

**GOVERNMENT OF INDIA**  
**MINISTRY OF FINANCE**  
**DEPARTMENT OF ECONOMIC AFFAIRS**

**EXPLANATORY MEMORANDUM AS TO THE ACTION TAKEN ON THE RECOMMENDATIONS MADE  
BY THE THIRTEENTH FINANCE COMMISSION IN ITS REPORT SUBMITTED TO THE PRESIDENT ON  
DECEMBER 30, 2009**

1. The Thirteenth Finance Commission (hereafter referred to as the Commission) was constituted by the President on November 13, 2007 to give recommendations on specified aspects of Centre State fiscal relations during 2010-15. The Commission submitted its report to the President on December 30, 2009 covering all aspects of its mandate.
2. The report of the Commission (hereafter referred to as the Report) covering the five year period commencing from April 1, 2010, together with this Explanatory Memorandum on the action taken on the recommendations of the Commission is being laid on the Table of the House, in pursuance of Article 281 of the Constitution. Summary of the main recommendations of the Commission relating to the sharing of net proceeds of Union taxes between Centre and States, grants-in-aid of revenue of States under Article 275, Goods and Services Tax (GST), financing of relief expenditure and roadmap for fiscal consolidation are contained in Chapter 1 of the Report of the Commission.
3. The Government has carefully examined the main recommendations of the Commission. The action to be taken on these recommendations is detailed below.

**Sharing of Union Taxes**

4. The Commission has recommended that for its award period, the share of States in the net proceeds of Union taxes may be fixed at 32%. The Commission has also recommended on the inter-se distribution of the States' share amongst the States. The details of the formula for inter-se distribution and the corresponding share of each State recommended by the Commission are indicated in Chapter 8 of the Report. It has also recommended that the total transfers to the States on the revenue account be subjected to an indicative ceiling of 39.5% of the gross tax revenues of the Centre.

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

**Grants -in-Aid of Revenues of States under Article 275 of the Constitution**

5. The Commission has recommended grants-in-aid of revenues of States for non plan revenue deficit, elementary education, environment related issues, improving outcomes, maintenance of roads and bridges, local bodies, disaster relief, GST implementation and state specific grants under Article 275 of the Constitution.

**Non Plan Revenue Deficit Grant**

6. The Commission has assessed the revenues and expenditure of the States for the period 2010-15 and has projected the deficit for each State after taking into account the amount of share in Central taxes for that State. The Commission has recommended a grant of Rs. 51800 crore to meet this deficit for eight States. The amount of grant recommended for each state year-wise is indicated in Chapter 12 of the Report. The Commission has also recommended a performance incentive grant of Rs. 1500 crore for three special category States of Assam, Sikkim and Uttarakhand that have graduated out of Non Plan Revenue Deficit. The details of this grant are indicated in Chapter 12 of the Report.

**The Government has accepted this recommendation .**

**Grant for Elementary Education**

7. The Commission has assessed the requirement of providing elementary education for each State based on the Sarva Shiksha Abhiyan norms and recommended to provide a grant of Rs. 24068 crore equivalent to 15%

of the assessed requirement. The year-wise allocation for each State and the conditionality for release of this grant are given in Chapter 12 of the Report.

**The Government has accepted this recommendation.**

### **Environment Related Grants**

8. The Commission has recommended three grants under this category of Rs. 5000 crore each aggregating to Rs. 15000 crore. The first grant of each of these Rs. 5000 crore grants is forest grant, the second is for promotion for renewable energy and the third is for water sector. The year-wise allocation for each State and the conditionalities for forest and water sector grants are indicated in Chapter 12 of the Report. The eligibility of each State for the grant for renewable energy is to be decided, as indicated in Chapter 12 of the Report, based on the achievement of each state on this front in the first four years of the award period.

