12th Finance Commission
Golden Jubilee function

Inaugural Session :

Summary record of the inaugural session of the Golden jubilee function to mark the completion of fifty years of Finance Commission

The Golden jubilee function to mark the completion of Fifty years of Finance Commissions in India was inaugurated by the Hon'ble President of India, Dr. A.P.J Abdul Kalam at Vigyan Bhawan in the forenoon of April 9, 2003. The function was presided over by the Hon'ble Union Minister for Finance, Shri Jaswant Singh. The inaugural address of the Hon'ble President was preceded by the welcome address of Dr. C. Rangarajan, Hon'ble Chairman, Twelfth Finance Commission, and by the address of Shri K.C.Pant, Hon'ble Deputy Chairman, Planning Commission. Dr. G.C. Srivastava, Secretary, Twelfth Finance Commission proposed the vote of thanks. The occasion was also graced by the presence of Chief Ministers and Finance Ministers of States, Members of Twelfth Finance Commission and Planning Commission, former Chairmen and Members of Finance Commissions, Secretaries and other officers of the Union and State Governments, eminent economists and media persons. The function was organized by the Twelfth Finance Commission.

The function provided an opportunity to trace the development of fiscal federalism in the first fifty years of independent India since the constitution of the first Finance Commission on 22nd November, 1951. The incumbent Finance Commission is the twelfth in the series, whose constitution on 1st November, 2002, coincides with the fiftieth year of Finance Commissions in India.

In his welcome address, Dr. C.Rangarajan, emphasized the need to establish a sound transfer mechanism for vertical sharing of resources between the Centre and the States and horizontal sharing among the States. Dr. Rangarajan also drew attention to the principles of need, cost disability and fiscal efficiency, which must characterize a sound transfer mechanism. On a note of caution, chairman Twelfth Finance Commission stated that the elimination of revenue account deficit and restraining fiscal deficit to debt sustainable level are the greatest fiscal challenges confronting the transfer mechanism currently in place.

Hon'ble Deputy Chairman, Shri K.C. Pant explained fiscal federalism from the Planning Commission's perspective by citing the Gadgil formula arrangement for Plan transfers to States as against the Finance Commission's transfers of tax revenues. Hon'ble Deputy Chairman also highlighted the significance of private sector flows to the States as equally important for economic development and concluded that the benefits of federalism and decentralization can be reaped only if certain modalities are evolved, which could not be envisaged by the founding fathers.

The Hon'ble Finance Minister, Shri Jaswant Singh highlighted the importance of Finance Commission and Planning Commission as principle pillars of economic and fiscal federalism. The Hon'ble Finance Minister complemented the Finance Commission and the Planning Commission for contributing uniquely to financial as well as political integration of the country. The Union Finance Minister expressed satisfaction at the remarkable journey of fiscal federalism in the last 50 years.

In his inaugural address the Hon'ble President of India congratulated the Chairman and Members of the previous Finance Commissions for the exemplary work accomplished by them. Elaborating on the theme of financial management in the public sector as an important pre-requisite for achieving the targets of the economic growth, Hon'ble President emphasized the need for comprehensively computerizing all the financial transactions between the Centre and the State. This would serve to ensure that funds are spent on the targeted population. The Hon'ble President also called for empowering various levels of governance for maximizing the best possible use of available funds. The Hon'ble President called upon the Twelfth Finance Commission to promote the vision for overall development by suitably empowering the Centre and the States.

Minutes of the meeting between the Twelfth Finance Commission and Finance Ministers of States

The Twelfth Finance Commission, under the chairmanship of Dr. C. Rangarajan held a meeting with the Finance Ministers of State Governments on April 9, 2003 at 2.P.M in Vigyan Bhawan, New Delhi. A list of participants is annexed. The meeting took place in the back-drop of the Golden jubilee function to mark the completion of fifty years of Finance Commissions in India. The function was inaugurated by the Hon'ble President of India, Dr.A.P.J Abdul Kalam, in the forenoon at the same venue.

The meeting was preceded by the launching of the official website of the Twelfth Finance Commission by Dr.C. Rangarajan, who also released a commemorative volume brought out by the Commission, titled, 'Fifty years of Fiscal Federalism'. Chairman, TFC, explained that the official website would facilitate greater exchange of views between the Commission and various stakeholders. He also explained the purpose of publishing the commemorative volume and stated that it would serve as a reference on the recommendations of the previous Finance Commissions and the action taken by the Government of India thereon.

Commencing the meeting, Chairman, TFC requested the Finance Ministers to comment on specific issues. Wherever prepared speeches have been circulated, they may be taken as read. Chairman sought the views of the Finance Ministers, inter-alia, on the following critical issues:-

- Size of the vertical devolution from the Centre to the States
- Principles of determination of horizontal devolution of resources among States.
- Desirability of providing conditional grants.
- Weight of the share of Central taxes and grants in vertical devolution
- Role of the Finance Commission in assigning funds to the Local bodies
- Calamity Relief
- Sustainable level of Fiscal Deficit of States
- Principles governing projection of revenues and expenditure of states
- Management of debt burden

The following were the views expressed by the participants:-

Uttaranchal (Shri N.D.Tiwari, CM)

- Every Five-year plan generates fresh commitments on maintenance, which increases the non-plan expenditure thereby bringing state finances into greater stress. The target of 8% growth in a huge non-plan deficit scenario is a big challenge. There can be no real growth unless the problems of unemployment and underemployment and social disparities are addressed. The Planning Commission and the Finance commission would have to jointly assess the genuine needs of the states in this regard.

