GOVERNMENT OF SIKKIM

MEMORANDUM
TO THE
THIRTEENTH FINANCE
COMMISSION

VOLUME – I

FINANCE, REVENUE & EXPENDITURE
DEPARTMENT

I N D E X

CHAPTER 1

INTRODUCTION

Under the Indian federal system, the Constitution assigns important functions and responsibilities in various economic and social sectors to the States. This is in addition to the normal governance role to be performed by the States. At the same time, more elastic and broad based taxes have been assigned to the Centre leaving insufficient and inelastic revenue resources under the control of States. This has created a gap between the needs and availability of resources for the States.

Keeping this in view, the Constitution provides for the setting up of a Finance Commission, once in five years, to enable the States to raise sufficient revenue to bring about rapid economic growth in the State. The Commission provides the States a mandated forum for ventilation of views of State Governments on Centre-State financial relations.

Constitution and Terms of Reference of the Thirteenth Finance Commission

In this context, the State of Sikkim welcomes the appointment of the Thirteenth Finance Commission and eagerly looks forward to its deliberations with the hope that the Commission would be able to design a more rational revenue transfer system and bring about a national consensus for a fair and balanced fiscal federalism in our country.

The Thirteenth Finance Commission (TFC) has been constituted by the President of India vide order of the 13th November, 2007. The TFC consists of:

1. The Chairman, Dr. Vijay L. Kelkar, Former Union Finance Secretary and Adviser to the then Finance Minister, and four other members, *viz.* (i) Shri B.K. Chaturvedi, Member Planning Commission (Part-time), (ii) Dr. Indira Rajaraman, Professor Emeritus, National Institute of Public Finance & Policy, New Delhi, (iii) Dr. Sanjiv Misra, Former Secretary (Expenditure), Government of India, and (iv) Prof. Atul Sarma, Former Vice-Chancellor, Rajiv Gandhi University.
2. Shri Sumit Bose, the Secretary to the Commission
3. The Commission shall make recommendations as to the following matters, namely :-
   a. the distribution of the net proceeds of the taxes between the Union and the States which are to be, or may be, divided between them under Chapter I Part XII of the Constitution and the allocation of the respective shares of such proceeds amongst the States ;
   b. the principles which will govern the grant-in-aid from the revenues of the States out of the Consolidated Fund of India and the sums to be paid to the States which are in need of assistance for grants-in-aid from their revenues under article 275 of the Constitution for purposes other than those specified in the provisos to clause (1) of that article; and

c. the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State.

4. The Commission shall review the state of the finances of the Union and the States, particularly keeping in view the operation of the States' Debt Consolidation and Relief Facility 2005-2010 introduced by the Central Government on the basis of the recommendations of the Twelfth Finance Commission, and suggest measures for maintaining a stable and sustainable fiscal environment consistent with equitable growth.
5. In making its recommendations, the Commission shall pay regard, among other considerations, to –
   a. the resources of the Central Government, for five years commencing on 1st April 2010, on the basis of levels of taxation and non-tax revenues likely to be reached at the end of 2008-09;
   b. the demands on the resources of the Central Government on account of the projected Gross Budgetary Support to the Central and State Plan, expenditure on civil administration, defense, internal and border security, debt-servicing and other committed expenditure and liabilities;
   c. The resources of the State Governments, for the five years commencing on 1st April 2010, on the basis of levels of taxation and non-tax revenues likely to be reached at the end of 2008-09;
   d. The objective of not only balancing the receipts and expenditure on revenue account of all the States and the Union, but also generating surpluses for capital investment;
   e. The taxation efforts of the Central Government and each State Government and the potential for additional resource mobilization to improve the tax-Gross Domestic Product ratio in the case of the Union and tax-Gross State Domestic Product ratio in the case of the States;
   f. The impact of the proposed implementation of Goods and Services Tax with effect from 1st April, 2010, including its impact on the country's foreign trade;
   g. The need to improve the quality of public expenditure to obtain better outputs and outcomes;
   h. the need to manage ecological, environmental and climatic changes consistent with sustainable development;
   i. the expenditure on the non-salary component of maintenance and upkeep of capital assets and the non-wage related maintenance expenditure on plan schemes to be completed by 31st March, 2010, and the norms on the basis of which specific amounts are recommended for the maintenance of the capital assets and the manner of monitoring such expenditure;
   j. the need for ensuring the commercial viability of irrigation projects, power projects, departmental undertakings and public sector enterprises through various means, including levy of user charges and adoption of measures to promote efficiency.