**The Government has accepted these recommendations.**

### **Grants for Improving Outcomes**

9. The Commission has recommended six grants under this category aggregating to Rs. 14446 crore over the award period. An incentive grant for reduction in infant mortality of Rs. 5000 crore is to be released to States starting 2012-13 depending on the reduction in Infant Mortality Rate (IMR) achieved by the States with reference to the baseline level of 2009-10 figures. Grant of Rs. 5000 crore for improved delivery of justice has been recommended for Lok Adalats and Legal Aid, Alternate Dispute Resolution Centres, Heritage Court Buildings, State Judicial Academy and training of judicial officers and public prosecutors. The grant for Unique Identification (UID) programme amounting to Rs. 2989.10 crore is to be released based on the number of people covered under the UID database. Two grants of Rs. 616 crore each have been recommended for District Innovation Funds and improving statistical systems at district and State levels. Finally, a grant of Rs. 225 crore has been recommended for setting up database of employees and pensioners.

**The Government has accepted these recommendations.**

### **Grants for maintenance of Roads and Bridges**

10. The Commission has assessed the requirement of ordinary repairs of roads in a State and has recommended grant of Rs. 19930 crore equivalent to 90% of the assessed requirement for PMGSY roads and 50% of the assessed requirement for other roads, for four years of the award period starting 2011-12. The allocation for each year for each State and the conditionality for this grant are indicated in Chapter 12 of the Report.

**The Government has accepted these recommendations.**

### **State Specific grants**

11. The Commission has recommended grants aggregating to Rs. 27945 crore for various state specific needs of the States. The details of these grants for each item of grant for each State are indicated in Chapter 12 of the report.

**The Government has accepted these recommendations.**

12. For monitoring and implementation of all the above grants at the State level, the Commission has recommended setting up a monitoring committee under the chairmanship of the Chief Secretary of the State. In addition to the grants mentioned above, the Commission has recommended grants for GST implementation, local bodies and disaster relief which, alongwith the other recommendations relating to these areas, are explained below.

### **Goods and Services Tax**

13. The Commission has recommended a model GST structure that includes features such as single rate, zero rating of exports, inclusion of various indirect taxes at the Central and State level in GST ambit, major rationalisation of the exemption structure, etc. The Commission has recommended a grant of Rs. 50000 crore for implementation of GST as per the recommended model. This grant is to be disbursed initially in the form of compensation for loss due to implementation of GST and residual amount to be distributed amongst States in the terminal year of the award period as per the devolution formula. It has also recommended administrative structure for implementation and monitoring of this grant.

**The Government has accepted these recommendations in principle. However, in view of the ongoing discussions between Centre and States on this aspect, implementation of these recommendations alongwith modalities may await the outcome of the discussions.**

## Local Bodies

14. The Commission has recommended a basic grant and a performance grant for local bodies. Both these grants in any year have been quantified based on a percentage of the divisible pool of the preceding year. For every year of the award period, the Commission has recommended a basic grant amounting to 1.5% of the size of divisible pool in the preceding year. Similarly, for 2011-12 the Commission has recommended a performance grant of 0.5% of the divisible pool of the preceding year and for subsequent years in the award period, 1% of the divisible pool of the preceding year.

15. It has also recommended a separate special area basic grant of Rs. 20 per capita, carved out of the total basic grant, for every year in the award period for Schedule V and Schedule VI areas and areas excluded from Part IX and IXA of the Constitution. For these areas, it has recommended a special area performance grant of Rs. 10 per capita for 2011-12 and Rs. 20 per capita for subsequent years of the award period.

16. The performance grants are to be released if the States meet conditions specified by the Commission in Chapter 10 of the Report.

17. As per the revenue projections of the Commission, total grant recommended for the local bodies aggregates to Rs. 87519 crore over the award period. The Commission has also recommended distribution of the grants between urban and rural areas and the inter-se distribution between States. The formula and the inter-se shares are indicated in Chapter 10 of the Report.

**The Government has accepted these recommendations.**

## Disaster Relief

18. The Commission has reviewed the existing arrangement of financing relief expenditure in light of the Disaster Management Act, 2005 and has recommended merger of the National Calamity Contingency Fund (NCCF) into National Disaster Response Fund (NDRF) and merger of Calamity Relief Funds (CRF) into State Disaster Response Fund (SDRF) with effect from 01.04.2010 and transfer of the balances in the existing funds into the new funds.