- The economic growth target of 8 percent set by the Tenth Five year Plan can be achieved only if the Centre helps out the states with large vertical transfers.
- VRS may ultimately lead to economy in revenue expenditure thereby bringing in greater stability in states' finances but it also leads to unemployment and underemployment, particularly in smaller states.
- There are wide disparities among States in the credit : deposit ratio. This is indicative of lack of effort to solve the unemployment problem.
- State Finance Commissions have greater flexibility and reach in addressing the requirements of Local bodies. The Twelfth Central Finance Commission must discharge its constitutional mandate by recommending a lump sum grant to states for disbursement by the State Finance Commission.
- For states with locational disadvantages and newly created states, a special consideration is required. The TFC should submit an interim report for such states as the Eleventh Finance Commission had not considered their problems.

- A newly created state like Uttaranchal needs substantial assistance to build its physical infrastructure and preserve its ecology. Funds should be provided for the Himalayan glaciers and a proper link between Kumaon and Garhwal which are not directly connected because of Corbett National Park.

Assam (Tarun Gogoi, CM)

- The vertical share of Central tax devolution should be raised to 50 percent in view of the fact that the share of Central taxes in absolute terms has been showing little growth during the EFC's award period.
- The revenue gap for states should be assessed realistically. The actual size of the gap for Assam has turned out to be much larger than what was assessed by the EFC. This should be redressed.
- Efforts should be made to reduce regional disparities and Assam's problems should be given special attention.
- Linking grants to performance is not desirable for states like Assam where insurgency takes a heavy toll of the resources.
- Autonomous councils should be provided a special dispensation.
- The salary component of plan expenditure must be taken into account for assessment of revenue expenditure by the Finance Commission. Depressed expenditure levels on account of withholding additional D.A. should be taken note of and not excluded.
- Liability on account of State Electricity Boards should be kept in view while making expenditure forecasts.
- Assam should be considered for a special debt relief.
- Revenue loss on account of VAT should be fully compensated.

- Calamity Relief Fund should also be allowed to be used for restoring physical infrastructure damaged by recurring calamities.

Manipur (Ibobi Singh, CM)

- There are serious shortcomings in the way the EFC handled issues concerning the North-East.
- As the implementation of the Fifth Pay Commission was unavoidable for the State, the enormity of its burden on State finances must be considered by the TFC. In the case of Manipur it was about Rs.500-600 crore. This has reduced availability of resources for development.
- There was discrimination even among NE States by EFC in the matter of grants for maintenance of roads. While Meghalaya got Rs.218 crore, Manipur got only Rs.13 crore.
- Loktak power project was provided inadequate funding by the Tenth Finance Commission while it was completely ignored by the Eleventh Finance Commission.
- Geographical terrain and insurgency warrant liberal assistance to the State by the TFC. Special grants should be provided for security related expenditure of major projects.
- A better convergence between projections and actual must be brought about by the Commission to arrive at a correct assessment of the states' needs.

Mizoram (Zoramthanga, CM)

- Some of the lapses committed by the EFC may have to be reviewed by TFC to guard against possible repetition.

- It is not fair to withhold 15 percent of the revenue gap grant against specified improvements in the revenue account under the MTFRP. It amounts to as much as 6 months' salary in the case of Mizoram.
- Although Mizoram has signed an MoU with the Government of India, possible resource benefits in this regard are not forthcoming.
- The entire committed liability of the State on in its continuing plan schemes should be included in the assessment of the Non-plan revenue expenditure of the state. The EFC made a faulty assessment of revenue and expenditure which was completely off the mark.
- Impact of the Fifth Pay Commission should have been taken into account.
- 19% of the non-plan revenue expenditure is incurred on debt servicing. The Planning Commission and Finance Commission must reach an understanding on the level of borrowings.
- Maintenance of electricity and water supply entails huge recurring costs. Grants should be provided to meet these costs.
- Upgradation grants for infrastructure should be recommended for Mizoram.

Meghalaya (Dr. Donkupar Roy, Dy.CM)

- It should be ensured that the resource devolution to the State is adequate to meet the growth targets set under the Tenth Plan.
- Growing insurgency in the state should be taken note of by the TFC in its assessment of the state's requirements.
- The revenue gap assessed by EFC fell much short of the actuals which has forced the State to ask for Rs.200 crore of additional annual grant as also moratorium on debt repayment.

- All committed liabilities carried on the plan side should be transferred to non-plan for a correct assessment of non-plan revenue expenditure.
- The decline in the growth of central taxes is a matter of concern.