6. In making its recommendations on various matters, the Commission shall take the year 1971 as the base for population figures in all cases where population is the factor for determination of devolution of taxes and duties and grants-in-aid.
7. The Commission may review the present arrangements as regards financing of Disaster Management with reference to the National Calamity Contingency Fund and the Calamity Relief Fund and the funds envisaged in the Disaster Management Act, 2005 (53 of 2005), and make appropriate recommendations thereon.
8. The Commission shall indicate the basis on which it has arrived at its findings and make available the estimates of receipts and expenditure of the Union and each of the States.
9. The Commission shall make its report available by the 31st day of October, 2009, covering the period of five years commencing on the 1st day of April, 2010.

The setting up of the Thirteenth Finance Commission, with the above mentioned terms of reference, indicates that in the Indian federation there exists a well-defined framework of financial devolution from the Union to the States, which has evolved over fifty years through the working of the various Finance Commissions.

Special Emphasis Needed on Basic Fabric of Federal Structure

Article 280 of the Constitution, under which a Finance Commission is constituted, is basic to the fabric of Centre–State financial relations. Recognizing the need for transfer of resources from the Union to the States, a number of provisions are made in the Constitution in a logical order. The Centre-State financial flows are along the following five routes.

i. Tax devolution and gap filling grants (under Article 275 of the Constitution) given as per the Finance Commission’s award.
ii. Non-plan grants for calamity relief, up-gradation etc. as mandated by the Finance Commission.
iii. Non-plan loans comprising mainly plough back of the net small saving collections mobilized by the States.
iv. Normal Plan assistance under the Gadgil formula and additional Central assistance for externally aided projects.
v. Assistance for Centrally Sponsored Schemes.

The State of Sikkim feels that in addition to making recommendations on the aspects assigned to the TFC, vide the above notification, the time is now ripe to pay special attention to the overall existing system of Centre–State financial flows.

First, the share of the States in Central revenues is restricted to just 30.5 percent. After the acceptance of the Tenth Finance Commission’s recommendation of 29 per cent share in the overall divisible pool of taxes, the Eleventh Finance Commission and the Twelfth Finance Commission have not brought any substantial improvement in the Tenth Finance Commission’s scheme. The share was only marginally increased. Given the various functions of the States, the States’ share in the divisible pool of taxes must be increased considerably.

Second, the gap filling approach through grants under Article 275(1) is confronted with the in-built flaw of not distinguishing between the fiscally imprudent and the fiscally disadvantaged States. This approach has a built-in incentive for the backward States to continue lagging behind the other better off States as they are cross subsidized by the latter.

Third, based on the elaborate procedures laid down by the Planning Commission, the overly centralized planning process for a State is too rigid, unnecessary and counterproductive. The States are unable to reflect their regional priorities in the plan. Also, it puts a premium on fresh capital formation and leads to the corresponding neglect of maintenance of existing assets even though the latter yield much greater returns for every rupee invested.

Finally, the arena of Centrally Sponsored Schemes (CSS) in the planning process is too rigid in design and does not reflect grass root priorities and constraints. The release and monitoring procedure set up by the Union Ministries is tedious and often results in delays. There is no provision of release of advance funds in most ongoing schemes.

The State of Sikkim strongly urges the TFC to give due consideration to the above aspects as these are crucially relevant for the Indian fiscal federal fabric.

State's Views on 1971 Population as a Factor for Devolution of Resources

In this context, the State of Sikkim will like to point out that the Commission is required, under para 7 of the terms of reference, to adopt the population figures of 1971 in all cases where population is regarded as a factor for determination of devolution of taxes and duties, and grants-in-aid. The State Government does appreciate the objective underlying such a stipulation, but at the same time would like to reiterate its earlier stand made to the previous Finance Commissions that such a condition is opposed to the provision under Article 275 of the Constitution where it is clear that such grant is to be extended to the States which are in need of assistance. Such a need of assistance cannot be with reference to the population figures of a year three decades ago but must be based on the population figures for the period for which the grant is being made available.

