributions to the taxes.
2. Determination of factors governing Grants-in Aid to the states and the magnitude of the same.
3. To make recommendations to the President of India as to 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.

The Finance Commission is a body of five experts including a chairman constituted under Article 280 of the Constitution of India by the President. The primary mandate of the Commission is to recommend a formula for sharing net proceeds of tax revenues of the Centre with the states, principles which should govern the transfer of grants-in-aid of the revenues of the states out of the Consolidated Fund of India and measures required to augment the Consolidated Fund of individual states during a five year period.

Constitution and Terms of Reference of the Fourteenth Finance Commission

As mandated by the Article 280 of the Constitution, the Government of India has constituted the Fourteenth Finance Commission consisting of **Dr. Y.V.Reddy, former Governor Reserve Bank of India, as the Chairman** and the following four other members, namely: -

1. **Prof Abhijit Sen** — Member (Part Time)
   Member, Planning Commission
2. **Ms. Sushma Nath** — Member
   Former Union Finance Secretary
3. **Dr. M.Govinda Rao** — Member
   Director, National Institute for Public Finance and Policy, New Delhi
4. **Dr. Sudipto Mundle** — Member
   Former Acting Chairman,National Statistical Commission

Shri Ajay Narayan Jha shall be the Secretary to the Commission. The Commission shall make its report available by the 31st October, 2014, covering a period of five years commencing on the 1st April, 2015.

The Commission shall make recommendations regarding the sharing of Union taxes, principles governing Grants-in-aid to States and transfer of resources to local bodies.

Terms of Reference and the matters that shall be taken into consideration by the Fourteenth Finance Commission in making the recommendations are as under:

1. (i) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under Chapter I, Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds;

   (ii) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India and the sums to be paid to the States which are in need of assistance by way of grants-in-aid of their revenues under article 275 of the Constitution for purposes other than those specified in the provisos to clause (1) of that article; and

(iii) 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.

2. The Commission shall review the state of the finances, deficit and debt levels of the Union and the States, keeping in view, in particular, the fiscal consolidation roadmap recommended by the Thirteenth Finance Commission, and suggest measures for maintaining a stable and sustainable fiscal environment consistent with equitable growth including suggestions to amend the Fiscal Responsibility Budget Management Acts currently in force and while doing so, the Commission may consider the effect of the receipts and expenditure in the form of grants for creation of capital assets on the deficits; and the Commission shall also consider and recommend incentives and disincentives for States for observing the obligations laid down in the Fiscal Responsibility Budget Management Acts.

3. In making its recommendations, the Commission shall have regard, among other considerations, to –

(i) The resources of the Central Government, for five years commencing on 1st April 2015, on the basis of levels of taxation and non-tax revenues likely to be reached during 2014-15;

(ii) The demands on the resources of the Central Government, in particular, on account of the expenditure on civil administration, defence, internal and border security, debt-servicing and other committed expenditure and liabilities;

(iii) The resources of the State Governments and the demands on such resources under different heads, including the impact of debt levels on resource availability in debt stressed states, for the five years commencing on 1st April 2015, on the basis of levels of taxation and non-tax revenues likely to be reached during 2014-15;

(iv) The objective of not only balancing the receipts and expenditure on revenue account of all the States and the Union, but also generating surpluses for capital investment;

(v) The taxation efforts of the Central Government and each State Government and the potential for additional resource mobilisation to improve the tax-Gross Domestic Product ratio in the case of the Union and tax-Gross State Domestic Product ratio in the case of the States;

(vi) The level of subsidies that are required, having regard to the need for sustainable and inclusive growth, and equitable sharing of subsidies between the Central Government and State Governments;

(vii) The expenditure on the non-salary component of maintenance and upkeep of capital assets and the non-wage related maintenance expenditure on plan schemes to be completed by 31st March, 2015 and the norms on the basis of which specific amounts are recommended for the maintenance of the capital assets and the manner of monitoring such expenditure;

(viii) The need for insulating the pricing of public utility services like drinking water, irrigation, power and public transport from policy fluctuations through statutory provisions;

(ix) The need for making the public sector enterprises competitive and market oriented; listing and disinvestment; and relinquishing of non-priority enterprises;

(x) The need to balance management of ecology, environment and climate change consistent with sustainable economic development; and

(xi) The impact of the proposed Goods and Services Tax on the finances of Centre and States and the mechanism for compensation in case of any revenue loss.

4. In making its recommendations on various matters, the Commission shall generally take the base of population figures as of 1971 in all cases where population is a factor for determination of devolution of taxes and duties and grants-in-aid; however, the Commission may also take into account the demographic changes that have taken place subsequent to 1971.