Gujarat (Shri Vajubhai Vala, FM)

- The state received a lower share of Central tax revenues from the Eleventh Finance Commission compared to the Tenth Finance Commission's award.
- In the tradition of best fiscal practices, the state has imposed a ceiling on the issue of guarantees and has set up a renewal fund. Seven PSUs have been closed. Disinvestment is being pursued in respect of many others.
- Efficiency needs to be rewarded.
- The damage due to cyclone and earthquake was inadequately recompensed by the Central Government.
- The adverse impact of Centre's policies on States' finances such as Pay Commission recommendations, withdrawal of CST etc. should not be missed.
- Financially strong states should not be weakened through increasingly progressive horizontal transfers. Stronger states are more capable of contributing to the enlargement of the sharable pool through which larger gains can accrue to financially weaker states.

West Bengal (Dr. Asim Das Gupta, FM)

- A long standing vertical imbalance in sharing the Central revenues has caused the present crisis. Fifth Pay Commission, funding of revenue plan through borrowings, high interest rates of Central and RIDF loans, and shortfall in tax collection by both the Centre and the States are other contributing factors. An appropriate solution can evolve only with time.
- The immediate concerns are to bridge the revenue-expenditure gap of states, which have increased significantly due to Centre's inability to agree to a moratorium on states' repayment of debt as also shortfalls in Centre's tax revenues resulting in lower accruals from devolution.
- The TFC should endeavour to protect development expenditure to ensure the targeted growth rates along with fiscal stability.
- A mere 5% reduction in debt stock is not adequate.
- The norms for revenue and expenditure growths must also be applicable on the Centre.
- The vertical devolution should be raised to 50 percent. This is possible if Centrally sponsored schemes costing over Rs.15000 crore are transferred to the States. Unearthing of black money through the joint efforts of the Centre and States would also help.
- EFC's relative weights for equity and efficiency were rational and sensible.
- Tax efforts resulting in beyond targeted 15% growth must be rewarded.
- The GSDP growth should be assigned a positive weight in determining horizontal devolution.
- Rescheduling and/or moratorium on repayment of States' debt to the Centre should be considered. This was ignored by the last three Commissions. Debt swap alone is inadequate. Where it is done, it

should be through additional market borrowings and not small savings loans which cost more.

- With regard to the State VAT, the formula for compensation has been worked out, which can be taken into account by the TFC.
- The Centre should fund the maintenance of infrastructure by PRIs.

Mahrashtra (Jayant Patil, FM)

- The projection of revenue and expenditure should be realistic, which is possible if the sanctity of budget estimates is maintained and not moderated by applying unrealistic norms. EFC's approach was sound but it failed to factor in the impact of Fifth Pay Commission
- As the Centre's fiscal policies have a direct bearing on the states' resources as well as expenditure, the States should not be penalized for under-performance attributable to these factors.
- The interest rate must be reduced further on Central loans as the rise in the rate since 1991 contributed significantly to the growth of states' debt burden.
- Rescheduling of States' debt to the Centre is necessary to ease the burden on the States.
- A revenue corpus should be constituted by each state to guard against any unforeseen drop in the growth of revenues.
- The TFC must note the need for resources to improve the infrastructure services in Mumbai.

Uttar Pradesh (Lal ji Tandon, Housing & Development Minister)

- The occasion of the fiftieth anniversary of Finance Commissions provides an opportunity to review the working of the Finance Commissions.
- The use of 1971 population census in the formula of horizontal devolution should be reviewed as it is irrational.
- The Commission should make recommendations under its inherent powers in view of the fact that its terms of reference do not find a mention of upgradation and special problem grants.
- The Commission should arrive at a comprehensive scheme of horizontal distribution encompassing all aspects of equity and efficiency according due weightage to population.
- Upgradation of infrastructure of Local bodies must be suitably accommodated in the TFC's report.
- The Commission may consider recommending a one-time settlement of States' debt.
- Interest rate on Central loans should be brought down proportionately with the fall in deposit rates.

Himachal Pradesh (Chandresh Kumari, Minister)

- The sharable pool of Central taxes should be determined on gross and not net revenues. The determination of the cost of collection often involves an element of arbitrariness. Vertical devolution should be increased to 33.3%.

- An earmarking of 30 percent of the sharable pool of Union taxes should be made in the same manner as for Normal Central Assistance done by the Planning Commission.
- The award of revenue gap grants should be unconditional.

- The recommendations of the State Finance Commissions should be duly accommodated in evolving principles for grants to Local Bodies.
- The Commission should recommend the principles for sustained support to states on account of losses due to the introduction of VAT. The losses should be compensated 100%.