The population figures of 1971 Census cannot be considered error free so far as Sikkim is concerned. This is because the State had not become part of the Union at that time and the Census operation in 1971 in Sikkim did not conform to the rigors and refinement laid out for the rest of the country in the decennial census operation. Prior to 1971, the growth of population in Sikkim was lower than that of India. However, after joining the Indian Union in 1975, Sikkim's population has grown at a higher rate than the average growth rate of the country as a whole due to the influx of people from other areas. The expansion of population in a short period was abnormally high and the 1981 Census revealed that the growth of population over the decade was over 50%. However, after 1981, population grew at a significantly lower rate as the State Government undertook family planning measures vigorously and also adopted stringent measures to contain the influx. The decennial growth of population in the six decades for Sikkim as compared to All India figures is shown below:

Table 1.1: Decennial Growth of Population of Sikkim & All – India

Year	Population (In Thousands)	Decennial growth (%)	
		Sikkim	All India
1941	121	10.67	14.22
1951	138	13.34	13.31
1961	162	17.76	21.64
1971	210	29.38	24.80
1981	316	50.77	24.66
1991	406	28.47	23.86
2001	540	32.98	21.34

In this regard, the Commission should take note of the National Policy Resolution on population, 29th June 1977, where it was *inter-alia* stated that 'in all cases where population is a factor as in the allocation of Central assistance to State Plans, devolution of taxes and duties and grant-in-aid, population figures of 1971 will continue to be followed till the year 2001'.

In the past, previous Finance Commissions have also adopted 1981 and 1991 Census population figures along with 1971 Census population figures for different purposes. For instance, the population figures of the latest census available were adopted for distribution of the grants for additional duties of excise in lieu of sales tax on tobacco, sugar and textiles by the previous Finance Commissions. The Tenth Finance Commission used 1991 census population figures for the purposes of *ad hoc* grants for local bodies and additional excise duties. We, therefore, request the Commission to consider earnestly the adoption of the latest 2001 Census population figures instead of the three decades old population figure of 1971 Census as during these three decades (1971-2001) Sikkim's population has increased by 157.57 percent, *i.e.* more than doubled. By the time the recommendations of the Thirteenth Finance Commission become effective, the figures from Census 2011 may also become available.