5. The Commission may review the present Public Expenditure Management systems in place including the budgeting and accounting standards and practices; the existing system of classification of receipts and expenditure; linking outlays to outputs and outcomes; best practices within the country and internationally, and make appropriate recommendations thereon.

6. The Commission may review the present arrangements as regards financing of Disaster Management with reference to the funds constituted under the Disaster Management Act, 2005(53 of 2005), and make appropriate recommendations thereon.

7. The Commission shall indicate the basis on which it has arrived at its findings and make available the State-wise estimates of receipts and expenditure.

8. The Commission shall make its report available by the 31st October, 2014, covering a period of five years commencing on the 1st April, 2015.

The evaluation study is expected to critically analyse the overall States' finances over the ten-year period with reference to above and the ToR of the 14th Finance Commission. Suggestions for improved financial performance may also be given.

2. The total duration of the study would be 6 months from the date of signing of the Agreement. The first draft of the study should be submitted to the commission after the expiry of five months and the Final Report shall be submitted incorporating therein the suggestions/input, if any, made by the Referee appointed by the First party or by the First party.

3. The duration of the Study Report would be six months (6 months) commencing from **15th April, 2013** and concluding on **14th October, 2013**. The total Agreement amount for the study project would be Rs. 2,50,000/- (Rs. Two lakhs and fifty thousand only) inclusive of all expenses covering lead researchers, stipends for research assistants, books, contingency, printing, data collection, travel cost and institutional overheads. The applicable taxes, if any, will be paid additionally. The Second Party shall indicate separately the proportion of the Agreement Amount towards expenses and towards professional fees/charges etc. The payment shall be subject to all taxes/cess (including TDS), if any payable. It is made clear that the First party to the contract will not reimburse any other expenditure on Study Report over and above Agreement Amount plus applicable taxes.

CHAPTER 2

Sikkim – A Financial Overview

2.1 Introduction

Under the Indian federal system, the Constitution assigns important functions and responsibilities in various economic and social sectors to the States. This is in addition to the normal governance role to be performed by the States. At the same time, more elastic and broad based taxes have been assigned to the Centre leaving insufficient and inelastic revenue resources under the control of States. This has created a gap between the needs and availability of resources for the States.

Keeping this in view, the Constitution provides for the setting up of a Finance Commission, once in five years, to enable the States to raise sufficient revenue to bring about rapid economic growth in the State. The Commission provides the States a mandated forum for ventilation of views of State Governments on Centre-State financial relations.

Terms of Reference for the Evaluation of State Finances

The present report relates to the evaluation of state finances for the state of Sikkim under the aegis of the Fourteenth Finance Commission. This study has been conducted by the Department of Economic Studies and Planning, Sikkim University with Dr Ruma Kundu as the Principal Investigator. The terms of reference for the study are as follows:

1. The study should provide an analysis of the State Finances over a period of 10 years starting from 1st April, 2002. Specifically, the study should include (and may not be restricted to) the following:

   i. Estimation of revenue capacities of State and Measures to improve the tax-GSDP ratio during last five years. Suggestions for enhancing the revenue productivity of the tax system in the State.

   ii. Analysis of the state's own non-tax revenues and suggestions to enhance revenues from user charges and profits from departmental enterprises and dividends from non-departmental commercial enterprises.

iii. Expenditure pattern and trends separately for Non-Plan and Plan, Revenue and Capital, and major components of expenditure thereunder. Measures to enhance allocative and technical efficiency in expenditures during the last 5 years. Suggestions for improving efficiency in [public spending.

iv. Analysis of Deficits – Fiscal and Revenue along with Balance of Current Revenues for Plan financing.

v. The level of Debt: GSDP ratio and the use of debt (i.e whether it has been used for capital expenditure or otherwise). Composition of the state's debt in terms of market borrowing, Central government debt (including those from bilateral/multilateral lending agencies routed through the Central government), liabilities in public account (small savings, provident funds etc) and borrowings from agencies such as NABARD, LIC etc.

vi. Implementation of FRBM Act and commitment towards targets. Analysis of MTFP of various departments and aggregate.

vii. Analysis of the state's transfers to urban and rural local bodies in the state. Major decentralisation initiatives. Reforms undertaken under JNNURM conditionalities.

viii. Impact of State Public Enterprises finances on the States' financial health and measures taken to improve their performance and/or alternatives of closure, disinvestment etc.

ix. Public Expenditure and Financial Management (PEFM) Reforms implemented in the State.

x. Impact of Power Sector Reforms on States' fiscal health. In case reforms have not been implemented, the likely outcome on the States' fiscal health.

xi. Analysis of contingent liabilities of the state.