Rajasthan (Praduman Singh, FM)

- The implementation of the Fifth Pay Commission's recommendations has led to a phenomenal growth of salaries and pensions in the states.
- High interest rates on loans from the Centre and public financial institutions has led to an enormous increase in debt servicing burden of the states.
- Further compounding the problems of state finances is the shortfall of the states share of Central taxes with respect to projections. It was of the order of Rs.800 crore in the last three years.
- The Commission should consider recommending a scheme for reducing the debt burden of states.
- Some relief to the states would be available if the vertical share of the Union taxes is raised to 35 percent.
- Historical disabilities and special problems like drought proneness call for more progressive elements in the formula for horizontal devolution.
- Guidelines for tapping NCCF should be framed so as to leave little discretion with the Centre in the treatment of calamities as normal or one of 'rare severity'.

Arunachal Pradesh (Rima Taipodia, Minister of State for Finance)

- The vertical share of Union taxes to states should be suitably enhanced. There should be a mechanism to compensate States in the event of a shortfall in the Central revenues.
- The 90-10 distribution of grant-loan of Central Assistance to special category states needs to be reviewed. It should be made 100 percent grants.
- The Plan-non-Plan distinction needs to be reviewed as separate assessments of states' requirement by the two bodies which the distinction necessitates, suffers from problems of coordination.
- The Commission may consider granting a ten year moratorium on states' repayment of Central debt.
- Special grants may be recommended for technical consultancy and support, computerization etc. for the purpose of reorganizing the tax regime.

Chattisgarh (Dr. Ram Chandra Singh Deo, FM)

- The implementation of the Fifth Pay Commission's recommendations has ruined the finances of states. Additional D.A. every six months is further compounding the problem.
- We are turning into a capital consumption economy. Consumption of assets must be stopped. This adversely affects the future economic growth. The Finance Commission should suggest measures to prevent this.
- Interest rates on Central loans must come down.
- Royalty rates on minerals should be revised every three years.

Jammu & Kashmir (Muzzafar Hussain Baig, FM)

- The State is in a debt trap. Special problems of States should receive due attention.
- Needs should be given a higher weightage as against efficiency norms in devolving resources to the states.
- The Commission should formulate a suitable approach to accommodate the conflicting needs of both the states and local bodies.
- The Commission should take note of the fact that although the state of Jammu & Kashmir was granted special category status in 1969, it was given the benefit of 90 percent grant and 10 per cent loan in Central Assistance only from 1980-81.
- The Commission should also accommodate in the assessment of States' requirements the payment of 'ghost' salaries, the state has been making to its employees, who have migrated and settled elsewhere in the country.

Tripura (Badal Chowdhury, FM)

- The Commission should look into debt liabilities of the state with a view to recommending a moratorium or waiver.
- The Commission must take into account the problems of insurgency in the state, while recommending its award.
- Stress on equity considerations in horizontal devolution would automatically lead to the ultimate achievement of efficiency in resource use.
- The fact that the State has undertaken power sector and fiscal reforms should be viewed favorably by the Commission.

- A macro-level policy of reducing interest rates would help the state reduce its debt-servicing burden.
- The Commission must take cognizance of the fact that terrain problems in the state add immensely to the maintenance cost of capital assets.

Orissa (Panchanan Kanungo, FM)

- Under vertical devolution, the determination of the net proceeds of Union taxes is critical. The 'collection' charges should be normatively fixed.
- Vertical devolution should be increased to 40%.
- Gap between the richer and poorer States should not be widened in the name of efficiency.
- The relative levels of debt servicing burden should be used to categorize states. The highly stressed states should be given more debt relief and debt waiver. Debt swapping will not solve the problem. Moratorium and substantial waiver of principal and interest burden would be necessary.
- In view of the frequency and intensity of natural calamities, which have hit the state, the states' contribution to its Calamity Relief Fund should not be insisted upon.
- Security issues like the Naxalite problem need to be addressed and provision made for adequate expenditure in this regard.
- State's fiscal problems are also attributable to Fifth Pay Commission recommendations.

Bihar (Jagdanand Singh, Water Resources Minister)

- Although EFC was favorably disposed towards Bihar, it will take several Finance Commissions and Five-year plans before the regional imbalances are removed. The very purpose of constituting the Finance Commission is to ensure equity. The gap between the richer and the poorer States should not be allowed to widen.
- Even if removal of regional imbalances is not fully possible in the short run, some minimum level of reduction should be agreed to and the Commission should direct its efforts towards the quick attainment of this objective.
- The arguments in favour of efficiency do not specify how efficiency will be assessed.
- The 1971 population basis should be replaced by the latest available census for arriving at state wise entitlements under horizontal devolution.
- The shortfall in Centre’s revenues impacts the states’ resources for capital expenditure as other expenditures are committed and thus cannot be forsaken. The devolution formula should, therefore, prescribe minimum transfers in case the percentage share falls below projections.

Nagaland (Kewekhape Therie, FM)

- The size of vertical devolution to states must be increased.
- Grant-in-aid should be based on proper assessment of needs.
- The horizontal share under tax devolution of the State of Nagaland was reduced by EFC vis-à-vis Tenth Finance Commission and this should be rectified by the Twelfth Finance Commission.
- The Fiscal Reform Facility must be reviewed.
- Debt swap scheme introduced by the Centre should be pursued.

