GIST OF FIFTEENTH FINANCE COMMISSION MAIN REPORT ALONG WITH ACTION TAKEN REPORT ON ITS RECOMMENDATIONS

FINANCE DEPARTMENT

September - 2021

I N D E X

Sl. No.	Subject	Page Nos.
I	Salient Recommendations of the Fifteenth Finance Commission’s 2021-26 Report	1-28
II	Explanatory Memorandum as to the Action Taken on the Recommendations made by the Fifteenth Finance Commission in its Final Report submitted to the President on November 9, 2020.	29-34

SALIENT RECOMMENDATIONS OF THE FIFTEENTH FINANCE COMMISSION'S 2021-26 REPORT

Vertical devolution

1. In order to maintain predictability and stability of resources, especially during the pandemic, the Commission has recommended maintaining the vertical devolution at 41 percent – the same as in their report for 2020-21. The vertical devolution is also in line with the recommended share of the FC-XIV. The Commission has made the required adjustment of about 1 per cent due to the reorganisation of the erstwhile State of Jammu and Kashmir into the new Union Territories of Ladakh and Jammu and Kashmir.

Horizontal devolution

2. Based on principles of need, equity and performance, overall devolution formula among the States is as follows.

Criteria	Weight (%)
Population	15.0
Area	15.0
Forest & Ecology	10.0
Income Distance	45.0
Tax & Fiscal Efforts	2.5
Demographic Performance	12.5

3. On horizontal devolution, while the Commission agreed that the Census 2011 population data better represents the present need of States, to be fair to, as well as reward, the States which have done better on the demographic front, the Commission has assigned a 12.5 per cent weight to the demographic performance criterion.

4. Based on the formula on horizontal devolution, the Commission recommended the following inter se shares of States in the net proceeds of the taxes (divisible pool) for the period 2021-22 to 2025-26.

Inter se shares of States in horizontal devolution

State	Share (%)
Andhra Pradesh	4.047
Arunachal Pradesh	1.757
Assam	3.128
Bihar	10.058
Chhattisgarh	3.407
Goa	0.386
Gujarat	3.478
Haryana	1.093
Himachal Pradesh	0.830
Jharkhand	3.307
Karnataka	3.647
Kerala	1.925
Madhya Pradesh	7.850
Maharashtra	6.317
Manipur	0.716
Meghalaya	0.767
Mizoram	0.500
Nagaland	0.569
Odisha	4.528
Punjab	1.807
Rajasthan	6.026
Sikkim	0.388
Tamil Nadu	4.079
Telangana	2.102
Tripura	0.708
Uttar Pradesh	17.939
Uttarakhand	1.118
West Bengal	7.523
Total	**100.00**

Cesses and Surcharges

5. Fourteenth Finance Commission had highlighted the problematic growing share of cesses and surcharges in Union revenues. Article 270 of the Constitution enables the Union Government to levy and retain any cess levied for a specific purpose. Article 271 empowers Parliament to levy a surcharge on any taxes which fall within the Union Government's taxing powers. Cesses are statutory levies whose proceeds are earmarked for utilisation for specific purposes. Hence, the Union Government merely acts as a custodian of funds so collected in the Public Account till these are appropriated for the mandated purpose. Similarly, surcharges are meant to be levied only for short periods. Both cesses and surcharges are excluded from the divisible pool. The **Annexure – A** shows the trend of cesses and surcharges, which constituted over 19.9 percent of gross tax receipts in 2018-19.

Disaster Risk Management

6. The ratio of contribution by Union and States to the State-level allocations for disaster management recommended by FC-XIII should be maintained. Thus, States are to contribute 25 per cent of funds of State Disaster Response Fund (SDRF) and State Disaster Mitigation Fund (SDMF) except the NEH States which shall contribute 10 per cent, and the rest is to be provided by the Union Government.

7. Mitigation Funds should be set up at both the national and State levels, in line with the provisions of the Disaster Management Act. The Mitigation Fund should be used for those local level and community-based interventions which reduce risks and promote environment-friendly settlements and livelihood practices.

8. Allocation of disaster management funds to State Disaster Risk Management Funds (SDRMF) should be based on past expenditure, area and population and disaster risk index (which reflect States' institutional capacity, risk exposure and hazard and vulnerability respectively). Factoring an annual increase of 5 per cent, the Commission arrives at the total corpus of Rs.1,60,153 crore for States for disaster management for the duration of 2021-26, of which the Union's share is Rs.1,22,601 crore and States' share is Rs.37,552 crore.

9. Total States' allocation for SDRMF should be subdivided into funding windows that encompass the full disaster management cycle. The SDRF should get 80 per cent of the total allocation and the SDMF 20 per cent. The SDRF allocation of 80 per cent should be further distributed as follows: Response and Relief – 40 per cent; Recovery and Reconstruction – 30 per cent; and Preparedness and Capacity building – 10 per cent. While the funding windows of the SDRF and SDMF are not interchangeable, there could be flexibility for re-allocation within the three sub windows of SDRF.

10. The allocation for the National Disaster Risk Management Fund (NDRMF) should be based on expenditure in previous years. Factoring an annual increase of 5 per cent, the total national allocation for disaster management is estimated to be Rs.68,463 crore for the duration of 2021-26.

11. The allocation for the NDRMF should also be subdivided into funding windows similar to that of States' allocation for disaster management. Hence, the NDRF is assigned 80 per cent of the total allocation for the NDRMF, with further division into 40 per cent for Response and Relief, 30 per cent for Recovery and Reconstruction and 10 per cent for Preparedness and Capacity-building. The National Disaster Mitigation Fund (NDMF) should be allotted 20 per cent of the total allocation for the NDRMF. If required, the Ministry of Home

Affairs may examine the need for amending the Disaster Management Act to create three sub windows within the NDRF. While the funding window of NDRF and NDMF should be maintained, there could be flexibility for re-allocation within these sub windows.

12. To discourage excessive and unsubstantiated demands from States, all Central assistance through the NDRF and NDMF should be provided on a graded cost-sharing basis. States should contribute 10 per cent for assistance up to Rs.250 crore, 20 per cent for assistance up to Rs.500 crore and 25 per cent for all assistance exceeding Rs.500 crore.

13. A Recovery and Reconstruction Facility should be set up within the NDRF and SDRF. Assistance for recovery and reconstruction is generally a multi-year programme, and the assistance, shared between the Union and States, needs to be released annually against expenditures and only as a percentage of total cost.

14. State and local governments need to have essential disaster preparedness to respond effectively to disasters. State and Local Government institutions and facilities must be equipped and well-functioning to meet the exigencies of a situation. The preparedness and capacity-building grants could be used to support the State Disaster Management Authorities (SDMAs), State Institutes for Disaster Management (SIDMs), training and capacity-building activities and emergency response facilities. A similar window of preparedness and capacity-building should be made available within the NDRF, which could be used to support national agencies.

15. Major capital works required for proper upstream river basin management (to mitigate annual flood disasters caused by river erosion) with gestation periods of ten to fifteen years cannot be accommodated through Finance Commission award. Therefore, the Commission recommended that such projects should be considered as national priority projects. Only such holistic projects can help address flood mitigation properly. A piecemeal approach will simply result in yearly washing away of river embankments.

16. There should be six earmarked allocations for a total amount of Rs.11,950 crore for certain priority areas, namely, two under the NDRF (Expansion and Modernisation of Fire Services and Resettlement of Displaced People affected by Erosion) and four under the NDMF (Catalytic Assistance to Twelve Most Drought prone States, Managing Seismic and Landslide Risks in Ten Hill States, Reducing the Risk of Urban Flooding in Seven Most Populous Cities and Mitigation Measures to Prevent Erosion).

17. In order to strengthen institutional capacities, a dedicated capacity should be set up to supervise the NDRMF and SDRMF and augment disaster funding through other sources. In addition, a disaster database should be developed to help assess the impact of expenditures on different aspects of disaster management. Other interventions such as disbursing assistance to women members of households will make disaster management more effective and efficient. NDMA, as a leading agency in disaster management, needs to be proactive and collaborate with States in promoting the agenda of reforms in disaster management.