Subsidies given by the States (Other than Central subsidies), its targeting and evaluation.

With regard to the State of Sikkim the time is now ripe to pay special attention to the overall existing system of Centre-State financial flows.

First, the share of the States in Central revenues is restricted to just 30.5 percent. After the acceptance of the Tenth Finance Commission's recommendation of 29 per cent share in the overall divisible pool of taxes, the Eleventh Finance Commission and the Twelfth Finance Commission have not brought any substantial improvement in the Tenth Finance Commission's scheme. The share was only marginally increased. Given the various functions of the States, the States' share in the divisible pool of taxes must be increased considerably.

Second, the gap filling approach through grants under Article 275(1) is confronted with the in-built flaw of not distinguishing between the fiscally imprudent and the fiscally disadvantaged States. This approach has a built-in incentive for the backward States to continue lagging behind the other better off States as they are cross subsidised by the latter.

Third, based on the elaborate procedures laid down by the Planning Commission, the overly centralised planning process for a State is too rigid, unnecessary and counterproductive. The States are unable to reflect their regional priorities in the plan. Also, it puts a premium on fresh capital formation and leads to the corresponding neglect of maintenance of existing assets even though the latter yield much greater returns for every rupee invested.

Finally, the arena of Centrally Sponsored Schemes (CSS) in the planning process is too rigid in design and does not reflect grass root priorities and constraints. The release and monitoring procedure set up by the Union Ministries is tedious and often results in delays. There is no provision of release of advance funds in most ongoing schemes.

From the viewpoint of Sikkim due consideration needs to be given to the above aspects as these are crucially relevant for the Indian fiscal federal fabric.

2.2 State's Views on 1971 Population as a Factor for Devolution of Resources

As per the terms of reference, Commission were required to adopt the population figures of 1971 in all cases where population is regarded as a factor for determination of devolution of taxes and duties, and grants-in-aid. While the State Government does appreciate the objective underlying such a stipulation, it has reiterated its earlier stand made to the previous Finance Commissions that such a condition is opposed to the provision under Article 275 of the Constitution where it is clear that such grant is to be extended to the States which are in need of assistance. Such a need of assistance cannot be with reference to the population figures of a year three decades ago but must be based on the population figures for the period for which the grant is being made available.

The population figures of 1971 Census cannot be considered error free so far as Sikkim is concerned. This is because the State had not become part of the Union at that time and the Census operation in 1971 in Sikkim did not conform to the rigors and refinement laid out for the rest of the country in the decennial census operation. Prior to 1971, the growth of population in Sikkim was lower than that of India. However, after joining the Indian Union in 1975, Sikkim's population has grown at a higher rate than the average growth rate of the country as a whole due to the influx of people from other areas. The expansion of population in a short period was abnormally high and the 1981 Census revealed that the growth of population over the decade was over 50%. However, after 1981, population grew at a significantly lower rate as the State Government undertook family planning measures vigorously and also adopted stringent measures to contain the influx. The decennial growth of population in the six decades for Sikkim as compared to All India figures is shown below:

Table 2.1: Decennial Growth of Population of Sikkim & All – India

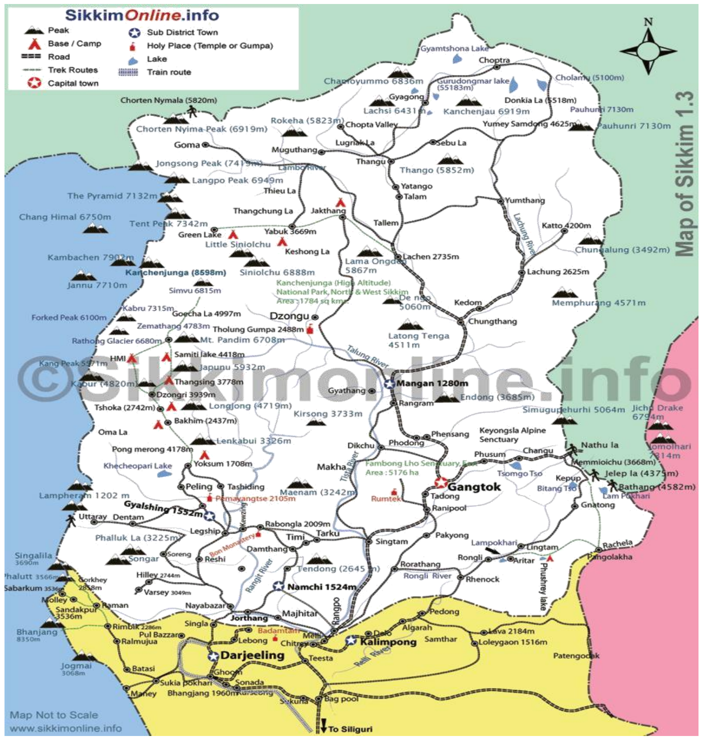
Year	Population (In Thousands)	Decennial growth (%)	
		Sikkim	All India
1941	121	10.67	14.22
1951	138	13.34	13.31
1961	162	17.76	21.64
1971	210	29.38	24.80
1981	316	50.77	24.66
1991	406	28.47	23.86
2001	540	32.98	21.34
2011	608	12.36	17.64