Some States were represented by their Chief Secretary/Principal Secretary(Finance)/Finance Commissioners. The following views were expressed by them:-

Andhra Pradesh (S.K. Arora, Principal Secretary, Finance)

- The total revenue devolution to states, indicated at 37.5 per cent of gross revenues of the Centre by the EFC should be raised to 50 percent.
- All CSS schemes should be withdrawn
- Just as the 1971 census figures are adopted for population, the assessment of inequality among states, as reflected in the relative levels of per capita income must also be frozen at some benchmark year so that non-performance is not rewarded.
- Revenue Deficit grants should be minimized and replaced by incentive grants.
- A pragmatic debt relief scheme should be designed as the schemes suggested in the past have been non-starters.
- Compensation for introducing State VAT should be determined on the basis of Tax/GSDP ratio.

Haryana (Chander Singh, Principal Secretary, Finance)

- Due to its proximity to Delhi, there is immense pressure on the infrastructure of Haryana. The Commission should recommend special grants for the State keeping this in view.
- The levy of service tax should be awarded to the States or brought under the divisible pool.

- Better managed States should be rewarded for efficiency.

Karnataka (Sudha Pillai, Principal Secretary, Finance)

- The vertical devolution of Central taxes should be raised to 35%.
- The weight of efficiency in the formula for horizontal devolution should be raised.
- Karnataka is being wrongly treated as a revenue surplus State.
- The utilization of grants awarded to the states should be left to them entirely. Special grants must be recommended for VRS and closure of PSUs.
- State specific monitorable parameters should be fixed under MTFRP.
- Interest rates on loans should be aligned with market rates.
- The Commission should consider recommending 100 percent compensation for loss on account of VAT.
- The prospective impact of the recommendations of judicial pay Commission must be included in the assessment of states' expenditure.

Kerala (L. Krishnan, Special Secretary, Finance)

- Tax evasion at the Centre and the States should be addressed.
- Expansion of CSS and externally aided projects burden the states significantly and cause financial problems.

Tamil Nadu

- Under horizontal devolution, 50 percent should be assigned for equity and 50 percent for efficiency.

Chairman, Twelfth Finance Commission thanked the participants and assured a detailed discussion on specific problems during the Commission's visits to the states.

List of Participants (Meeting with Finance Ministers of States)

Twelfth Finance Commission

1. Dr. C. Rangarajan, Chairman
2. Shri Sompal, Member
3. Shri T.R. Prasad, Member
4. Prof. D.K. Srivastava, Member
5. Dr G.C. Srivastava, Secretary
6. Shri R. Ramanujam, Jt. Secretary
7. Shri R.N. Choubey, Jt. Secretary

States

1. Shri N.D.Tiwari, CM, Uttaranchal
2. Shri Tarun Gogoi, CM, Assam
3. Shri Ibobi Singh, CM, Manipur
4. Shri Zoramthanga, CM, Mizoram
5. Dr. Donkupar Roy, Dy.CM, Meghalaya
6. Shri Vajubhai Vallah, FM, Gujarat
7. Dr. Asim Das Gupta, FM, West Bengal
8. Shri Jayant Patil, FM, Maharashtra
9. Shri Lal ji Tandon, Housing & Development Minister, Uttar Pradesh
10. Ms. Chandresh Kumari, Health Minister, Himachal Pradesh
11. Shri Praduman Singh, FM, Rajasthan
12. Ms. Rima Taipodia, Minister of State for Finance, Arunachal Pradesh
13. Dr. Ram Chandra Singh Deo, FM, Chattisgarh
14. Shri Muzzafar Hussain Baig, FM, Jammu & Kashmir
15. Shri Badal Chowdhury, FM, Tripura
16. Shri Panchanan Kanungo, FM, Orissa

17. Shri Jagdanand Singh, Minister, Water Resources, Bihar
18. Shri Kewekhape Therie, FM, Nagaland
19. Shri S.K. Arora, Principal Secretary, Finance, Andhra Pradesh
20. Shri Chander Singh, Principal Secretary, Finance, Haryana
21. Karnataka
22. Ms. Sudha Pillai, Principal Secretary, Finance, Kerala
23. Shri L. Krishnan, Special Secretary, Finance, Tamil Nadu
24. Madhya Pradesh
25. Goa

Minutes of the meeting between the Twelfth Finance Commission and Chairmen, Members of Previous Finance Commissions

The Twelfth Finance Commission, under the chairmanship of Dr.C.Rangarajan, held a meeting with the Chairmen and Members of previous Finance Commissions, on 10th April, 2003, at 10.A.M in Vigyan Bhawan, New Delhi.

Welcoming the participants, Chairman, TFC, stated that the Commission looked forward to hearing them on their experience in handling the intricacies of resource transfers from the Union to the States. Chairman sought their views on the ideal share of States in Central resources. He pointed out that the EFC had determined this as 37.5% of Centre's gross revenue receipts out of which 26% was to be through the Finance Commission route in the form of tax devoloution and grants in aid. Within the vertical devolution, the relative weights for tax devolution and grants in aid would also have to be determined.