18. To improve and streamline the access of Central assistance to the states, the existing system of assessment of the damages caused by any natural calamity should be replaced by a two-stage assessment – an initial humanitarian needs assessment for response and relief assistance and a post-disaster needs assessment (PDNA) for recovery and reconstruction needs.

19. All the new funding windows need to be supported through development of guidelines, the drawing up of which should be led by the NDMA.

20. An annual report at the national level may record all the allocations, expenditures, key achievements and results against various indicators developed for the implementation of the SFDRR. The contribution of these allocations to national and State capacities may be evaluated against a set of indicators determined by the NDMA.

21. In the event of SDRMF and NDRMF assistance falling short of the required assistance, the Union and States should have recourse to other financial instruments. These instruments are identified as reconstruction bonds, contingent credit/stand-by facility with international financial institutions, crowd funding platforms and corporate social responsibility.

22. Insurance mechanisms, which act as a social safety net and supplement the existing financial mechanisms, need to be introduced in partnership with insurance companies after due diligence is done. These mechanisms are: national insurance scheme for disaster-related deaths, synchronising relief assistance with crop insurance, risk pool for infrastructure protection and recovery, and access to international reinsurance to the outlier hazard events.

Local Governments

23. The total size of the grant to local governments should be Rs.4,36,361 crore for the period 2021-26. The Commission favour a fixed amount rather than a proportion of the divisible pool of taxes to ensure greater predictability of the quantum and timing of fund flow.

24. Of these total grants, Rs.8,000 crore is performance-based grants for incubation of new cities and Rs.450 crore is for shared municipal services. A sum of Rs.2,36,805 crore is earmarked for rural local bodies, Rs.1,21,055 crore for urban local bodies and Rs.70,051 crore for health grants through local governments.

25. The Commission recommends that all States which have not constituted State Finance Commissions (SFCs), must constitute them, act upon their recommendations and lay the explanatory memorandum as to the action taken thereon before the State legislature on or before March 2024. After March 2024, no grants should be released to a State that has not complied with the Constitutional provisions in respect of the SFCs and these conditions. The Ministry of Panchayati Raj (MoPR) will certify the compliance of all Constitutional provisions by a State in this respect before the release of their share of grants for 2024-25 and 2025-26.

26. The entry level condition for rural and urban local bodies for availing any grant due to them is to have both provisional and audited accounts online in the public domain. States will receive grants for those rural and urban local bodies that have their provisional accounts for the previous year and audited accounts for the year before the previous available online.

27. For urban local bodies, apart from the entry level condition of having both provisional and audited accounts online in the public domain, after 2021-22, fixation of minimum floor for property tax rates by the relevant State followed by consistent improvement in the collection of property taxes in tandem with the growth rate of State's own GSDP will be an additional mandatory pre-condition.

28. To supplement the resources needed to fulfil national priorities, 60 per cent of the grants to rural local bodies should be tied to support and strengthen the delivery of two categories of basic services: (a) sanitation and maintenance of ODF status- management and treatment of household waste, and human excreta and faecal sludge management in particular; and (b) drinking water, rain water harvesting and water recycling.

29. Urban local bodies have been categorised into two groups, based on population, and different norms have been used for flow of grants to each, based on their specific needs and aspirations. For cities with million-plus population (Million-Plus cities), 100 per cent of the grants are performance -linked through the Million-Plus Cities Challenge Fund (MCF). Basic grants are proposed only for cities/towns having a population of less than a million.

30. Category I cities (urban agglomerations with a population of more than one million) will be treated as a single unit for monitoring of performance indicators of ambient air quality and service level benchmarks. One-third of the total MCF of each city is earmarked for achieving ambient air quality standards. The balance two-thirds of the city-wise MCF is earmarked for achieving service level benchmarks for drinking water (including rainwater harvesting and recycling) and solid waste management. For drinking water (including rainwater harvesting and recycling) and sanitation and solid waste management criteria under service level benchmarks, the MoHUA shall act as the nodal ministry for determining the eligible urban local bodies.

31. Sixty per cent of the basic grants for urban local bodies in non-Million-Plus cities should be tied to supporting and strengthening the delivery of: (a) sanitation and solid waste management (especially stopping dumping and providing collection and environmentally-sound waste disposal service) and attainment of star ratings as developed by the MoHUA; and (b) drinking water, rain water harvesting and water recycling.

32. The Commission has recommended that for the five-year award period (2021-22 to 2025-26) grants should go to all the three tiers of panchayati raj institutions. Since no resident of India should be denied a share of the local body grants, these should be distributed to even those areas which are not required to have panchayats (Fifth and Sixth Schedule areas and Excluded Areas) for augmenting their resources to provide basic services by similar local level bodies.

33. State Governments, while deciding the share of basic grant among various urban local bodies in cities other than Million-Plus cities, shall make allotment of grants (only under basic grants) on a per capita basis for the Cantonment Boards falling within the State.

34. The grants recommended by the Commission for rural local bodies and non-Million-Plus cities shall be released in two equal instalments each year in June and October after ascertaining the entry level benchmarks and other requirements recommended by them. The States shall transfer grants-in-aid to the local bodies within ten working days of having received them from the Union Government. Any delay beyond ten working days will require the State Governments to release the same with interest as per the effective rate of interest on market borrowings/State Development Loans for the previous year.

35. Since health grants are meant for addressing the gaps in primary health infrastructure, the allocations would not be on a per capita basis for States or for local governments. Based on the MoHFW proposal, the recommended year-wise State-wise fund allocation for this purpose is provided in the main report. The MoHFW shall closely coordinate with respective State Governments and work out a

mechanism for flow and utilisation of these health grants and also involve panchayati raj institutions at all three levels by entrusting them with the responsibility to supervise and manage the delivery of health services in a phased manner.

36. A sum of Rs.8,000 crore is recommended to States as grants for incubation of new cities and Rs.450 crore for facilitating shared municipal services.

37. Since the ceiling for professions tax was not revised for the last three decades, it is time that the relevant amendment to the Constitution is carried out on a priority basis.

Health

38. The Commission has recommended that health spending by States should be increased to more than 8 per cent of their budget by 2022.

39. The Commission has recommended that primary health care should be the number one fundamental commitment of each and every State and that primary health expenditure should be increased to two-thirds of the total health expenditure by 2022.

40. The Commission has recommended that public health expenditure of the Union and States together should be increased in a progressive manner to reach 2.5 per cent of GDP by 2025.

41. Given the inter-State disparity in the availability of medical doctors, it is essential to constitute an All India Medical and Health Service as is envisaged under Section 2A of the All-India Services Act, 1951. For this purpose, the Union Public Service Commission (UPSC) would need to do annual recruitments, based on the State-wise requisitions by each State Government. The Commission has urged the Union Government to implement this proposal in coordination with State Governments.

42. The MBBS curriculum should be restructured to make it competency based. A certain degree of specialisation should be included in the curriculum and the Medical Council of India (MCI)/National Medical Council (NMC) should develop small courses on wellness clinic, basic surgical procedures, anaesthesia, obstetrics and gynaecology, eye, ENT etc. for MBBS doctors and encourage AYUSH as an elective subject for medicine undergraduates.

43. The asymmetric distribution of medical colleges needs to be corrected as most of them are situated in the western and southern parts of India. All public health facilities including district hospitals, private sector facilities and corporate hospitals should be utilised for starting specialist Diplomate of National Board (DNB) courses which will not only enhance the service provisioning but will also ensure the availability of trained human resource.

44. Measures should be taken to assign a larger role for nursing professionals and the concept of nurse practitioner, physician assistant and nurse anaesthetist should be introduced for better utilisation of nursing professionals. The early passage of this legislation should be fast-tracked given its multiplier benefits.

45. The total grants-in-aid support to the health sector over the award period works out to Rs.1,06,606 crore, which is 10.3 per cent of the total grants-in-aid recommended by the Commission. The grants for the health sector will be unconditional.

46. The Commission recommends health grants aggregating to Rs.70,051 crore for urban health and wellness centres (HWCs), building-less sub centre, PHCs, CHCs, block level public health units, support for diagnostic infrastructure for the primary healthcare activities and conversion of rural sub centres and PHCs to HWCs. These grants will be released to the local governments. Given the importance of health grants to fight the pandemic, it has not put any conditions for release of these grants to the local governments.