19. The Commission has assessed the relief expenditure requirements of all States and recommended that 75% of the SDRF requirement for general category states and 90% for special category states be met by the Centre through a grant to the States. It has also recommended a grant of Rs. 525 crore for capacity building. Overall, to meet the Central share of SDRF and for capacity building, the Commission has recommended a grant of Rs. 26373 crore. It has mandated all states to follow the required accounting practices to properly account for relief expenditure.

**The Government has accepted these recommendations.**

## Fiscal Roadmap

20. The Commission has assessed the finances of the Union and States and specified a combined debt target of 68% of Gross Domestic Product (GDP) to be met by 2014-15. It has worked out a roadmap for Fiscal Deficit (FD) and Revenue Deficit (RD) for the award period. For Centre, it has recommended RD to be eliminated and FD to be brought down to 3% of GDP by 2013-14. For States, the Commission has worked out fiscal roadmap for each State depending on its current deficit and debt levels. The States are required to eliminate RD and achieve FD of 3% of their respective Gross State Domestic Product (GSDP) during the Commission's award period in stages, in a manner that all the States would eliminate RD and achieve FD of 3% of GSDP latest by 2014-15. The Commission has also recommended that the borrowing limits of the States should be fixed by the Centre in line with these targets.

**The Government has accepted these recommendations in principle.** Detailed proposals for amendment of the FRBM Act, as may be necessary, will be taken up separately.

## Debt Relief to States

21. The Commission has recommended two debt relief measures to be extended to all States. Firstly, it has recommended that the interest rates on loans from National Small Savings Fund (NSSF) to States contracted till the end of 2006-07 and outstanding as at the end of 2009-10 be reset at interest rate of 9%. The implication of this relief during the award period is estimated by the Commission to be Rs. 13517 crore. The financial

implication over the entire period till the maturity of the last loan covered in this relief measure is estimated to be Rs. 28360 crore. The Commission has also recommended that structural reforms should be brought in the NSSF to make it more market linked.

22. The second debt relief recommended by the Commission is write-off of Central loans to States that are administered by central ministries other than Ministry of Finance outstanding as at the end of 2009-10. The amount of loans outstanding as at the end of 2007-08 was Rs. 4506 crore as noted by the Commission. The Commission has also recommended that any further loans under Centrally Sponsored Schemes should be completely avoided.

23. The Commission has also recommended extension of the debt consolidation facility recommended by the Twelfth Finance Commission to States that have not yet availed this benefit.

24. All the above mentioned debt relief is available to States only if they amend/legislate FRBM Acts in accordance with the recommendations of the Commission. The Commission has also recommended that the States will be eligible for the state specific grants only if they comply with this condition.

With regard to the recommendation relating to interest rate reset on NSSF loans to the States, **the Government has accepted it in principle.** However, since the recommendations are comprehensive and cover other structural aspects like interest rate mismatch, tenor mismatch and other administrative matters, Ministry of Finance will constitute a Committee to work out detailed modalities for implementation of this recommendation.

With regard to write-off of the Central loans to States, extension of the debt consolidation scheme recommended by the Twelfth Finance Commission to States that did not avail the benefit till now, and the conditions laid down by the Commission for availing these benefits, **the Government has accepted the recommendations of the Commission.**

With regard to completely avoiding central loans to states in the future, **action will be taken in consultation with the respective ministries.**

### **Other Recommendations**

25. In addition to the above, the Commission has made other recommendations that deal with issues including revenue and expenditure reforms at Central and State levels, accounting and budgeting reforms, additional disclosures by the Centre, State and local bodies, etc.

These recommendations will be examined in due course.

### **Implementation**

26. Orders on the recommendations under Articles 270 and 275(1) of the Constitution relating to share in Union taxes and duties and grants-in-aid, respectively, will be issued after obtaining the approval of the President. The recommendations relating to reorganisation of Funds for disaster relief, debt relief to States and borrowing ceilings will be implemented by executive orders. Other recommendations of the Commission will be acted upon in due course.

New Delhi  
February 25, 2010

**PRANAB MUKHERJEE**  
Minister of Finance