Chairman, TFC, drew the attention of the participants to the conflicting demands with regard to equity and efficiency in the horizontal devolution and wanted to know what factors/variables could be kept in view to determine efficiency. Chairman, TFC, further requested the participants to comment on the considerations, which should go into designing a pragmatic scheme for restructuring of public finances. The other issues on which views were sought were the role of Finance Commission in augmenting the resources of local bodies, calamity relief, Medium Term Fiscal Restructuring Plan and the extent of coordination required between Planning Commission and Finance Commissions so as to ensure that resource transfers effected by these two separate bodies are complementary without any conflict of goals and objectives.

The views expressed by the participants were as under:-

Shri G. Ramachandran (Member Secretary, Sixth Finance Commission)

The issues facing the current Finance Commission are not much different from the ones confronted by Commissions thirty years ago. Resource transfers from the Union to the States were as difficult to determine. However, Finance Commissions then dealt with healthy revenue surpluses at the Centre. Even States used to have a comfortable revenue account, with many of them reporting pre-devolution surpluses. Now the gap between advanced and backward States has widened in terms of per capita income and standards of essential services. Horizontal devolution has, therefore, to strike a delicate balance between considerations of equity and efficiency. The Finance Commissions have tilted more in favor of equity with the result that relatively advanced states have developed the perception of being treated unfairly.

Although, the Finance Commission has the option of redressing this by raising the weight for efficiency criteria in the horizontal devolution, a lasting solution to the problem lies in doing something radical. Considering that there is some scope for increasing income tax rates, a surcharge could be allowed to be levied by the States from where the income tax is collected. This would augment the resources for the advanced States without hurting the interests of the poorer States as the Finance Commission could continue to protect equity considerations in respect of amounts collected as the principal tax. On the issue of restructuring of public finances, he wondered why the Centre and the States should have a creditor-debtor relationship. Surpluses on the revenue account should be devolved as grants and States could be allowed to borrow directly from the market based on their credit-worthiness for capital expenditure.

Dr.B.S. Minhas (Member, Sixth Finance Commission)

It is very important for Finance Commissions or for that matter any body involved with transfer of resources to be clear on the concept of equity. The very purpose of constituting an expert neutral body to go into the determination of resource transfers is to ensure equity. Superior performance attributable to historical or locational advantages should not be regarded as efficiency. The Twelfth Finance Commission would be well advised to make a report totally based on equity considerations and then consider marginal changes to allow for the political dynamics of the system. The robustness of the Commission's Report will also be tested by what it recommends on privatization of services hitherto provided by the public sector and the suggested scheme for utilization of the disinvestment proceeds. Retiring the debt burden at various governmental levels should be the preferred option. Care should be taken to see that the resources so raised are not frittered away on the current account.

Shri N.K.P Salve (Chairman, Ninth Finance Commission)

Over the years the fiscal health of both the Union and State Governments has deteriorated. The optimism regarding 8-9% growth is, therefore, out of tune with realities. Unlimited borrowings have caused fiscal instability which the Commission should quickly redress. While the Commission would address the equity concerns in the inter-se distribution of surpluses among the States, its assessment should be more comprehensive and accommodate the intra-state backwardness as well. The Commission should not only act as an 'accountant' but also as an 'auditor' and ruthlessly clamp down on profligacy and populism.

Dr. C.H. Hanumantha Rao (Member, Seventh & Eighth Finance Commissions)

Much of the blame for the overall fiscal deterioration must lie with the Centre as it did not tap its revenue potential adequately. A case in point is of the services sector, which despite growing phenomenally in recent years has attracted very little tax levy. Revenues must be raised significantly if the Centre has to secure the targeted additional 2-2.5% tax /GDP ratio for the purpose of transferring reasonable surpluses to the States. Presently there is a gap of at least 3% between the taxable capacity and the tax efforts. Tax rates are being reduced but adequate attention is not paid to widening the tax base. Regional disparities have increased in the last few years. While there have been studies on the effect of the equity considerations, the impact of efficiency parameters such as fiscal discipline, tax efforts etc. built into the devolution formula is not visible. Determination of fiscal prudence for the purpose of monitoring is a difficult and complex task. It is important to increase the grant component of Finance Commission transfers and ensure that such funds are targeted towards redressing regional disparities as well as specific problems. The Commission would do well to go slow on the fiscal efficiency parameters in horizontal devolution as equity consideration alone can achieve a just and fair distribution of resources. The relative weight for tax devolution could, however, be reduced in favour of conditional grants.

Shri V.B Eswaran (Member Secretary, Seventh Finance Commission)

Finance Commission must clarify unequivocally that States are not subordinate bodies but equal partners with the Centre in the task of nation building. Efficiency cannot be induced by the Finance Commission as it is not brought about by any money-transfer mechanism. The Centre itself is not a shining example of efficiency. The Finance Commission must ensure adequate provisioning of resources so that citizens are assured of equal access to basic minimum services such as education, health, safe drinking water, sanitation etc. irrespective of the State in which he resides. As for effective utilization of resources and proper expenditure management, the Commission may only indicate the areas where improvement is possible. This should equally apply to Central Government finances.