47. Out of the remaining grant of Rs.31,755 crore for the health sector, the Commission recommends Rs.15,265 crore for critical care hospitals. This includes Rs.13,367 crore for general States and Rs.1,898 crore for NEH States. The inter se distribution of this grant is made on the basis of per capita health expenditure distance method, which is similar to the income distance method recommended in the horizontal formula. However, the inter se distribution is made separately for general and NEH States.

48. The Commission has recommended Rs.469 crore for States for building public health laboratories. The remaining share may come from the Union Government as part of PM-ASBY.

49. The Commission has recommended Rs.13,296 crore for training of the allied healthcare workforce. Out of this, Rs.1,986 crore will be for NEH States and Rs.11,310 crore for general States. Based on the number of district and sub-divisional hospitals given by the MoHFW, it has provided Rs.3 crore per facility for each State. To determine the variable amount for each State, they have used the per capita health expenditure distance method as described in the section on critical care hospitals.

50. The Commission has recommended Rs.2,725 crore for starting DNB courses in district hospitals for overcoming the shortfall of specialists.

51. All the grants will be administered by the MoHFW. Though various components have been earmarked, they are cognisant of the fact that some inter component adjustments within each State's

overall share may be required in future years, as per the emerging ground realities. Hence, within each State's respective share, inter-component flexibility is allowed in consultation with the MoHFW.

Performance-based Incentives and Grants

52. The Commission has recommended total revenue deficit grants (RDG) of Rs 2,94,514 crore over the award period for seventeen States. The details are given below:

State	2021-22	2022-23	2023-24	2024-25	2025-26	2021-26
Andhra Pradesh	17257	10549	2691	Nil	Nil	30497
Assam	6376	4890	2918	Nil	Nil	14184
Haryana	132	Nil	Nil	Nil	Nil	132
Himachal Pradesh	10249	9377	8058	6258	3257	37199
Karnataka	1631	Nil	Nil	Nil	Nil	1631
Kerala	19891	13174	4749	Nil	Nil	37814
Manipur	2524	2310	2104	1701	1157	9796
Meghalaya	1279	1033	715	110	Nil	3137
Mizoram	1790	1615	1474	1079	586	6544
Nagaland	4557	4530	4447	4068	3647	21249
Punjab	10081	8274	5618	1995	Nil	25968
Rajasthan	9878	4862	Nil	Nil	Nil	14740
Sikkim	678	440	149	Nil	Nil	1267
Tamil Nadu	2204	Nil	Nil	Nil	Nil	2204
Tripura	4546	4423	4174	3788	2959	19890
Uttarakhand	7772	7137	6223	4916	2099	28147
West Bengal	17607	13587	8353	568	Nil	40115
Total of States	**118452**	**86201**	**51673**	**24483**	**13705**	**294514**

53. It has recommended grants of Rs.4,800 crore (Rs.1,200 crore each year) from 2022-23 to 2025-26 for incentivising the States to enhance educational outcomes. The performance grant received by the State will be utilised by the education department for enhancing educational outcomes and not diverted for use by any other department by the State.

54. The Commission has recommended Rs.6,143 crore for online learning and development of professional courses (medical and engineering) in regional languages (matribhasha) for higher education in India.

55. The Commission has recommended that Rs.45,000 crore be kept as performance-based incentive for all the States for carrying out agricultural reforms during the award period.

a. It has recommended that States may appropriately amend their land related laws on the lines of NITI Aayog's model law to allow short-term and long-term lease of agricultural land both for agricultural purpose as well as for agro-industry, logistics for agricultural trade and supply chains.

b. It has recommended incentive-based grants to States that maintain and augment groundwater stock and put a check on any fall in the water table.

c. It has recommended using growth in agricultural exports as a target indicator for the award on export performance of a State.

d. It has recommended increasing production of oilseeds, pulses and wood and wood-based products as an indicator to make India self-reliant in pulses, edible oils and wood and wood products.

e. This performance grant for agriculture should be used only for infrastructure and activities related to the development of agriculture and allied sectors by the States.

56. The Commission has recommended Rs. 27,539 crore for maintenance of PMGSY roads for the years 2021-26, out of which Rs. 14,743 crore is for the general States and Rs.12,796 crore is for the NEH States.

57. The Commission has recommended grants of Rs.10,425 crore for fast-track courts for speedier justice delivery in cases of heinous crimes, civil cases of marginalised people, five year - old property cases and economic offences as well as special fast-track courts for POCSO cases.

58. The Commission has recommended total grants to the States, with fixed and variable components, of Rs.1,175 crore from 2022-23 to 2025-26 for improving the quality of statistics. It has also recommended that, initially, the fixed grant of the total allocation, amounting to Rs.677 crore, which is unconditional may be released in 2022-23. The remaining variable component of Rs.498 crore may be disbursed equally over the remaining three years 2023-24 to 2025-26, based on achievements of specified milestones. Both the fixed and variable grants will be utilised by the State's statistics department only.

59. It has recommended Rs.3,150 crore for incentivising aspirational districts and blocks for a period of five years from 2021-22 to 2025-26.

60. The Commission has recommended an extra annual borrowing space for the States, of the magnitude of 0.50 per cent of their GSDP for each of the first four years of the award covering the period 2021-22 to 2024-25, based on certain performance criteria in the power sector.

61. The Commission has recommended that the nutrition of children and pregnant and lactating mothers may be accorded the highest priority by Union Government through the Integrated Child Development Scheme.

62. The Commission has recommended that the Union Government may put forward an arrangement to ensure completion of the pending railways projects at the earliest.

63. The Commission has recommended State-specific grants of Rs.49,599 crore during its award period for social needs, administrative governance and related infrastructure, conservation and sustainable use of water, drainage and sanitation, preserving culture and historical monuments, high-cost physical infrastructure and tourism.

The details of the schemes along with the amount allocated for Tamil Nadu are placed below:

1) **Revamping Chennai water bodies:** The State Government has apprised the Commission about the shrinking of water bodies in Chennai as a result of urbanisation. The State Government wants to have demarcation of groundwater protection zones, construction of check dams across waterways and additional sub-surface storage tanks to cope with the loss of natural and adapt to climate change. The Commission has recommended an amount of Rs.200 crore for this purpose.

2) **Renovation of historically important ancient temples:** The Government of Tamil Nadu has briefed the Commission that the state has the highest number of ancient temples known for their historical, architectural and sculptural significance. It has proposed to renovate 500 of these ancient temples. The Commission has recommended an amount of Rs.300 crore for this purpose.

3) **Heritage Buildings:** The State Government has requested a grant for the preservation and restoration of heritage buildings - Fort St. George, High Court of Madras, Government Museum, PWD Complex in Chennai, which are around a century old. The Commission has recommended a grant of Rs.150 crore for this purpose.

4) **Restoration of traditional water bodies:** The State Government has sought support to take up works for restoring of water bodies in the State. It has proposed to establish ground water recharge structures with various work components needed for construction of check dams, re-construction of anicuts, putting up artificial recharge schemes and restoration of tanks. The Commission has recommended an amount of Rs.900 crore for works related to these water bodies.

5) **Development of key towns of tourist importance:** The State Government has highlighted the importance of key town (Rameshwaram, Madurai, Palani, Tiruchendur, Srirangam) in the tourism sector of the State. These towns have historical importance in terms of ancient temples and heritage sites. It has stated that the development of these key town will boost the economy of the State. The Commission has recommended an amount of Rs.650 crore for this purpose.

64. Following table gives the break-up of total grants-in-aid to the States.

(in Rs. Crore)

Sl. No.	Grant Components	2021-26
1.	**Revenue Deficit Grant**	294514
2.	**Local Governments Grants**	436361
3.	**Disaster Management Grants (Union Government Share)**	122601
4.	**Sector-specific Grants**	129987
	i. Sectoral Grants for Health	31755
	ii. School Education	4800
	iii. Higher Education	6143
	iv. Implementation of agricultural reforms	45000
	v. Maintenance of PMGSY Roads	27539
	vi. Judiciary	10425
	vii. Statistics	1175
	viii. Aspirational district and blocks	3150
5.	**State specific**	49599
	Total	**1033062**

65. State-wise total aggregate transfers recommended during 2021-26 period are given in the **Annex-B** of this document.