In this regard, it would be useful to take note of the National Policy Resolution on population, 29th June 1977, where it was *inter-alia* stated that 'in all cases where population is a factor as in the allocation of Central assistance to State Plans, devolution of taxes and duties and grant-in-aid, population figures of 1971 will continue to be followed till the year 2001'.

In the past, previous Finance Commissions have also adopted 1981 and 1991 Census population figures along with 1971 Census population figures for different purposes. For instance, the population figures of the latest census available were adopted for distribution of the grants for additional duties of excise in lieu of sales tax on tobacco, sugar and textiles by the previous Finance Commissions. The Tenth Finance Commission used 1991 census population figures for the purposes of *ad hoc* grants for local bodies and additional excise duties. We, therefore, request the Commission to consider earnestly the adoption of the latest 2001 Census population figures instead of the three decades old population figure of 1971 Census as during these three decades (1971-2001) Sikkim's population has increased by 157.57 percent, *i.e.* more than doubled. By the time the recommendations of the Thirteenth Finance Commission become effective, the figures from Census 2011 may also become available.

The impact of taking 1971 population figures for Sikkim can be empirically highlighted by taking the award of the Twelfth Finance Commission on the State of Sikkim. According to 1971 census, the share of Sikkim's population was 0.0383 as against 0.0526 in 2001. If population of 2001 is taken as the base, the additional share for Sikkim will be 0.0143. Now if we apply these criteria to the award of the Twelfth Finance Commission, its total tax devolution was Rs 613112 crore, of which 25 percent (*i.e.* Rs 153278 crore) was on the basis of population. Sikkim's share from Twelfth Finance Commission is Rs 1392.94 crore; hence, by using 2001 population in place of 1971 population Sikkim may get 1.57% more than what it actually got from the Twelfth Finance Commission. This will be tantamount to getting an additional Rs 21.9 crore (0.0143 percent of Rs 153278 crore) if 2001 population is used as the basis.

Finally, grants (whether on a normative basis or need based) must not be on the basis of population. These must be sufficient to meet the financial needs of the State.



Source: http://www.indiatraveltimes.com/

2.3 Finances in Sikkim – An Overview

Sikkim is a sparsely populated state situated in the Eastern Himalayas. It became part of the Indian Union on 26th April 1975. It has a total area of 7,906 sq km, which constitutes 0.22 % of the total geographical area of India. As Sikkim is landlocked, the NH 31A is the only lifeline which connects Sikkim with the rest of the country. Sikkim, categorised as a special category state[1], has four districts and nine subdivisions and has also been included in the North Eastern Council since December 2002.

According to the Census of India 2011, the population of Sikkim stood at 6.07 lakh and the percentage of rural population of the state (75%) was more than that of the whole country (72%). The literacy rate of Sikkim was 82.2% as against the All India rate of 74.04%. Similarly, the infant mortality rate at 33 per 1000 live births was better than the All India Average of 53 per 1000 as per the Sample Registration system of the Registrar General and Census Commissioner of India in 2008.

The annual accounts of the state government consist of Finance Accounts and Appropriation Accounts. The following table provides a summary of the fiscal transactions of the state government for 2010-11 with respect to the previous year.

[1] Special privileges given to Sikkim include financial assistance from the Government of India in the form of 90% grant and 10 % loan unlike non-special category states which get Central Assistance in the ratio of 70 % grant and 30 % loan.