Shri G.C. Baveja (Member, Eighth Finance Commission)

Presently, the emphasis on equity is about 80% and efficiency 20% in the devolution formula. It is not clear if fiscal behaviour could be changed by emphasizing efficiency. However, the Commission must dwell at length on the need to ensure fulfilment of specified efficiency norms while expanding the quantum of vertical transfers from the Union to the States. The Commission could do this by increasing the weights for efficiency criteria and specific purpose grants in its scheme of devolution. Upgradation grants have been recommended in the past even when it was not part of the Commission's Terms of Reference. The specific purpose grants, inter-alia, must be targeted towards advancing the educational opportunities for children in the age group of 6-14 years now that it has become a fundamental right. The Commission would also do well to recommend a suitable scheme of debt relief and debt swapping for easing the resource constraints of the states.

Shri Justice T.P.S. Chawla (Member, Eighth Finance Commission)

It is necessary that the award period of Finance Commission and Five-year plan periods are synchronized for a proper coordination and to ensure complementarity of resource transfers from the Union to the States. The Commission must have representation from the judiciary. Making the provision of any service a fundamental right raises the issue of enforceability. Judicial intervention would be meaningless in matters requiring huge public outlays for which the State may be lacking resources.

Shri Justice A.S. Qureshi (Member, Ninth Finance Commission)

The Terms of Reference of the Finance Commission are in violation of the Constitutional Scheme as it is the sole prerogative of the Commission to recommend resource transfers. It is a matter of concern that Constitutional provisions are being brushed aside and the Planning Commission is expanding its role. Grants are to be provided to the States on the recommendations of the Finance Commission under Article 275 of the Constitution. The efforts to ensure equity and justice are diluted by invoking Article 282, which is essentially a residuary provision for making grants for public purposes. Finance Commission is a quasi-judicial body and should not only do justice to all the states but also assert its authority in matters of devolution and grants in aid.

Shri Mahesh Prasad (Member Secretary, Ninth Finance Commission)

The elimination of Revenue deficit, being a pre-requisite to restore stability of Public Finances should be achieved in one clean sweep and not through a gradual process. A graduated approach will diffuse the very focus of reforms. The Finance Commission should become a permanent Constitutional body monitoring resource transfer to the States. The Planning and Finance Commissions could be merged to achieve this. Inefficient use of public resources should be penalized.

Shri BPR Vithal (Member, Tenth Finance Commission)

Satisfactory improvement in the transfer of resources from the Centre to the States is possible only if the Centre significantly raises its tax-GDP ratio. The existing design of horizontal devolution, does not adequately address the problem of States like Orissa, which have a relatively small population and are also backward. It is important that the

Finance Commission also takes on the role of State Finance Commissions, at least for the present, as SFCs are not being seen to be doing anything substantial except for providing useful data on the Local Bodies. The efficiency criterion must be applied with great caution as there could be a balanced budget even with low levels of income and expenditure which reflects lack of efforts to tackle issues of development. On the other hand, a deficit budget may reflect larger expenditure commitments on account of developmental efforts inspite of large growth in revenues as well. Thus, in a balanced budget, larger the size, greater would be the efficiency, whereas in a deficit budget, efficiency parameter should be assessed by looking at growth rates of revenue in relation to expenditure. As for conditionalities to ensure proper utilization of funds, it must be appreciated that only the grants could be made conditional and not entitlements.

Shri M.C. Gupta (Member Secretary, Tenth Finance Commission)

The issue of governance is core to the improvement of Fiscal performance. Good governance consists in controlling rampant evasion of taxes and exploiting the tax base available under Articles 268-270 of the Constitution. Better compliance alone can substantially improve the fiscal situation and there is no need to increase tax rates. The adoption of a comprehensive VAT regime would be in the interests of both the Centre and the States as it plugs leakages and evasion. A single VAT is preferable to a dual VAT which is presently being adopted. The MPLAD scheme is a negation of basic budgetary ethics. Such schemes go against the principles of fiscal responsibility. The Commission should comment on such acts violative of fiscal discipline by the Centre and the States.

Shri Arun Sinha (Member Secretary, Tenth Finance Commission)

The Commission should explore the possibility of devising a mechanism by which its recommendations are made enforceable. Proper coordination between the Planning and Finance Commissions could be the first step in this direction. It may also help in avoiding duplication of decision making, enable a joint effort for devising an equity framework and establish the minimum requirements for subsidies. Where allocations are on equity considerations, a proforma should be prescribed for monitoring achievements. Subsidies should be targeted and provided efficiently to benefit only the deserving. The Calamity Relief Fund must be reviewed. Normal relief can be provided under various other schemes. In case of calamities of rare severity, the surcharge itself determines the size of the corpus required to meet the situation. Major calamities should be directly funded by the Centre.