66. No funds from any of the State-specific grants may be used for payment of government-owned land. Wherever additional land is required to be acquired from private parties for the project/ construction, the State-specific grants may be used for such compulsory acquisition payments, subject to a ceiling of 50 per cent of such land acquisition cost for new green field projects. However, for brownfield projects where the infrastructure is complete and functional, the State-specific grants would be for productivity enhancement and reaping externalities of scale. In such brownfield projects, the additional expenditure is primarily on land acquisition (such as airport runway extension); therefore, there need not be any such ceiling for utilisation of the State-specific grant. To expedite the execution of all projects, land acquisition payments as above made in 2021-22 would be eligible for retroactive funding in 2022-23 from the State-specific grants.

67. The Commission has recommended that every State should constitute a high level committee for reviewing and monitoring the proper utilisation of grants. This committee may be headed by the Chief Secretary with the Finance Secretary and the secretaries/heads of relevant departments as members. It has recommended that the progress of these projects also be reviewed annually by a committee headed by the Chief Minister with the State Finance Minister and the State ministers concerned as members. It has recommended that no conditionalities, other than what the Commission has prescribed, should be imposed by the Union Government for release or utilisation of the grants.

Defence and Internal Security

68. Keeping in view the extant strategic requirements for national defence in the global context, the Commission has, in their approach, re-calibrated the relative shares of Union and States in gross revenue receipts by reducing their grants component by 1 percent. This will enable the Union to set aside resources for the special funding mechanism that they have proposed.

69. The Union Government may constitute in the Public Account of India, a dedicated non-lapsable fund, Modernisation Fund for Defence and Internal Security (MFDIS), to bridge the gap between projected budgetary requirements and budget allocation for defence and internal security. This may be called Rashtriya Suraksha Naivedyam Kosh or any other appropriate name. The proceeds of the fund will be utilised for the following three purposes:

a. capital investment for modernisation of defence services;
b. capital investment for CAPFs and modernisation of state police forces as projected by MHA; and
c. a small component as welfare fund for our soldiers and para-military personnel.

The fund shall have the standard notified rules for its administration, public reporting and audit by the CAG.

70. This Fund will have four specific sources of incremental funding:

a. transfers from the Consolidated Fund of India;

b. disinvestment proceeds of DPSEs;

c. proceeds from the monetisation of surplus defence land, including realisation of arrears of payment for defence land used by State Governments and for public projects and cost recovered of encroached land; and

d. proceeds of receipts from defence land likely to be transferred to State Governments and for public projects in future.

The total indicative size of the proposed MFDIS over the period 2021-26 is Rs.2,38,354 crore.

71. The maximum size of the recommended fund is Rs. 51,000 crore per annum. Any amount exceeding the same shall be deposited into the Consolidated Fund. This amount shall be maintained in the Public Account and shall be operated through the extant procedures for operating such accounts. The unutilised amount from the normal budgetary allocations to the MoD and MHA for capital expenditure shall not be part of the Fund and should be governed as per the principles of the annual budget process.

72. The MoD would have exclusive rights over the use of the amounts deposited in the Fund from the specified sources of revenue. The MHA will only be permitted to use the fund that is earmarked for it from the source of revenue. The amount proposed for capital expenditure towards internal security for five years is Rs.50,000 crore. Out of this Rs.50,000 crore, the MHA will allocate Rs.500 crore for redeveloping/improving the residential facilities for police personnel in Delhi. This would be augmented by Rs.100 crore per annum for improved communication systems and technology upgradation of the police personnel.

73. The fund may be operated by a suitably empowered High-Powered Committee (HPC) notified by the Union Government. This may be headed by the Cabinet Secretary and consist of the Secretaries of Defence, Home and Expenditure and the Chief of Defence Staff. The HPC would also allocate Rs.1,000 crore per annum for the welfare of families of the defence and CAPF personnel who sacrifice their lives in frontline duties. As this is more in the nature of a humanitarian support, the Commission would suggest simple processes and procedures that would enable this amount to be quickly placed at the disposal of the heads of the services in respect of defence forces and heads of the CAPFs engaged in internal security for disbursal.

74. It also expect that over the next year or two (medium-term), the Union Government will review its existing expenditures and rationalise and re-prioritise them to focus on certain key sectors and interventions with nation-wide externalities, defence and internal security. This will reduce pressures on the revenue account of the Union to enable higher capital expenditure within the available fiscal space.

75. Due to overall fiscal constraints, the MoD should also take immediate measures to innovatively bring down the salaries and pension liabilities.

76. The Commission has also recommended that MoD shall reduce its dependence on defence imports with a specific roadmap by corresponding enhancement in indigenous production at a faster rate.

Resource Mobilisation

Administrative/Operational Changes

77. The IT platform of GST needs to be rectified forthwith and strict compliance ensured with the timelines of filing GST returns, which should lead to seamless invoice-matching and identification of frauds. This should also facilitate regular flow of consistent data on turnovers, output GST, input tax credits and net collections, with possible degree of disaggregation to facilitate scrutiny, analysis and feedback to policy.

78. The unit level information from GSTN should help in expanding the breadth of direct taxes. Tax authorities need to overcome technical impediments and operationalise the tax information system efficiently. (Action by Union and the States)

79. States will need to step up field efforts for expanding the GST base and for ensuring compliance, commensurate with their field strength and infrastructure for VAT collection (Action by States).

80. With the help of information from GST returns, the increasing number of formal transactions and the trail of bank transactions, the direct tax administration should track individual proprietorships and partnerships more effectively (Income Tax – Action by Department of Revenue, Government of India).

81. Closer co-ordination should be ensured between agencies involved in TDS and TCS, filers of withholding tax and information filers for various financial transactions to trace assessees not filing returns. (Income Tax – Action by Department of Revenue, Government of India)

82. To reduce excessive dependence on income tax on salaried incomes, it is important to expeditiously expand coverage of provisions relating to TDS and TCS to more transactions and incomes, which will leave behind an audit trail that acts as deterrent to tax evasion. (Income Tax – Action by Department of Revenue, Government of India)

83. Another issue that calls for urgent departmental resolution, irrespective of revenue consequences, is the disputed direct taxes. Timely clarifications and removal of doubts by authorities, review and improvement in the quality of orders passed and conduct of multi-year audits as against the current single-year audit will help stem the origin of disputes. The constitution of an apex body at the highest level in the CBDT and CBIC to clarify all matters of interpretation will help ensure consistency and uniformity across jurisdictions. The data on disputes should be maintained on a case-wise basis, facilitating analysis of cases and drawing of lessons for the future. (Income Tax-Action by Department of Revenue, Government of India)

84. At the State Government level, stamp duty and registration fees is one tax with large untapped potential. States should integrate computerised property records with registration of transactions and capture market value of properties. State Governments should also streamline their methodology of property valuation to yield regular and realistic updating of property values. This will also help property taxation at the third tier of government. (Stamp duty and registration fees: Action-State Governments).

Tax policy changes

85. The inverted duty structure between intermediate inputs and final outputs present in the GST for many items should be resolved by streamlining its multiple rate structure. This can be corrected even without the weighted effective tax rate going up, with a salutary impact on net revenue collections of the general government. (GST-Appropriate recommendations by Union and the States for action by the GST Council).

86. Efficiency gains can be similarly reaped in customs duty collections by reducing its multiple rate structure: (a) broad banding of industrial finished products on MFN basis; (b) broad banding for intermediate industrial products and industrial raw materials on MFN basis; (c) streamlining and reducing non-tariff barriers; and (d) continuing with zero rating of imports, to facilitate exports for global value chains. The changes at (a) to (c) above may be made in calibrated fashion. (Customs Duty-Action by Department of Revenue, Government of India).

87. The myriad exemptions under different direct tax laws that breeds tax evasion, especially by the richer groups, will need to be reduced. Incentives leading to ambiguous interpretations and evasion

will need to be eliminated. The concessions given to perquisites also need to be reviewed comprehensively. The threshold limits may be kept at the current level for some time to build stability in the tax regime and to ensure greater predictability and better tax planning for the taxpayer. (Income Tax-Action by Department of Revenue, Government of India).