Table 2.2: Summary of the fiscal transactions of the state government from 2009-10 to 2010-11

Receipts			Disbursements				
2009-10		**2010-11**	**2009-10**		**2010-11**		
Section A: Revenue					**Non-Plan**	**Plan**	**Total**
3,254.39	Revenue Receipts[2]	3,047.31	2,738.04	Revenue Expenditure[3]			2,907.53
223.65	Tax Revenue	279.54	1,566.63	General Services	1,559.97	20.58	1,580.55
1,356.44	Non-Tax Revenue	1,137.76	691.28	Social Services	449.99	366.44	816.43
374.68	Share of Union Taxes/Duties	524.99	480.13	Economic Services	209.36	288.25	497.61
1,299.62	Grants from Govt. of India	1,105.02		Grants-in-Aid and Contribution	12.94	-	12.94
Section B: Capital							
-	Misc. Capital Receipts	-	648.53	Capital Outlay	-	451.07	451.07
0.30	Recoveries of Loan	0.79	36.98	Loans & Advances Disbursed			5.75
392.11	Public Debt Receipts	95.03	86.29	Repayment of Public Debt			73.23
	Contingency Fund	-		Contingency Fund			0.10
2,967.71	Public Account Receipts	2,915.63	2,784.90	Public Account Disbursements			2,902.28
708.24	Opening Balance	1,028.01	1,028.01	Closing Cash Balance			746.81
7,322.75	**Total**	**7,086.77**	**7,322.75**	**Total**			**7,086.77**

Source: Audit Report on State Finances of Sikkim for the year ended 31 March 2011

As per the report of the Third Sikkim Finance Commission, the state government has tried to raise revenues through revision of rates taxes, duties and non-tax items. It has also tried to reduce non-

[2] Revenue receipts and non-tax revenue are inclusive of gross receipt (Rs 938.15) from state lotteries

[3] Revenue expenditure and General Services (Non-Plan) are inclusive of expenditure (Rs 895.61 crore) on state lotteries

plan expenditure by using the debt swap facility to reduce the interest burden. However, all these measures did not have any substantial impact in improving the finances of the state.

Non-Plan Revenue Receipts

The non-plan revenue receipts have increased over the years at the rate of 8.72 percent. the composition of its different components indicates that less than half of the revenue receipts came from the State's own revenue receipts (except in the year 2006-07) and more than half was realised from Central transfers.

State's Own Tax Revenue

Like in other special category States, the non-plan revenue receipts of Sikkim are a little higher than the Central devolutions. However, the State has made efforts to improve its own tax base.

Consequently, the State's tax base has increased in recent years. The State's own tax revenues have increased from 80.39 crore in 2001-01 to Rs. 164.16 crore in 2006-07, exhibiting an impressive growth rate of 14.42 percent per annum. As a result, its percentage share in GSDP has also gone up to 8.05 percent in 2006-07. since 2003-04, the ratio of own taxes to the GSDP has been hovering around 8 percent as compared to an all-states ratio of around 6 percent. The State's own resources (SORs) have started increasing since 2006-07.

State's Own Non-Tax Revenue

Non-tax revenue in Sikkim consists of a variety of receipts, viz. interest receipts on loans given by the State Government; dividends on equity investments; user fees and tariffs on services provided by the State government in the social and economic sectors; royalty on mines and minerals; receipts from forestry and wildlife; lottery income and other miscellaneous receipts.

Sikkim has maintained a growth rate of 11.67 percent per annum in non-tax revenue during the period 2001-2002 to 2006-07. In 2006-07, non-tax revenue was Rs. 171.00 crore as compared to only Rs. 71.12 crore in 2001-02. The non-tax to GSDP ratio of the State has remained around 6 to 7 percent as compared to the All-States average of less than 2 percent. However, its share in the State's own revenue has been fluctuating in the range of 44% to 57.6 % during the period

Central devolution to the State

Sikkim has a limited tax base. As a result the devolution of Central taxes and grants form a significant portion of the revenue. The transfers received by the Government of Sikkim have been more than 50 percent of the total non-plan revenue receipts of the State in all the years except 2006-07. The Share declined to 46.13 percent in 2006-07 due to the recommendations of the Twelfth Finance Commission. It is important to note that the Twelfth Finance Commission recommended 30.5 percent of the net proceeds of the common shareable Central taxes and duties to be devolved to the States as against 29.5 percent recommended by the Eleventh Finance Commission. Of the 30.5 percent, the share of the State of Sikkim in the Union taxes was 0.227 percent. However, this was higher than its share of 0.184 percent recommended by the Eleventh Finance Commission and 0.126 percent by the Tenth Finance Commission. However, the grant component, as awarded by the Twelfth Finance Commission, was much lesser.

Central Non-Plan Grants

The magnitude of non-plan grants has also come down considerably over the years. The quantum of non-plan grants in 2002-03 was Rs. 21386 lakhs. This was 73.48 percent of the non-plan grants (i.e. total grants minus plan grants) from the Centre. Over the years, the non-plan grants have been reduced to a mere Rs. 6426 Lakh, which is only 22.4 percent of the total non-plan Central grants. This is primarily due to the adverse impact of the award of the Twelfth Finance Commission.

