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Main recommendation of the Twelfth Finance Commission

The Twelfth Finance Commission (TFC) was appointed by President on 1st November 2002 under the Chairmanship of Dr. C. Rangarajan. The Terms of Reference of the Commission are at Annex-I.

Summary of the recommendations of the TFC are placed at Annex-II.

State-wise estimation of share in central taxes and specific amounts of grants recommended for various purposes have been compared with the recommendations of the Eleventh Finance Commission (EFC). The comparative position is encapsulated in Annex-III.

Salient Features of TFC Recommendations

1. Total Transfers recommended

The 12th Finance Commission has recommended a total transfer of Rs.7,55,751.62 crore (share in central taxes and duties Rs.6,13,112.02 Crore + Grants-in-aid Rs. 1,42,639.60 crore) to States during 2005-10 as against Rs.4,40,209.26 crore (Rs. 3,76,318.01 crore as share in central taxes and duties + Rs. 58,587.39 crore as grant-in-aid +

Rs.5,303.86 crore as Centre's share of Incentive Fund) by 11th Finance Commission for the five years period 2000-05, showing an increase of 71.68% over TFC award period.

2. Grant in aid of States' revenues

The Non-plan grants under Article 275 of the constitution as per 12th Finance Commission are significantly higher when compared with the corresponding grants for the period of 11th Finance Commission 2000-05 as shown below:

(Rs. in crore)

| Purpose of Grant | During 2000-05 (11th FC) | During 2005-10 (12th FC) |
|---|---------------------------------|---------------------------------|
| 1. Local Bodies grants | 10,000.00 | 25,000.00 |
| 2. Centre's share in Calamity Relief | 8,255.69 | 16,000.00 |
| 3. Non-Plan revenue deficit grants | 35,359.07 | 56,855.87 |
| 4. Grant for education | Nil | 10,171.65 |
| 5. Grant for health | Nil | 5,887.08 |
| 6. Grant for maintenance of roads and bridges | Nil | 15,000.00 |
| 7. Grant for maintenance of public buildings | Nil | 5,000.00 |
| 8. Grant for maintenance of forest. | Nil | 1,000.00 |

| | | |
|---|-----------------|--------------------|
| 9. Grant for heritage conservation. | Nil | 625.00 |
| 10. Grant for State-specific needs | Nil | 7,100.00 |
| 11. Upgradation and special problem grants. | 4,972.63 | Nil |
| 12. Centre's share of Incentive Fund | 5303.86 | Nil |
| Total Non Plan Grants | 63891.25 | 1,42,639.60 |

Under the scheme of transfer recommended by the TFC, the share of grants in the total transfer is 18.9 percent, whereas it was 8.1%, 11.1%, 13.8%, 10.3% and 14.5% as per the recommendations of last five commissions.

3. Share in central Taxes

The share of the States in the net proceeds of shareable central taxes would be 30.5 per cent during 2005-10 (during 2000-05 it was 29.5%). For this purpose, additional excise duties in lieu of sales tax on textiles, tobacco and sugar are treated as a part of the general pool of central taxes. If the tax rental arrangement for these three commodities is terminated and the States are allowed to levy sales tax (or VAT) on these commodities without any prescribed limit, the share of the States in the net proceeds of shareable central taxes shall be reduced to 29.5 per cent.

Criteria and Relative Weights for determining Inter- se shares of States by 11th Finance Commission and 12th Finance Commission has been as under:-

| Criterion | Relative Weight (per cent) | |
|-----------------------------|----------------------------|-------------------------|
| | 11th Finance Commission | 12th Finance Commission |
| 1. Population | 10.0 | 25.0 |
| 2. Income (Distance Method) | 62.5 | 50.0 |
| 3. Area | 7.5 | 10.0 |
| 4. Index of infrastructure | 7.5 | 0.0 |
| 5. Tax effort | 5.0 | 7.5 |
| 6. Fiscal Discipline | 7.5 | 7.5 |

Commission has recommended that if any legislation is enacted in respect of service tax after the eighty eighth Constitutional amendment is notified, it must be ensured that the revenue accruing to a State under the legislation should not be less than the share that would accrue to it, had the entire service tax proceeds been part of the shareable pool.