88. The Union Government may initiate action for a Constitutional amendment to effect a change that enables periodic revision of the limits of professions tax upon the recommendations of the President of India, after taking into cognizance of a recommendation to this effect by the Finance Commission. (Action by Department of Revenue, Government of India).

Institutional and tax policy changes that will help achieve the full potential

89. It is important to restore the revenue neutrality of the GST rate, which was compromised by the multiple rate structure and several downward adjustments of rates. The rate structure can be rationalised by carefully merging the rates of 12 per cent and 18 per cent. The system can be operated with a three-rate structure of a merit rate, standard rate and demerit rate. Efficiency and revenue gains require that exemptions be minimised. (GST-Appropriate recommendations by Union and the States for action by the GST Council).

90. Over-reliance on consumption-based taxes by the general government, which reduces the progressivity of the tax system, should be reduced by widening the net of income and asset-based taxation. Different tiers of the Government should review their Constitutional entitlements to income and asset-based taxation and assess the feasibility of each untapped tax power, so that the erosion of the tax base and evasion of tax payments can be halted. Wherever inadequate devolution of taxation powers hinders resource mobilisation at the third tier of Government, especially in asset-based taxes, such devolution should be immediately undertaken and local administrative capacity strengthened.

Fiscal Consolidation Roadmap

91. The macro-stabilisation function of prudently supporting the State budgets to help them overcome the current crisis rests with the Union Government. However, the responsibility of balancing the budgets of States lies primarily with these governments themselves.

92. The current strain on the revenues of the Union and State Governments calls for strict discipline in revenue expenditure, opening up space for higher allocations on health and other urgent expenditure needs while ensuring fiscal sustainability in the medium term.

93. It is important that all committed expenditures and developmental expenditures are met from the augmented borrowing space recommended for the Union and the State Governments, without resort to off-budget or any non-transparent means of financing for any expenditures.

94. The Union Budget 2020-21 shows that fifteen of the thirty umbrella CSS account for about 90 per cent of the total allocation under CSS. Many umbrella schemes have, within them, a number of small schemes, some of them with negligible allocations. A threshold amount of annual appropriation should be fixed below which the funding for a CSS may be stopped. Below the stipulated threshold, the administrating department should justify the need for the continuation of the scheme. As the life cycle of ongoing schemes has been made co-terminus with the cycle of Finance Commissions, the third-party evaluation of all CSSs should be completed within a stipulated timeframe. The flow of monitoring information should be regular and should include credible information on output and outcome indicators. The funding pattern of the CSSs should be fixed upfront in a transparent manner and should be kept stable.

95. Centrally sponsored schemes (CSS) co-financed by the Government of India should be flexible enough to allow States to adapt and innovate. Top-down mandates and strictures on programme implementation are the antithesis of an open-source model. CSS should grant States significant latitude to tailor implementation modalities to local realities.

96. There is a need to shift the focus of inter-governmental fiscal health financing from inputs to outputs/outcomes while advancing the measurement agenda as an accountability tool. The Union Government can shift the focus of CSS and transfers away from line items and activities and towards outputs and outcomes, with States being empowered to choose their own pathways to achieve results.

97. For the State Governments, it has recommended that the normal limit for net borrowing may be fixed at 4 per cent of GSDP in 2021-22, 3.5 per cent in 2022-23 and be maintained at 3 per cent of GSDP from 2023-24 to 2025-26. The term 'normal' is used to clarify that it has not accounted for any additional borrowing to be done by the State Governments to manage the shortfall in GST compensation to them, or the incentive-based additional borrowing space that it has recommended for power sector reforms.

98. If a State is not able to fully utilise its sanctioned borrowing limit as specified above, in any particular year during the first four years of the award period (2021-22 to 2024-25), it will have the option of availing this unutilised borrowing amount (calculated in rupees) in any of the subsequent years within the award period.

99. The Commission has assessed that, given the compulsions on the revenue account of the Union Government, including of lending support to the budgets of sub-national governments, they may have to follow an elevated path of fiscal deficit with a terminal year (2025-26) target of 4 per cent of the GDP.

100. With the recommended path for the fiscal deficit of the Union and the State Governments, it has shown that the consolidated debt of the general government will have a downward trajectory during 2023-24 to 2025-26. Indicative debt trajectory of States is given at **Annex-C**. Indicative debt and deficit trajectory of general government is given at **Annex-D**.

101. In view of the uncertainty that prevails at the stage that the Commission has done their analysis, as well as the contemporary realities and challenges, it recognise that the FRBM Act needs a major restructuring and recommend that the time-table for defining and achieving debt sustainability may be examined by a High-powered Inter-governmental Group involving the Union and State Governments. This High powered Group can craft the new FRBM framework and oversee its implementation. It is important that the Union and State Governments amend their FRBM Acts, based on the recommendations of the Group, so as to ensure that their legislations are consistent with the fiscal sustainability framework put in place. This High-powered Inter-Governmental Group could also be tasked to oversee the implementation of the 15th Finance Commission's diverse recommendations.

102. Disclosure of the financial positions of the States and their credit rating will help in broadening the investor base. Credit rating will also reinforce self-discipline on the fiscal front and lead to better pricing of SDLs. The States and the Union should define contingent liabilities transparently, estimate them and assess the risks associated with them.

103. State Governments may explore formation of independent public debt management cells which will chart their borrowing programme efficiently.

104. States should have more avenues for short-term borrowings other than the WMA/OD facility provided by RBI, which has monetary policy implications. Such a facility may help States in meeting the temporary mismatches in their revenue flows at market-determined cost.

Public Financial Management (PFM) Architecture

105. Appropriate amendments may, therefore, also be taken up by the States in their respective fiscal responsibility legislations to ensure consistency with the amended Union Government FRBM Act and, in particular, with the definition of debt.

106. Strengthen cash management practices for each State and the Union Government through the more comprehensive Treasury Single Account (TSA) mechanism. This will allow a more effective management of cash, including of government entities and agencies, and special purpose vehicles that are financing government activity.

107. A comprehensive framework with essential elements of public financial management for consideration and deliberation by all the stakeholders. This framework needs to be developed further in consultation with the States and other relevant stakeholders, and the nature of its implementation agreed upon. The Commission believes that such a public financial management framework, if implemented, would bring India's second pillar of its fiscal architecture to global best practices in the twenty-first century.

108. The establishment of an independent Fiscal Council with powers to access records as required from the Union as well as the States. While this fiscal council would have an advisory role, acting in tandem with the other organs of the government, it would be an institution enabling better compliance by acting as a repository of fiscal data as well as creating awareness.

Aspirations and circumstances of the State of Tamil Nadu and the reforms suggested

Fiscal Indicators

Tamil Nadu’s Debt–GSDP ratio has increased from 17.2% in 2012–13 to 22.6% in 2018–19.

Ranking on the SDG Index of NITI Aayog (2019)

The State has an SDG Index value of 67 (as compared to the national average 60) and ranks 4th among the Indian States. However, the State needs to improve on SDG–2 Zero Hunger, SDG–5 Gender Equality, and SDG–13 Climate Action.

Tourism

The State offers vast and unexploited potential for domestic and international tourism. According to the Tourism Statistics at a Glance 2020, Tamil Nadu ranked first amongst all States in attracting foreign tourist visits in the country in 2019 (22% of foreign tourist visits were made to Tamil Nadu in 2019). The State ranked second amongst all States in attracting domestic tourists in 2019 (21.3% of all domestic tourist visits were made to Tamil Nadu in 2019.

Energy

Of Tamil Nadu’s total solar energy potential of 18 GW, about 1.0 GW has already been harnessed. While TN is a pioneer in the production of renewable energy (wind and solar), grid management needs more focus. Better grid management in renewables could generate substantial streams of future revenue.

Promotion of Aquaculture to Enhance Revenue

Despite a coastline of around 1,076 km, the aquaculture sector in Tamil Nadu is much smaller than that of its neighbour, Andhra Pradesh. Given the prevailing trend of declining Tax and NTR to GDP ratio, aquaculture can become an important revenue generator for Tamil Nadu. Forestry and Tourism are also sectors with significant potential for the State.