Non-Plan Revenue Expenditure

The trend in non-plan revenue expenditure of the State indicated that it has grown over the years at the rate of 9.42 percent per annum. However, the growth in the recent years has been much higher. With regard to the composition of expenditure-salary, pension liabilities and interest payments together accounted for 76 percent of the non-plan revenue expenditure in the year 2001-02. This gradually increased to 78.76 percent in 2006-07. Salary payments are at a very high level and constitute about 50 percent of the non-plan revenue expenditure. Pension, on the other hand, constitutes only 5 to 7 percent of the total non-plan revenue expenditure. It is the fastest growing component of non-plan revenue expenditure, exhibiting an average growth rate of 18.6 percent. The exponential growth rate of pension liabilities is a cause for major concern. Interest payments have been growing at a rate of 6.0 percent and constitute about 17.12 percent of the non-plan revenue expenditure.

Revenue Deficit

Revenue expenditure of Sikkim grew at an annual rate of 9.5 percent whereas the annual growth rate of revenue receipts has been 8.93 percent. The growth rate of revenue expenditure is higher than the growth rate of revenue receipts (Table 3.4). 14

There has been huge non-plan revenue (NPR) deficit in the years 2001-02 and in 2004-05. The NPR deficit finally turned into surplus of R. 73.78 crore in 2002-03. However, this surplus could not be sustained for long; the following two consecutive years witnessed a NPR deficit. However, fluctuations continued in the successive years.

Over-all Revenue, Expenditure and Deficit

The trends in overall receipts, revenue expenditures and deficit (surplus) suggest that there was a revenue surplus during the period 2001-02 to 2006-07. This was primarily due to the plan grants that formed a major part (75 to 80 percent) of the normal Central assistance and the additional Central Assistance. This surplus constituted only 19.06 percent of revenue receipts in 2001-02. However, it gradually declined in the later years. In fact, the revenue surplus fluctuates throughout the period.

Fiscal Deficit

While the fiscal deficit in Sikkim was Rs. 66.9 crore in 2001-02, with the efforts of the State Government, this deficit was reduced to a low of Rs.13.9 crore in 2002-03. However, this declining trend could not be sustained and the fiscal deficit increased to a whopping Rs. 186.46 crore in 2004-05. Such a high fiscal deficit was not sustainable and needed urgent corrective measures. Several measures initiated by the State Government resulted in increase in revenue income and a reduction in revenue expenditure. As a result, the fiscal deficit in 2005-06 fell down to Rs. 149.9 crore and further declined to Rs. 106.6 crore in the year 2006-07.

Fiscal Reforms and Additional Resource Mobilisation

Despite the deteriorating fiscal situation, Sikkim is one of the few States that has managed to follow progressive reformist polices. Sikkim has been making consistent efforts towards attaining self sufficiency. The State initiatives include efforts in additional resource mobilisation, capacity building in administration and also proficiency in e-governance, as described below:

Introduction of VAT

The State Government constituted a Project Management Team (PMT) to prepare an agenda for the gradual introduction of Value Added Tax (VAT) in the State on 27th March, 2001. The PMT was reconstituted in November 2004 to give a fresh impetus to the implementation of VAT. Initiatives like awareness programmes, training programmes for officers, seminars and study tours to countries like Thailand brought about the timely implementation of the VAT in the State with effect from April 1, 2005.

Land Revenue

In 2005-06, the State increased the existing rates of land revenue levied on different categories of rural land. The local rate for land revenue was initially Rs. 5 per annum for dwelling houses. This has been raised to Rs. 5, Rs. 10, and Rs. 20 per annum for thatch house, Egra House and RCC building, respectively. Similarly, the land rent has also increased considerably for different circles of revenue blocks and further categories of land.

Stamp Duty and Registration Fee

In 2005-06, Sikkim increased the registration fee for gifting land to 5 percent of the valuation of the land as per the rates approved by the Government for land acquisitions. The registration fee of land has also been revised to 5 percent from 4 percent in 2007. Along with this, the Government also revised the registration fee on property mortgages and deeds.

State Excise Duty

The Government of Sikkim revised the rate of import pass fee and export pass fee on all brands of Indian Made Foreign Liquor (IMFL) in 2004-05. Also, in the same year, the duty on beer imported from other States, as well as beer manufactured in Sikkim but exported to other States, was increased. Further, in 2005-06, Sikkim increased the excise duty on all brands of IMFL manufactured/bottled by the local companies; all brands of IMFL owned by the companies located outside the State of Sikkim and bottled by local companies; IMFL imported from other States, and beer manufactured in Sikkim and imported to other States. Further, in 2007-08, the Sikkim Government imposed import pass fee on portable foreign liquor, viz. whisky, brandy, rum, vodka, gin, cordials, bitters, wine, beer etc.