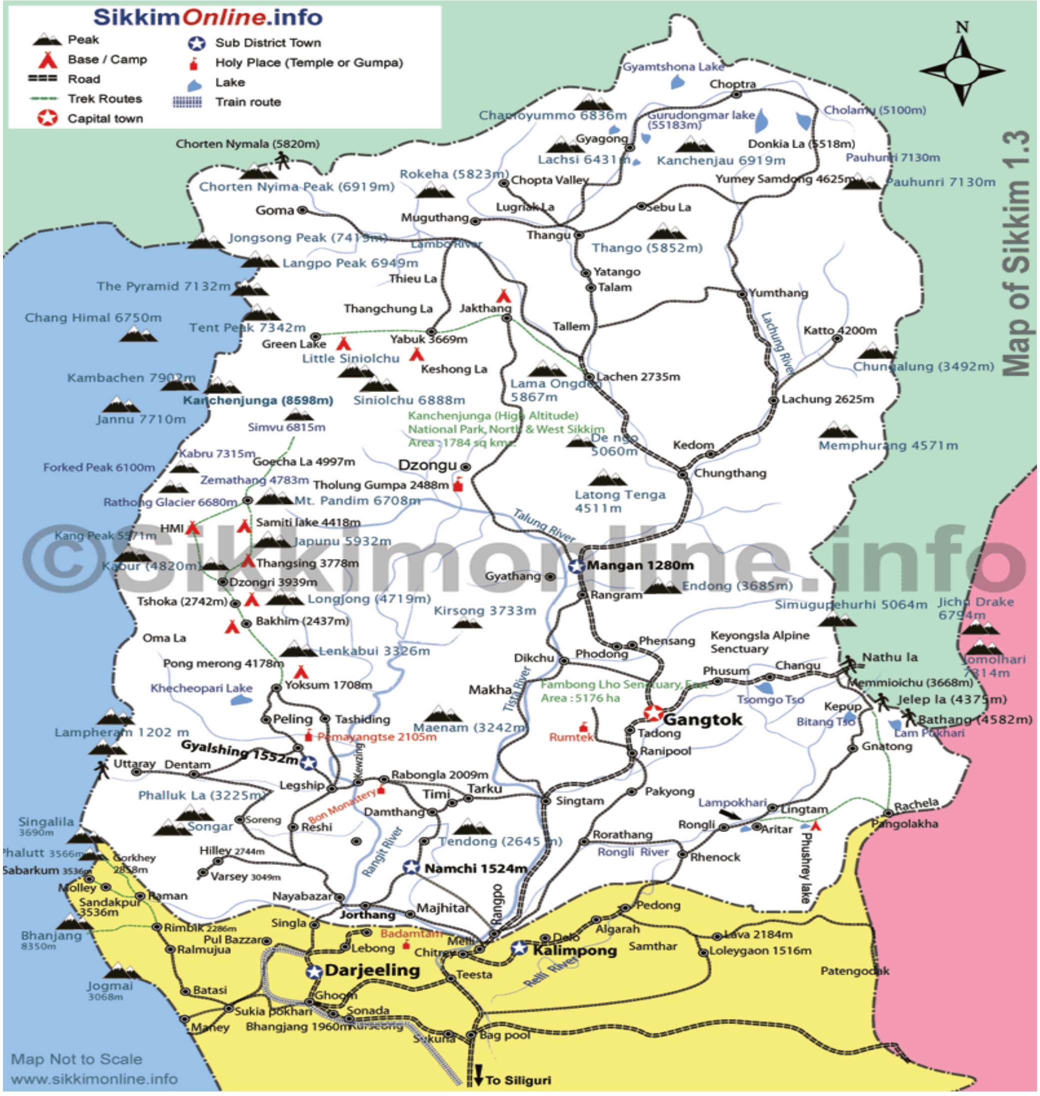
To empirically highlight the impact of taking 1971 population figures for Sikkim, we illustrate the point by taking the award of the Twelfth Finance Commission on the State of Sikkim. According to 1971 census, the share of Sikkim's population was 0.0383 as against 0.0526 in 2001. If population of 2001 is taken as the base, the additional share for Sikkim will be 0.0143[1]. Now if we apply this criteria to the award of the Twelfth Finance Commission, its total tax devolution was Rs 613112 crore[2] of which 25 percent (*i.e.* Rs 153278 crore) was on the basis of population. Sikkim's share from Twelfth Finance Commission is Rs 1392.94 crore; hence, by using 2001 population in place of 1971 population Sikkim may get 1.57% more than what it actually got from the Twelfth Finance Commission. This will be tantamount to getting an

[1] See for population table, Government of India (2008), *Economic Survey,* Ministry of Finance, New Delhi, last page.

[2] See for Tax share data, Government of India (2004), *Report of the Finance Commission,* Ministry of Finance, Government of India, New Delhi, p.197.

additional Rs 21.9 crore (0.0143 percent of Rs 153278 crore) if 2001 population is used as the basis.

Finally, grants (whether on a normative basis or need based) must not be on the basis of population. These must be sufficient to meet the financial needs of the State.



Summing Up

Sikkim has carved out a special position in the Indian Union as one of the most progressive and rapidly developing State within a short period of 33 years After joining the Union, the State has been able to overcome the disadvantages posed by its geographical and topographical situation by adopting ventures that are eco-friendly and sustainable. Given the above peculiar circumstances, in case it is not possible to make allocations as per the 2001 Census, the State Government would like to urge the Commission to reconsider the concessional measures and provide *adhoc* additional assistance for compensating the loss the State would incur from the adoption of 1971 Census figures for the purpose of devolution of the State's share of taxes and Grants-in-aid.