FDI into Infrastructure

Airports, roads, and ports may be expanded to provide necessary logistical support to industries. The State needs to establish cable-landing stations (such as those at Vizag and Mumbai) for increasing bandwidth for high data speed and create a digital ecosystem for industrial growth. For such purposes, Tamil Nadu should work towards attracting more FDI. Currently 7% of the total FDI into India flows to Tamil Nadu.

Power Sector

The State needs to upgrade its performance in UDAY Barometers, viz., Smart Metering (200–500 kWH), Smart Metering (above 500 kWH), and Distribution Transformer Metering (Urban). Tamil Nadu needs to be cognizant of its power purchase costs that have risen more than 5% in the last two years.

Public Sector Undertakings

Tamil Nadu has 68 working PSUs, of which 29 had accounts in arrears. The PSUs accumulated losses of Rs. 78,854.25 crore as per their latest finalised accounts. The overall budgetary support of the State to PSUs increased from Rs. 13,918 crore in 2012–13 to Rs. 46,127 crore in 2016–17. Given the outstanding liabilities and substantial budgetary support to SPSUs, the State needs to closely monitor them to avoid contingent liabilities imposing additional fiscal burden on the State. A time bound programme of restructuring the SPSUs should be adopted soon to remove the major hurdles in their performance.

Declining Industrial Growth

Growth in industry slowed down from 10.9% (2005–2011) to 4.6% (2011–2017) led by shrinking of manufacturing and construction activities. This is a major concern because both sectors are significant for employment generation.

Poor Learning Outcomes

The State is below the all India average on two key learning outcomes, which are the percentage of Children in Class III (of government and private schools) who can read Class II Text (2018) and the percentage Children in Class III (of government and private schools) who can at least do subtraction (2018).

Demographic Challenges

According to Census 2011, at 48.5%, Tamil Nadu has one of the highest urbanisation rates across Indian States. It therefore faces attendant challenges of urban poverty, infrastructure deficit, and pollution. Approximately 14 lakh persons have migrated to Tamil Nadu from other States in 2001–2011. The development strategy of Tamil Nadu must aim at ensuring that its migrant population remains more of an asset than a liability. With 10.4% of its population 60 plus in years, Tamil Nadu ranks third after Kerala (12.6%) and Goa (11.2%) as an ageing State.

Million-Plus Cities

Better infrastructure and logistics in Chennai, Coimbatore, Madurai, and Tiruchirappalli could improve investment climate and ensure quality of life for the citizens, thus developing them as economic centres. While cities like Chennai have ample internal resources, local bodies need to generate more Own Tax Receipts (OTR) for creating, upgrading, and maintaining critical infrastructure for better investment climate. Upgrading of roads, bridges, rail, and sewerage systems, urban flood management, solid waste management, improvement of slums, open spaces and parks, etc., need to be viewed comprehensively through the sustainable cities framework. This will entail putting the ULBs in the driver's seat.

Freshwater Deficit

Tamil Nadu is home to nearly 6% of India's population which survives on only 3% of the nation's freshwater resources. The average annual rainfall in TN is only 921 mm (compared to national average of 1,200 mm). The per capita water availability is 750 cubic metres per year (where availability below 1,700 cubic metres per capita per annum indicates 'water stress'). Water stress and seasonal fluctuations result in uncertainty in agriculture production. The State has a net irrigated area of 2.84 million hectare (ha) (2016–17). Its irrigation intensity is low as compared to the national average. Net sown area declined from 61.7 lakh ha (47.4% of total area) in 1970–71 to 43.5 lakh ha (38.9% of total area) in 2016–17 due to urbanisation and drought. The State needs a sustainable framework to ensure management of fresh water as a critical resource.

Reform Signposts

Though Tamil Nadu is one of the most progressive States of India contributing substantially to the national GDP and reporting good social indicators, it compares poorly to some of the other States in its class.

The State's fiscal indicators have deteriorated drastically from 2012–13 (latest year of analysis used for FC-XIV projections) to 2018–19 (latest year available for FC-XV). Tamil Nadu moved from a revenue surplus to a revenue deficit State post 2012–13.

Profligacy during 2014–2016 (in the run up to the elections in May 2016) had perhaps had a telling effect on the fiscal indicators of the State. Capital expenditure–GSDP ratio has fallen between 2011 and 2019 (except UDAY year of 2016–17). Revenue deficit–fiscal deficit (RD–FD) ratio has approached 50% in the recent years implying that most of the borrowings were being used to finance revenue deficit. The State experienced low growth in the major sources of revenue (VAT/GST, Stamp Duty and Registration, and State Excise) during the period 2014–2016.

Post 2017–18, TN has taken significant steps to increase its OTR. Government of Tamil Nadu has increased Excise duty and levied special fee on liquor. VAT/GST on petroleum products was increased in March 2017. After a decade, TN increased in water tariff (in 2017) and sewerage charges (in 2018) building an annual increase of @5% for domestic and @10% for commercial consumers into the tariff structure. After nearly 20 years Tamil Nadu increased property taxes in Chennai in 2018, subject to the condition that the general revision of property tax would not be more than 50% for residential and 100% for non-residential buildings.

Consequent to above efforts in 2017–18 and 2018–19, Tamil Nadu achieved 13% growth in OTR and 15% growth in ORR in 2018–19. The State may use this additional capacity to reverse the pandemic-driven out-migration of labour and spur industrial activity to revive the State's economy by innovatively deploying such additional resources.

The State needs to revert to its pre-2014 RD–FD ratio and invest the borrowings fully into capital expenditure. It also needs to improve the OTR–GSDP ratio further.

&&&&&&

Annexure – A

Cesses and Surcharges

(Rs. in Crore)

	2011-12	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20 (RE)**	**2020-21 (BE)**
Direct Taxes	29143	48862	63883	81543	40468	58840	53433	145802	155817	175807
Indirect Taxes (excluding GST)	63394	72545	77387	86417	137482	172224	150529	172312	182665	195460
Total Cesses and Surcharges	92537	121407	141270	167960	177950	231064	266574	413195	436809	481767
Total Cess and Surcharges as % of gross tax revenue of which	10.4	11.7	12.4	13.5	12.2	13.5	13.9	19.9	20.2	19.9

Annexure – B

Total Finance Commission Recommended Transfers to State (2021-26)

(Rs. in Crore)

States	Share in Central Taxes & Duties	Post Devolution Revenue Deficit	Local Governments	Disaster management	Health	PMGSY roads	Statistics	Judiciary	Higher Education	Agriculture	State Specific	Total Grants-in-Aid (sum of col.3 to 12)	Total Transfers (sum of column 2 & 13)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
Andhra Pradesh	170976	30497	18063	6183	877	344	19	295	250	4209	2300	63037	234013
Arunachal Pradesh	74227	0	1618	1382	133	1508	49	20	48	107	400	5265	79492
Assam	132152	14184	10934	4268	2161	3103	57	610	171	748	1375	37611	169763
Bihar	424926	0	35577	7824	3223	1694	77	960	483	1720	2267	53825	478751
Chhattisgarh	143938	0	10368	2387	588	911	54	200	146	917	1660	17231	161169
Goa	16307	0	609	63	56	0	5	15	50	63	700	1561	17868
Gujarat	146938	0	22163	7316	1070	330	51	310	298	2818	2860	37216	184154
Haryana	46177	132	9066	2715	695	128	40	300	146	1696	2003	16921	63098
Himachal Pradesh	35064	37199	3049	2258	377	2222	21	50	70	247	1420	46913	81977
Jharkhand	139712	0	12322	3138	1014	966	48	275	179	677	1300	19919	159631
Karnataka	154077	1631	21877	4369	1233	398	45	295	299	2290	6000	38437	192514
Kerala	81326	37814	12554	1738	607	113	20	405	181	1086	1100	55618	136944
Madhya Pradesh	331642	0	28367	10059	2340	2109	102	690	349	4587	1765	50368	382010
Maharashtra	266877	0	41391	17803	2710	613	63	1240	520	3285	2750	70375	337252
Manipur	30251	9796	1277	234	191	1193	28	30	54	101	900	13804	44055
Meghalaya	32403	3137	1385	363	187	544	23	30	54	86	800	6609	39012
Mizoram	21124	6544	713	259	115	546	14	15	48	86	700	9040	30164
Nagaland	24039	21249	1038	228	153	372	23	10	51	124	525	23773	47812
Odisha	191297	0	15752	8865	962	1949	45	425	218	1271	1775	31262	222559
Punjab	76343	25968	10305	2736	902	230	43	145	156	1966	1545	43996	120339
Rajasthan	254583	14740	27172	8186	1186	1618	57	460	332	3301	2322	59374	313957
Sikkim	16393	1267	360	279	100	484	7	5	45	41	500	3088	19481
Tamil Nadu	172329	2204	25526	5637	1002	506	47	250	347	2632	2200	40351	212680
Telangana	88806	0	13111	2483	624	255	46	245	189	1665	2362	20980	109786
Tripura	29912	19890	1580	378	265	502	17	85	55	228	875	23875	53787
Uttar Pradesh	757879	0	67160	10685	6150	1465	114	1825	893	5334	3495	97121	855000
Uttarkhand	47234	28147	4181	5178	728	2322	25	70	83	277	1600	42611	89845
West Bengal	317828	40115	30393	5587	2106	1114	35	1165	428	3438	2100	86481	404309
Total	**4224760**	**294514**	**427911**	**122601**	**31755**	**27539**	**1175**	**10425**	**6143**	**45000**	**49599**	**1016662**	**5241422**