In addition, the Government has rationalised the State excise policy by framing rules with regard to various excise licensing rules in the state.

Profession Tax

The state imposed a tax on profession, trades and employment In 2006-07 for raising additional resource for the benefit of the State.

Cesses/Surcharges

The Excise department in Sikkim has started levying 'The Sikkim Educational Cess on Alcoholic Beverages Act, 2007' on IMFL and Beer. The educational cess is levied at the rate of Rs. 2.70 per bulk litre on foreign liquor and Rs. 1.60 on bulk litre of beer manufactured in Sikkim and imported from other States for consumption in civil and army units within Sikkim. The cess collected is utilised specifically for the maintenance of school buildings in addition to the existing level of expenditure on such maintenance.

The Sikkim Ecology Fund and Environment Cess Act, 2005, have been enforced since April, 2007. The Act focuses on improving the quality of the environment by controlling and abating pollution and restoration of ecological balance in the State.

Bus Fare

Due to the increase in the cost of HSD and other operational costs, the State Government has revised (April 2008) and re-fixed the passenger fares on Sikkim's Nationalized Transport buses.

Steps taken for reducing Expenditure

The State has initiated several measures to reduce expenditure. These include the following:

(a) The State Government introduced VRS in 2002-03. This scheme was open to all State Government employees who had completed 20 years of regular service. The scheme was introduced with the objective of trimming down the Government workforce as a part of the fiscal reforms programme. An amount of Rs. 7 crore was spent specifically for this scheme by the State

Government out of the State Plan. The posts of the Government servants who were given VRS (138 during 2002-03) were also abolished.

(b) Various departments were amalgamated to ensure administrative re-organisation and curtailment of expenditure so as to improve the service delivery and efficiency of government officials.

(c) Conveyance allowance in lieu of government vehicle as an option for entitled officers was introduced.

(d) Introduction of Contributory Pension Scheme for fresh appointment with effect from 1.4.2006.

(e) To reduce the high and unsustainable subsidy in many social sectors, the State Government attempted to reduce the same by focusing this on deserving target groups.

(f) The State Government has already succeeded in entering into public-private partnership for financing of two major hydroelectric projects. This obviates the need for raising loans for these projects.

Administrative Reforms Measures

The state government has introduced the following measures in order to improve its administrative efficiency:

(a) Computerisation of VAT administration

Administration of VAT was fully computerised under the turnkey project undertaken by the National Informatics Centre (NIC). The Central Government has provided the VAT Division with computers, printers, VSAT facilities etc.

Capacity Building for E-governance

Efforts have been made to bring improvement in administration through efficient e-governance. Earlier, the Government has initiated State Wide Area Network (SWAN) with the help of the Government of India. This envisages inter-connectivity of all districts, sub-divisions, blocks and important commercial towns in the State. Also, de-centralization of financial powers to Panchayati Raj was implemented in August, 2003. This was done with the basic aim of delegating more administrative and financial powers to Panchayats at the Zilla and Gram Levels. A Committee was set up to look into the details of the PSEs and recommended ways to improve the efficiency of the PSEs. The concerned administrative departments have been providing continuous supervision to promote the functioning of the PSEs. Timely auditing of accounts is being undertaken. Finally, a single window system has been introduced in many departments. This has brought tremendous improvement in service delivery, efficiency, cost reduction and convenience to the general public.

In this context it would be relevant to go through the remarks and observations offered by the 3rd Sikkim Finance Commission:

In spite of the constitutional provisions and passage of one and half decade's time, empowerment of local governments in the real sense has not taken place. Under such circumstances it becomes the responsibility of the Union to find out the actual causes/problems/weakness and to take corrective measures to ensure implementation of the 73rd and 74th Constitutional Amendments both in letter and spirit. The Union Government should pay special consideration to the special category and small States in view of the basic fact that the resource/ tax base of such States remains very poor and expenditure cost is higher.