CHAPTER 2
STATE ECONOMY IN MACRO PERSPECTIVE

The economic structure of a State determines the tax base and thus influences its revenue potential. The geographic, social, demographic and infrastructure parameters of the State also have a direct implication on the expenditure of the State, as these variables have to be upgraded to bring it at par with the other developed States of the country. Also, the geography of Sikkim is such that it does not support large clusters of households. Therefore, the Government expenditure incurred in providing the minimum level of services increases. This is further fueled by the absence of economies of scale in providing many of these services. Each of these parameters has a direct relevance on the finances of the State. Keeping these aspects in view, this chapter presents the profile of the State of Sikkim in terms of geographic characteristics, economic structure and certain critical socio-demographic and infrastructure parameters.

Geographical Features

The State of Sikkim, nestled in the Himalayas, is a tourists' paradise. It has a total area of 7,096 sq. km, extending over 112 km from North to South and 64 km from East to West. It shares a 200 km border with Tibet, 33 km with Bhutan and 85 km with Nepal (Exhibit 1). It is bounded by the vast stretches of the Tibetan Plateau in the North; the Chumbi Valley of Tibet and the Kingdom of Bhutan in the East; the Kingdom of Nepal in the West and the Darjeeling District of West Bengal in the South. It is a land of exceptional natural beauty with high mountain peaks, passes, rivers, lakes, glaciers and hot springs. The rich biodiversity has alpine meadows, rhododendrons, orchids, butterflies, animals, fishes and birds (Table 1).The State receives an annual rainfall of 2000 mm to 4000 mm. Tista and Rangit, are the two rivers of the State, which originate from Cholamu Lake and Rathong Glacier, respectively. These major rivers of the State of Sikkim hold tremendous potential for power generation. The State has many important mountains. Some of those having great heights are Kanchenjunga (28,156 ft), Kabru (24,215 ft) and Talung (24,200 ft.). The nine important passes include Nathula (14,400 ft), Jelepla (14,500 ft.), Batangla (13,000 ft.), Charten Nyimala (19,000 ft.) and Donkiala La (18,400 ft). The State also has number of lakes and hot springs (Tables 2a to 2d).

Of the national parks and sanctuaries in Sikkim, the Kanchenjunga National Park is the most renowned. It houses wildlife species like the black bear, red panda and barking deer. The Fambong Lho Wildlife Sanctuary shelters the Himalayan black bear, red panda, civet cat and many varieties of birds and butterflies. The Maenam Wildlife Sanctuary, near Rabongla in South Sikkim, shelters the red panda, leopard cat, civet cat, blood pheasant, black eagle and other animals of the temperate forest. The Singba Rhododendron Sanctuary at Yumthang (North Sikkim) and the Keyongsla Alpine Sanctuary and the Barsey Rhododendron Sanctuary (West District) house some of the most beautiful flowers that make Sikkim unique for its biodiversity.

The many glaciers of Sikkim determine its landscape. The State has number of glaciers having an important role in the formation of its landscape and rivers. Glaciers influence Sikkim's land structure, soil quality, flow of water into the snow-fed rivers, crops, flora and fauna, and also bring about many of the ecological changes that are taking place in this land of pristine charm.

Given the peculiar features of the State, *i.e.* the smallness of the State in terms of geographical size and population, the disadvantage due to location and its socio-economic backwardness, the Government of India has bestowed a special status to Sikkim for the purpose of development and accordingly, has put it under the list of Special Category States. Though Sikkim has made significant progress in all spheres, particularly in the social sector by registering an impressive improvement in human development since the mid-1970s, it still requires a large infrastructure to develop economically and industrially for maintaining its growing population.

Economic Features

The gross state domestic product (GSDP) of the State increased from Rs. 403 crore in 1993-94 to Rs. 1717 crore in 2005-2006, showing a growth of more than four times that of the base year. The growth rate has been relatively much higher than the national average. Sikkim was second to only Pondicherry, Chandigarh and Delhi in having a growth rate of 8.3 percent in the 9th Five Year Plan (1997-2001). The State also achieved a double digit growth rate in the 10th Plan. The per capita GSDP recorded more than a three fold increase; from Rs.8,457 in 1993-94 to Rs. 29,808 in 2005-06 (Table 3). Among the 28 States and 7 Union Territories, Sikkim has the 5th highest growth rate in per capita income

Sectoral Performance: The sectoral distribution of the State income shows that the percentage share of primary sector (agriculture and allied services) has declined from 39.41 percent in 1995-96 to 20.54 percent in 2004-05. The share of the secondary sector and tertiary sector has gone up steadily during the same period. (Table 4)