Shri N.C. Jain (Member, Eleventh Finance Commission)

The Commission's recommendations must reflect concern for the last person whose lot has not improved. Economics is being sacrificed at the altar of political expediency. Recommendations regarding resource transfers to the Local bodies must be based on a closer observation of ground realities so as to make the deployment of funds more effective. It would help in resolving such matters if the Planning and Finance Commissions are merged. The merger will also restore the residuary character of Article 282 under which the Planning Commission has been recommending substantial grants for the States. The Commission should focus on infrastructure disabilities such as poor roads, lack of electricity etc.

Shri J.C. Jetly (Member, Eleventh Finance Commission)

A permanent secretariat is a must for the Finance Commission as a lot of fresh work has to be undertaken at the constitution of every Finance Commission. The permanent secretariat would be ready with data and save precious time for the Commission. The Finance Commission should insist on a decision on each of its recommendations. The present practice is to accept the recommendations involving resource transfers only and a number of important recommendations are overlooked. Further, the Commission in its recommendations must impress upon the States the need for implementation of the 73^{rd} and 74^{th} Constitutional amendments in their true spirit.

Dr. Amaresh Bagchi (Member, Eleventh Finance Commission)

Any scheme of restructuring the public finances can go awry if there does not exist a central policy making authority to ensure that actual performance levels are properly documented against the targets. Past levels of achievement in raising of revenues could be considered a fair norm and a decline in tax : GDP ratio should not be accepted. Given the large quantum of resource transfers due to the States from the Centre, actual performance of states may experience a dip in the face of poor revenue mobilization by the Centre. One way of protecting the resource entitlements of the states would be to fix the entitlements in relation to GDP. The protection of resource entitlements is a necessary support to the states, as unlike the Centre, the States face severe constraints with regard to borrowing. The Commission may consider recommending an enlargement of the taxation powers of the states with a view to augmenting their non-debt resources and ensuring a reasonable plan size. Income tax rates could be allowed to be determined by the States after fixing floor and ceiling rates. The Commission should also review the practice of approving large plans for heavily indebted states supported by further borrowings. This aggravates their liabilities and compounds their resource problems. Efficiency of resource use can only be ensured under a hard budget constraint and a regime of specific purpose grants. Revenue gap grants under Article 275 are entitlements and subjecting these to the achievement of certain pre-conditions would militate against the spirit of the Constitution. The grants component of the resource transfers may be increased so as to minimize the controversies over the relative weights for factors in the devolution formula

Shri T.N. Srivastava (Member Secretary, Eleventh Finance Commission)

Synchronisation of the Five Year Plan and Finance Commission award period is most critical to achieving a robust system of resource transfer from the Centre to the States. The huge revenue component in the Plan is an area of concern as it is funded by borrowings. The Commission may look into the need for upgradation grants though there is no specific mention of this in their TOR. If the Twelfth Finance Commission cannot address this issue, there has to be an alternative mechanism. Otherwise the requirements of the sectors coming under Non-Plan will suffer.

Concluding the meeting, Chairman, Twelfth Finance Commission, thanked the participants for their views and hoped that the Commission would be able to use their suggestions accommodate them suitably in its attempt to balance different conflicting interests and come up with an acceptable resource transfer mechanism.

List of Participants (Meeting with Chairmen and Members of Previous Finance Commissions)

Twelfth Finance Commission

1. Dr. C. Rangarajan, Chairman
2. Shri Sompal, Member
3. Shri T.R. Prasad, Member
4. Prof. D.K. Srivastava, Member
5. Shri G.C. Srivastava, Secretary
6. Shri R. Ramanujam, Jt. Secretary
7. Shri R.N. Chowbey, Jt. Secretary

Chairman and Members of previous Finance Commissions

1. Shri G. Ramachandran, Member Secretary, Sixth Finance Commission
2. Dr.B.S. Minhas, Member, Sixth Finance Commission
3. Shri N.K.P Salve, Chairman, Ninth Finance Commission
4. Dr. C.H. Hanumantha Rao, Member, Seventh & Eighth Finance Commissions
5. Shri V.B Eswaran ,Member Secretary, Seventh Finance Commission
6. Shri G.C. Baveja, Member,Eighth Finance Commission
7. Shri Justice T.P.S. Chawla, Member, Eighth Finance Commission
8. Shri Justice A.S. Qureshi, Member, Ninth Finance Commission
9. Shri Mahesh Prasad, Member Secretary, Ninth Finance Commission
10. Shri BPR Vithal, Member, Tenth Finance Commission
11. Shri M.C. Gupta, Member Secretary, Tenth Finance Commission
12. Shri Arun Sinha, Member Secretary, Tenth Finance Commission
13. Shri N.C. Jain, Member, Eleventh Finance Commission
14. Shri J.C. Jetly,Member, Eleventh Finance Commission
15. Dr. Amaresh Bagchi, Member, Eleventh Finance Commission
16. Shri T.N. Srivastava, Member Secretary, Eleventh Finance Commission