Note : (1) Amounts under 'Share in Central taxes and duties'-Column 2 are indicative and actual amounts will vary with the size of the divisible pool over the five year award period; (2) An amount of Rs.16,400 crore is not included in the total Grants-in-aids figure in column 13. This comprises of three grants (a) School Education (Rs.4,800 crore), (b) Grants for aspirational districts and blocks (Rs.3,150 crore) and (c) Local Bodies grants for (i) Incubation of new Cities (Rs.8,000 crore) and (ii) National Data Centre (Rs.450 crore)

Annexure – C

Indicative Debt Path of State Governments

(per cent of GSDP)

State	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Andhra Pradesh	35.0	34.1	34.0	33.4	32.7	32.1
Arunachal Pradesh	40.0	38.4	38.0	36.9	35.8	34.8
Assam	27.1	27.7	29.1	29.7	30.2	30.4
Bihar	41.2	40.2	40.8	40.4	39.9	39.3
Chhattisgarh	28.1	28.8	30.2	30.8	31.3	31.6
Goa	33.3	32.5	32.5	31.9	31.2	30.6
Gujarat	30.6	30.0	30.9	30.6	30.3	29.8
Haryana	31.9	31.2	31.4	30.9	30.4	29.9
Himachal Pradesh	39.8	38.3	37.8	36.8	35.7	34.7
Jharkhand	37.2	36.7	37.5	37.4	37.1	36.8
Karnataka	26.1	26.1	27.1	27.2	27.2	27.1
Kerala	35.9	34.7	34.5	33.7	32.8	32.0
Madhya Pradesh	31.3	31.7	32.9	33.3	33.6	33.7
Maharashtra	25.7	26.0	27.5	28.1	28.5	28.5
Manipur	42.8	41.5	41.8	41.2	40.4	39.6
Meghalaya	40.5	39.9	40.3	39.8	39.1	38.4
Mizoram	37.0	35.8	35.6	34.8	34.0	33.2
Nagaland	45.2	43.0	42.1	40.6	39.1	37.7
Odisha	29.4	30.0	31.3	31.8	32.2	32.5
Punjab	46.3	45.2	45.4	44.9	44.2	43.4
Rajasthan	41.1	39.9	40.2	39.6	38.9	38.2
Sikkim	27.4	27.5	28.1	28.1	28.0	27.9
Tamil Nadu	28.9	28.7	29.3	29.1	28.9	28.7
Telangana	29.5	29.3	29.7	29.5	29.3	29.0
Tripura	36.3	34.9	35.1	34.5	33.7	32.8
Uttar Pradesh	40.9	40.0	40.5	40.2	39.7	39.1
Uttarkhand	33.2	33.1	33.9	34.0	33.9	33.7
West Bengal	42.9	42.1	42.6	42.2	41.7	41.2
All States	**33.1**	**32.6**	**33.3**	**33.1**	**32.8**	**32.5**

Annexure – D

Indicative Deficit and Debt Path for the Union, States and General Government

(as per cent of GDP)

	2020-21	**2021-22**	**2022-23**	**2023-24**	**2024-25**	**2025-26**
Revenue Deficit - Union	5.9	4.9	4.5	3.9	3.3	2.8
Revenue Deficit-States	-0.1	-0.4	-0.8	-1.1	-1.6	-2.4
Revenue Deficit-Combined	5.8	4.5	3.7	2.8	1.7	0.4
Fiscal deficit-Union	7.4	6.0	5.5	5.0	4.5	4.0
Fiscal deficit-States	4.2	3.3	3.3	2.8	2.8	2.8
Fiscal Deficit-Combined	11.6	9.3	8.8	7.8	7.3	6.8
Total liabilities-Union	62.9	61.0	61.0	60.1	58.6	56.6
Total liabilities-States	31.1	30.7	31.3	31.1	30.9	30.5
Netting (*)	4.2	3.4	2.7	2.1	1.7	1.4
Total liabilities-Combined	89.8	88.3	89.6	89.1	87.8	85.7

(*) The items netted include the stock of Union Government loans to the States, the stock of NSSF securities and Treasury Bills held by the State Governments.

EXPLANATORY MEMORANDUM AS TO THE ACTION TAKEN ON THE RECOMMENDATIONS MADE BY THE FIFTEENTH FINANCE COMMISSION IN ITS FINAL REPORT SUBMITTED TO THE PRESIDENT ON NOVEMBER 9, 2020.

1. The Fifteenth Finance Commission (XV-FC) [Commission, henceforth] was constituted on 27th November 2017 by the President, vide Order number S.O. 3755(E) dated 27th November 2017. The Commission, vide S.O. No.4308 (E) dated 29th November, 2019, was mandated to submit two reports i.e., a first report for financial year 2020-21 and a final report for the period 2021-22 to 2025-26. The Commission submitted its first report covering the financial year 2020-21 to the President on 5th December 2019 and an Explanatory Memorandum on the Action taken was presented to Parliament on 1st February 2020.

2. The Final Report of the Commission covering the financial years 2021-22 to 2025-26 commencing from April 1, 2021, 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 related to sharing of the Net proceeds of Union taxes between the Centre and the States, grants-in-aid of revenue of States under Art 275(1) of the Constitution, financing of relief expenditure, grants to local bodies and other recommendations are contained in this Memorandum. This Memorandum also contains the recommendations related to Sectoral Grants, State Specific Grants and fiscal path as contained in the Report submitted by the Commission to the President on November 9th 2020.

Sharing of Union Taxes

3. The Commission has recommended that 41 per cent of the net proceeds of Union taxes should be shared with the States as against the present 42%. The Commission felt that, financial resources equivalent to 1% of the net proceeds of Union taxes should be retained with the Central Government for financing the requirements of the newly formed Union Territories of Jammu & Kashmir and Ladakh.

The Government has accepted the above recommendation of the Commission.

Grants-in-aid of Revenues of States under Article 275 of the Constitution

4. The Commission has recommended Grants-in-aid of revenues of States for revenue deficit, local bodies, disaster management, sector-specific and certain state specific under Art 275 of the Constitution.

Revenue Deficit Grants

5. The Commission has recommended Post-devolution Revenue Deficit Grants amounting to Rs.2,94,514 crore for seventeen States over 2021-22 to 2025-26. The number of States qualifying for the revenue deficit grants decrease from seventeen (17) in 2021-22, the first year of the award period to six (6) in 2025-26, the last year of the award period. Over the five-year period Andhra Pradesh, Assam, Haryana, Himachal Pradesh, Karnataka, Kerala, Manipur, Meghalaya, Mizoram, Nagaland, Punjab, Rajasthan, Sikkim, Tamil Nadu, Tripura, Uttarakhand and West Bengal are being recommended to be provided the deficit grants in one year or the other. The details of the revenue deficit grants and the manner of providing them are contained in paras 10.11 to 10.19 and Tables 10.2, 10.3 and 10.4 of Chapter 10 of Volume–I of the Final Report.