2. Article 280(3) (bb) of the Constitutions provides that it shall be the duty of the Central Finance Commission to make recommendations to the President as to the measures needed to augment the consolidated fund of a State to supplement the resource of the Panchayats in the State on the basis of the recommendations made by the Finance Commission of the State. Keeping in view the spirit of the 73rd and 74th amendments and the clear need to provide an impetus to the decentralization process, the Twelfth Central Finance Commission (2005-10) had recommended a sum of Rs. 25,000 crore for the period 2005-10 as grants-in-aid to augment the consolidated fund of the States to supplement the resource of the Panchayats and municipalities. This was equivalent to 1.24 per cent of the sharable tax revenues and 0.9 per cent of gross revenue receipts of the centre as estimated by the Twelfth Central Finance Commission during the period 2005-10. above Commission had felt that a share at l20 per cent to the Municipalities would appear to be in order and accordingly recommended that the amount of Rs. 25,000 crore would be divided between the Panchayats and the Municipalities in the ratio of 80:20. on the basis of the criteria used for inter-se allocation of grants (population 40%, geographical area 10%, distance from highest per capita income 20%, index of deprivation 10% and revenue effort 20%), the share of Sikkim was only 0.65% in respect of Panchayats and 0.20% in respect of Municipalities. Accordingly a sum of Rs. 1300.00 Lakhs for the Panchayats and a sum of Rs. 100.00 Lakhs for the Municipalities were allocated. Certain conditions were again attached with the allocation and accordingly, only a part of above allocation has actually been released to Sikkim in spite of several requests to the concerned Ministry for release of the whole amount recommended by the Twelfth Central Finance Commission.

The Commission put forward the following recommendations:

(a) The Central Finance Commission /Union Government should consider above grant at least @ Rs. 150 per capita per annum in respect of Sikkim which is a special category State, for the period 2010-11 to 2014-15.

(b) As for the inter-se allocations among the States, common criterion/ weight should not be used, special category/disadvantaged States should be given special weightage.

3. While SIRD and other institutions involved in training Panchayat functionaries have been imparting training to the target beneficiaries, much more is required for elaborate training/ capacity building and for skill development. Opportunities available in other advanced States/ International Training Institutes should also be availed.

4. All necessary steps should be taken to ensure that the Gram Panchayat Financial Rules and Zilla Panchayat Financial Rules are strictly followed. The system of preparation of Annual Budgets, District Plans, and Annual Statement of Accounts should be adhered to in letter and spirit. Directorate of Panchayat should monitor this vigorously.

5. The auditing system should be intensified to bring about higher transparency and accountability and everything should be displayed for information of public in general. The Commission recommends that a Directorate of Local Fund Audit with appropriate and efficient manpower should be set up immediately. The Directorate of Local Fund Audit may also undertake intensive training of the PRIs.

6. The functions of monitoring and evaluation of performance of the PRIs should be taken up vigorously by the Directorate of Panchayats and a mechanism of developing a system of performance based allocation of grants to the PRIs to be undertaken. The Director, Local Fund Audit may also be made a member of such Monitoring Committee. The existing Directorate of Panchayats needs to strengthen suitably.

7. A special incentive grant of Rs. 20.00 Lakhs to each of the top three GPs and Rs. 30.00 lakhs to the top ZP annually be provided. The awareness and competition among the PRIs would definitely bring improvement in functioning.

8. A permanent State Finance Commission Cell within the Finance, Revenue and Expenditure Department be created to administer and monitor the functioning of the SFCs and to maintain the records /datas developed by each SFC.

9. In order to look after the day to day functioning of the PRI Offices and to maintain the accounts of the PRIs systematically, it has become necessary to provide one Accountant to each GP. The GPs may be empowered to select and appoint suitable /capable candidate as an Accountant with minimum qualification as a Commerce graduate on a consolidated pay as may be deemed right by the GP, the expenditure would be met by concerned GP out of its own revenue generated.

10. The Gram Panchayat Financial Rules and the Zilla Panchayat Financial Rules should be so amended to give full power to the GPs/ZPs for incurring expenditure within the sanctioned annual budget provisions under each item. The budget heads may be codified/ standardised.

11. Activity mapping of all centrally sponsored Schemes should be taken up.

12. The system of implementation of Schemes on the basis of approved District Plan should be followed. The system/ procedure of implementation of District Plans should be clearly spelt out.

13. The District Planning Committee should be make more functional and ensure that the District Plans are effectively implemented under the administrative control of DPER and NECAD.

14. The salary of RDAs/GRSs, etc. posted under GPs should be paid through respective GPs. The honorarium of GP members should be paid through concerned GPs.

15. The offices of Gram Prasashan Kendra open for public service during normal working hours as in the case of Government Departments.

2.4 Conclusion

Sikkim has carved out a special position in the Indian Union as one of the most progressive and rapidly developing State within a short period of 33 years. After joining the Union, the State has been able to overcome the disadvantages posed by its geographical and topographical situation by adopting ventures that are eco-friendly and sustainable. Given the above peculiar circumstances, in case it is not possible to make allocations as per the 2011 Census, the State Government would like to urge the Commission to reconsider the concessional measures and provide *ad hoc* additional assistance for compensating the loss the State would incur from the adoption of 1971 Census figures for the purpose of devolution of the State's share of taxes and Grants-in-aid.