

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 ₹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 ₹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 ₹ 2,36,805 crore is earmarked for rural local bodies, ₹1,21,055 crore for urban local bodies and ₹70,051 crore for health grants through local governments. ₹8,000 crore is performance-based grants for incubation of new cities and ₹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 ₹8,000 crore is recommended to States as grants for incubation of new cities and ₹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 ₹1,60,153 crore for States for disaster management for the duration of 2021-26, of which the Union share is ₹1,22,601 crore and States share is ₹ 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 per cent 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 ₹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 ₹250 crore, 20 per cent for assistance up to ₹500 crore and 25 per cent for all assistance exceeding ₹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 ₹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 ₹49,599 cr 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 ₹2,38,354 crore. Of this amount the Commission has recommended that a total of ₹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.