

Explanatory Memorandum as to the action taken on the recommendations made by the Seventh Finance Commission in its Report submitted to the President on the 28th October, 1978

The Report of the Seventh Finance Commission, together with this explanatory memorandum as to 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, is summarised in Chapter-13 of its Report.

A-Shares of Central taxes and duties

The Commission's recommendations, covering a period of five years commencing from the first day of April, 1979, relating to sharing of income tax, Union excise duties, additional excise duties in lieu of States' sales tax, estate duty on property other than agricultural land as also payment of grants in lieu of the repealed tax on Railway passenger fares and on account of wealth tax on agricultural property, have been accepted.

B-Grants-in-aid of the revenues of States under the substantive provision of article 275 of the Constitution

- (a) Grants-in-aid to cover non-Plan gap on revenue account. Government have accepted the recommendation
- (b) of the Commission for payment of grants-in-aid of the revenues of certain States, under the substantive provision of article 275(1) of the Constitution, towards meeting their non-Plan revenue gap, as assessed by the Commission, for the five years 1979-84, amounting in all to Rs. 1173.12 crores.

In recommending payment of grants-in-aid amounting to Rs. 1173.12 crores, referred to above, the Commission could not compute the net interest liability of the States arising out of their fresh borrowings and lendings during the five years 1979-84. The Commission has recommended that the Central Government should, from year to year, compute in relation to each of the years 1979-84, the net interest liability of the States arising from their fresh borrowings and lendings and that, thereupon, the President should be moved to increase, to the extent required, the amounts of the grants-in-aid recommended by the Commission for the 8 States and, in the case of the other States, the net interest liability so computed should be set off against the surplus as assessed by the Commission and the net deficit, if any, should be give as grants-in-aid to the States concerned by Presidential Order under article 275(1) of the Constitution. Government have accepted this recommendation and necessary action on this will be taken accordingly.

- (c) Grants-in-aid for upgradation of standards of administration. - Government have accepted the Commission's recommendations for making grants-in-aid to certain States for upgradation of the standards of administration, equivalent to the revenue and capital provisions which the Commission has recommended, subject to the implementation and the monitoring of the upgradation schemes in the manner indicated by the Commission in Chapter 10 of its Report.
- (d) Grants-in-aid to compensate States' loss in excise revenue consequent upon introduction of prohibition. - Government of India had decided to compensate the States in each of the years 1978-84, by way of grants-in-aid, to the extent of one-half of the established loss of State excise revenue on the introduction of prohibition treating the actual excise revenue of 1977-78 as the base. The decision was communicated to the States in August, 1978 and the Seventh Finance Commission also was informed. The Commission, however, has held the view that, where a State Government implements further measures towards achieving total prohibition in the years from 1979-80 onwards, and thereby suffers a loss in the excise revenue from potable liquor to a figure below that assumed by it for the relevant year, the differences should be made up entirely by the Central Government, by grants-in-aid under Article 275(1) of the Constitution, and has recommended accordingly. The Government of India, however, consider it appropriate that in the matter of introduction of total prohibition, which is in pursuance of the Directive Principles of State Policy, the losses in State excise revenue should be shared jointly by the Government of India and the State Governments concerned. The Government also consider that with the successful implementation of measures towards achieving total prohibition, there is scope for the State Governments to increase their other revenues. Accordingly, Government have decided to adhere to its decision to compensate the States to the extent of one-half of the loss in revenues from State excise, and not accept the recommendation of the Commission in this regard.

C-Alternative criteria of devolution

The Report of the Commission has appended to it a Note of Dissent by one of the Members suggesting an alternative formula for devolution of Central taxes and duties as also statutory grants-in-aid to the States. Government have carefully considered the Note of dissent together with the observations of the majority thereon and have decided that in regard to devolution of resources, which involves a delicate issue of Centre-State financial relations, it would be appropriate to accept the recommendations of the majority.

D-Recommendations on other terms of reference

- (i) Financing of relief expenditure. The recommendations of the Commission relating to modifications in the existing arrangements for financing of relief expenditure by the States affected by natural calamities have been accepted by the Government.

- (ii) Debt relief. _ Government have accepted the debt relief, estimated at Rs. 2155.80 crores, recommended by the Commission for the States for the five years 1979-84, but not the recommendations to convert the small savings loans to the States into "loans in perpetuity". However, in order not to disturb the order of the debt relief recommended by the Commission for the five years 1979-84, the State Government will not be required to make any repayment during 1979-84 on account of such loans as may be outstanding at the end of 1978-79.

E-Implementation

The Commission's recommendations fall into three categories, (i) those to be implemented by Order of the President, (ii) those to be implemented by law of Parliament, and (iii) those to be implemented by executive orders. The recommendations under articles 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. Recommendations relating to distribution of Union duties of excise, Additional duties of excise and Estate duty on property other than agricultural land fall in the second category. Necessary legislation will be promoted to implement them. The recommendations relating to distribution of grants to States in lieu of the repealed tax on Railway fares and grant on account of Wealth tax on agricultural property and also changes in terms of repayment of Central loans will be implemented by executive orders.

The Government while taking decisions on the recommendations of the Seventh Finance Commission have taken note of the inter-se distribution of resources resulting from the Commission's recommendations. Having regard to the fact that some of the States may not be as favourably placed as others vis-à-vis their developmental requirements, particularly in so far as the minimum needs programme is concerned, Government have decided that modalities will be worked out, in consultation with the Planning Commission, to see that the States with relatively weak financial resource base are enabled to implement adequately the revised minimum needs programme, covering rural water supply, house sites for the homeless, rural roads, rural electrification, rural health care, bonded labour and elementary/adult education.

The Commission had made certain general suggestions in the Report. These do not require any immediate decision and will be considered in due course.

Sd/-
(H.M. Patel)
Minister of Finance

New Delhi
November 24, 1978.