4. Overall transfers to States

The Commission has recommended that indicative amount of over all transfer to States may be fixed at 38 per cent of the central gross revenue receipts, as against 37.5% of the gross revenue receipts of the Central Government recommended by EFC for 2000-05

5. Non-plan Revenue Deficit Grant

A total non-plan revenue deficit grant of Rs.56,855.87 crore is recommended during the award period for fifteen States. During the first year of the award period, non-Plan revenue deficit grant has been recommended for fifteen States amounting to Rs. 15091.86 crore. By the last year of the award period, only nine States would get non-Plan revenue deficit grant amounting to Rs.9,528.14 crore. Non-plan revenue deficit grants are largely for special category States, except four non-special category states of Kerala, Orissa, West Bengal and Punjab. The amount of the grant for each State having non-Plan deficits is indicated in Annex-IV for each of the 5 years starting from the financial year 2005-06.

6. Grant for Education and Health

Eight States have been recommended for grants amounting to Rs.10171.65 crore over the award period for the education sector, with a minimum of Rs.20 crore in a year for any eligible State.

Seven states have been recommended for grants amounting to Rs.5887.08 crore over the award period for the health sector, with a minimum of Rs.10 crore in a year for any eligible State.

Year-wise allocation for each State in the grants for education and health may be seen at Annex-V.

Grants for the education and health sectors are an additionality, over and above the normal expenditure to be incurred by the States in these sectors. The Commission has recommended that these grants should be utilized only for the respective sectors (non-Plan) based on certain conditionalities specified by the Commission. Monitoring of the expenditure relating to these grants will rest with the State government concerned.

7. Grants for maintenance of roads & bridges, public buildings and forests:

The 12th Finance Commission has recommended grants separately for maintenance of roads and bridges, maintenance of buildings and forests as under:

- i. A grant of Rs.15,000.00 crore over the award period has been recommended for maintenance of roads and bridges.
- ii. An amount of Rs.5000 crore is recommended as grants for maintenance of public buildings.
- iii. Grant of Rs.1000 crore spread over the award period 2005-10 has been recommended by the Commission for maintenance of forests.
- iv. State-wise and year-wise allocations for these three grants may be seen at Annex-VI.
- v. The maintenance grants are an additionality, over and above the normal maintenance expenditure to be incurred by the states. These grants are to be released and spent in accordance with certain conditionalities specified by the Commission.

8. Grants for heritage conservation

A grant of Rs.625 crore spread over the award period has been recommended for heritage conservation. This grant will be used for preservation and protection of historical monuments, archaeological

sites, public libraries, museums and archives, and also for improving the tourist infrastructure to facilitate visits to these sites. State-wise and year -wise allocation of grants made please be seen at Annex-VII.

9. Grants for State specific needs

The grant recommended by the TFC for State specific needs is on the pattern of the grant recommended by EFC for the special problems of the States. The grant recommended by EFC for the special problems of States was Rs. 1,129.00 crore. TFC has recommended an amount of Rs.7,100 crore as grant for States' specific needs . While these grants have been phased out equally over the last four years, Commission has observed that this phasing should be taken as indicative in nature. The States may communicate the required phasing of grants to the Central government. The State-wise allocations along with the purpose of the grants may be seen at Annex-VIII.

10. Grants for local bodies

The Commission 's mandate was to recommend as to the measures needed to augment the Consolidate Fund of a State to supplement the resources of the Panchayats and the Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State.

The Commission has recommended a sum of Rs.25,000 crore for the period 2005-10 as grants-in-aid to augment the consolidated fund of the States to supplement the resources of the municipalities and the panchayats. This is equivalent to 1.24 percent of the shareable tax revenue and 0.9 per cent of gross revenue receipts of the Centre as estimated by the Commission during the period 2005-10.

The Commission has also recommended that amount of Rs.25000 crore may be divided between the panchayats and the municipalities in the ratio of 80:20.

A total grant of Rs.20,000 crore for the panchayati raj institutions and Rs.5,000 crore for the urban local bodies may be given to the States for the period 2005-10 with inter-se distribution as indicated in Annex-IX. Factors and weight adopted for working out inter-se allocation of the grant among the States:

| Criterion | Relative Weight(per cent) | |
|--|---------------------------|-------------------------|
| | 11th Finance Commission | 12th Finance Commission |
| 1. Population | 40.0 | 40.0 |
| 2. Geographical area | 10.0 | 10.0 |
| 3. Distance from highest per capita Income | 20.0 | 20.0 |
| 4. Index of decentralization | 20.0 | 0.0 |
| 5. Revenue effort Of which | 10.0 | 20.0 |
| (a) with respect to own revenue of States | - | 10.0 |
| (b) with respect to GSDP | - | 10.0 |

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|-------------------------|-----|------|
| 6. Index of deprivation | 0.0 | 10.0 |
|-------------------------|-----|------|