The Government has accepted the above recommendations of the Commission.

Local Bodies Grants

6. The Commission has recommended total grants for duly constituted local governments that add up to Rs.4,36,361 crore for the period 2021-26. The Commission has recommended basing the inter-se distribution of grants for local bodies among the States, on population and area in the ratio of 90:10.

7. A sum of Rs.2,36,805 crore is earmarked for rural local bodies, Rs.1,21,055 crore for urban local bodies and Rs.70,051 crore for health grants through local governments. Rs.8,000 crore is performance-based grants for incubation of new cities and Rs.450 crore is for shared municipal services.

8. The Commission has recommended imposing entry-level conditions for local bodies to receive grants. These include (i) setting up of State Finance Commissions in States, act upon their recommendations and lay the explanatory memorandum as to the action taken thereon before the State legislature on or before March 2024 (ii) having both provisional and audited accounts online in the public domain (iii) fixation of minimum floor for property tax rates by the relevant State followed by consistent improvement in the collection of property taxes in tandem with the growth rate of State's own GSDP (for urban local bodies).

9. The Commission has recommended that 60 per cent of the grants to rural local bodies and for urban local bodies in non-Million-Plus cities should be tied to supporting and strengthening the delivery of two categories of basic services: (a) sanitation, maintenance of ODF status (for Rural Local Bodies), solid waste management and attainment of star ratings as developed by MoHUA (for non-million plus cities / Category-II Cities/Towns; (b) drinking water, rain water harvesting and water recycling (both for Rural Local Bodies and Urban Local Bodies).

10. The Commission has recommended that for cities with million plus population (Million-Plus cities), 100 per cent of the grants are performance-linked through the Million-Plus Cities Challenge Fund (MCF).

11. The Commission has recommended that a sum of Rs.8,000 crore is recommended to States as grants for incubation of new cities and Rs.450 crore for facilitating shared municipal services.

12. The detailed recommendations of the Commission related to local bodies grants are contained in Chapter 7 of Volume–I of the Final Report.

The Government has accepted the above recommendations of the Commission.

Disaster-related Grants- State Disaster Risk Management Fund (SDRMF) and the National Disaster Risk Management Fund (NDRMF)

13. The Commission has recommended the continuation of the existing cost sharing ratio between the Union and State Governments of 75:25 for general states and 90:10 for North-East and Himalayan States. The Commission has recommended allocation of disaster management funds to SDRMFs should be based on factors of past expenditure, area, population, and disaster risk index (which reflect States' institutional capacity, risk exposure, and hazard and vulnerability respectively). Assuming an annual increase of 5 per cent, the Commission recommends the total corpus of Rs.1,60,153 crore for States for disaster management for the duration of 2021-26, of which the Union share is Rs.1,22,601 crore and States share is Rs. 37,552 crore.

14. The Commission has recommended that the total States allocation for SDRMF should be sub-divided into funding windows that encompass the full disaster management cycle. Thus, the SDRF (State Disaster Response Fund) should get 80 per cent of the total allocation and the SDMF (State Disaster Management Fund) 20 per cent. The SDRF allocation of 80 per cent to be further distributed as 40 per cent for Response and Relief, 30 per cent for Recovery and Reconstruction and 10 percent for Preparedness and Capacity-building. While the funding windows of the SDRF and SDMF are not interchangeable, there could be flexibility for re-allocation within the three sub-windows of SDRF.

15. The Commission has recommended that the allocation for the National Disaster Risk Management Fund (NDRMF) should be based on expenditure in previous years. Assuming an annual increase of 5 per cent, the total national allocation for disaster management is estimated to be Rs.68,463 crore for the duration of 2021-26.

16. The Commission has earmarked allocations under NDRMF. The Commission has recommended that NDRF(National Disaster Response Fund) should get 80 per cent of the total allocation for the NDRMF, with further division into 40 per cent for Response and Relief, 30 per cent for Recovery and Reconstruction and 10 per cent for Preparedness and Capacity-building. The National Disaster Mitigation Fund (NDMF) should be allotted 20 per cent of the total allocation for the NDRMF. If required, the Ministry of Home Affairs may examine the need for amending the Disaster Management Act to create three sub-windows within the NDRF. While the funding window of NDRF and NDMF should be maintained, there could be flexibility for re-allocation within these sub-windows.

17. The Commission has recommended that all Central assistance through the NDRF and NDMF should be provided on a graded cost-sharing basis. States should contribute 10 per cent for assistance up to Rs.250 crore, 20 per cent for assistance up to Rs.500 crore and 25 per cent for all assistance exceeding Rs.500 crore.

The Government has accepted these recommendations of the Commission.

Grants to States for Specific Sectors

18. The Commission has recommended providing grants to State Governments in eight different sectors, namely health, school education, higher education, agriculture, maintenance of PMGSY roads, aspirational districts and blocks, judiciary, statistics. The Commission has recommended providing grants to these sectors amounting to Rs.1,29,987 cr during the five year period of the award period.

19. The details of the sectoral grants for health to be provided through State Governments are contained in paras 9.52 to 9.67 of Chapter-9 of Volume-I of the Final Report. The details of these sectoral grants are contained in paras 10.31 to 10.92 of Chapter 10 of Volume-I of the Final Report.

Government will give due consideration to sectors identified by the Commission while formulating and implementing existing and new Centrally Sponsored and Central Sector Schemes.

State Specific Grants

20. The Commission has recommended State Specific Grants amounting to Rs.49,599 crore over the award period of the Commission. These recommendations are contained in paras 10.117 to 10.125 including Table 10.11 and Annexes 10.9 and 10.10 in Chapter 10 of Volume-I of the Final Report.

Keeping in view the untied resources with the State Governments and the fiscal commitments of the Central Government, due consideration will be given to the above recommendation.

Modernization Fund for Defence and Internal Security (MFDIS)

21. The Commission has recommended to constitute in the Public Account of India, a dedicated non-lapsable fund, Modernisation Fund for Defence and Internal Security (MFDIS), to bridge the gap between projected budgetary requirements and budget allocation for defence and internal security. Total indicative size of the proposed MFDIS over the five-year period to be Rs.2,38,354 crore. Of this amount the Commission has recommended that a total of Rs.1,53,354 cr shall be transferred to the MFDIS from the Consolidated Fund of India over the award period of the Commission. The details of the said Fund, its constitution etc are contained in Chapter 11 of Volume-I of the Final Report.

The Government has accepted in-principle the creation of non-lapsable fund for Defence in the Public Account of India. Sources of funding and modalities will be examined in due course.

Fiscal Roadmap

22. The Commission has recommended that the normal limit for net borrowings of State Governments may be fixed at 4 per cent of GSDP in 2021-22, 3.5 per cent in 2022-23 and be maintained at 3 per cent of GSDP from 2023-24 to 2025-26. The Commission has also recommended an extra annual borrowing space for the States, of 0.50 per cent of their GSDP for the period 2021-22 to 2024-25, based on performance criteria in the power sector.

23. The Commission has recommended that the FRBM Act needs a major restructuring and recommend that the time-table for defining and achieving debt sustainability may be examined by a High-powered Inter-governmental Group. This High-powered Group can craft the new FRBM framework and oversee its implementation. It is important that the Union and State Governments amend their FRBM Acts, based on the recommendations of the Group, so as to ensure that their legislations are consistent with the fiscal sustainability framework put in place.

The Government accepts in-principle, the recommendations in respect of the quantum (as a per cent of GSDP) of net borrowing ceilings for the States. Other recommendations related to the fiscal road map for the States and amendments to the FRBM Act will be examined separately.

Other recommendations

24. In addition to the above, the Commission has made other recommendations. These relate to resource mobilization (Chapter 5 of Volume-I of the Final Report), fiscal consolidation for States and the conditionalities associated with the same (Chapter 12 and 13 of Volume-I of the Final Report), performance-based incentives and grants (Chapter 10 of Volume-I of the Final Report) etc.

The Government will examine these recommendations of the Commission in due course.

Implementation

25. Orders on the accepted recommendations under Article 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 related to fiscal path, borrowing limits of the States and Other recommendations of the Commission will be acted upon in due course.

New Delhi
1st February, 2021

NIRMALA SITHARAMAN
Minister of Finance