Tertiary sector has recorded an increase from 41.79 percent to 49.24 percent during the same period. Within the tertiary sector, it is the sub-sectors like transport, banking, insurance, communications and public administration that are accounting for a much larger share of the State's GSDP

Over the years the focus of the State has been to strengthen the core sectors of the economy. This will help in accelerating the pace of development in the State of Sikkim. The main aim is to deal with the problems of poverty and deprivation by improving the quality of life of the people. A great deal of emphasis is being laid on human resource development and the empowerment of the people through access to basic education, health facilities and skill development.

In the agricultural sector, important crops are rice, wheat, maize, finger-millet, barley, buckwheat, ginger, large cardamom, turmeric and potato. Over the years, the food production in the State has increased from 61.8 tonnes in 1980-81 to 1.03 lakh tonnes in 2000-01 and to 1.07 lakh tonnes in 2005-06[3]. The State of Sikkim has managed to indigeneously produce a large portion of its food requirements in spite of having only 64,000 hectares of net sown area, smaller holdings, difficult hilly terrain, diverse agro-climatic conditions, low farm income and lack of adequate supportive infrastructure for agricultural development. The increase in production is

[3] Government of Sikkim (2007), *Economic Survey of Sikkim (2006-07)*, Gangtok.

attributed to the concurrent rise in crop area due to double cropping /mixed cropping and the cumulative effect of increased application of improved agricultural inputs. The HYV coverage has been as high as 98 percent in wheat, 41 percent in rice and 40 percent in maize.

Though the economy of the State is primarily based on agriculture, the investment in this sector has remained inadequate. As a result, the growth rate in the agriculture sector has declined sharply over the years.

As regards the secondary sector, its share in the GSDP of the State has increased from a mere 19.01 percent in 1999-00 to 31.37 percent in 2006-07. Major contribution from this sector to GSDP has come from construction, electricity, gas and water supply (about 28.28 percent in 2006-07), while the rest comes from the manufacturing sector. Even after 32 years of Sikkim's merger with India, the industrial activities are still at a nascent stage in the State. Except for a few small and medium industries like breweries and distilleries, jewel and watch making, there are no noteworthy industries in the State. Non-availability of raw materials, high transportation costs, absence of local markets and lack of entrepreneurial skills have been predominant factors hindering the development of industries. **In addition, landslide and frequent *bandh* called in North Bengal due to Political destabilisation blocking the movement of goods from the State to the other parts of the country have discouraged many industrialists who want to supply goods on a regular basis.** Even the Central Government has no enterprise in the State.

The State Government has made efforts to lure industrialist to set up industrial units in the State. The Sikkim Industrial Development and Investment Corporation provide technical expertise and financial assistance to prospective entrepreneurs. Traditional arts and crafts like carpet weaving etc. are being supported and facilitated in the State by the Directorate of Handloom and Handicraft and the Khadi & Village Industries Board.

However, a majority of the industrial units set up in the State have either been closed or are running at a loss for want of working capital and requisite market for their products. The increase in Service Tax recently in the 2008 budget has reduced the enthusiasm. There is a growing urgency for accelerating the growth in industrial activities in the State so as to meet the challenges posed by the growing levels of unemployment.

In the tertiary sector, the share of public administration is quite conspicuous, though over the period it has exhibited a decline. The major contributing sectors are real estate, ownership of dwellings and business services.

Agriculture is the main occupation of the people of the State. About 56.36 percent of the total labour force of the State is engaged in agriculture which includes 1.31 lakh cultivators and 17,000 agricultural labourers. The corresponding figure for 1991 was 1.11 lakh cultivators (66.16 percent). The percentage change in the labour force employed in household industries reveals a drastic decennial growth of 142.02 percent in 2001. Percentage of total workers with respect to population increased from 41.51 percent in 1991 to 48.64 percent in 2001. The percentage of female workers in rural area declined from 29.60 percent to 26.89 percent over the decade; in urban areas, it increased from 17.87% in 1991 to 19.43% in 2001.

The operational holdings in the State are about 15.69 percent of the total geographical area of 709,600 hectares. The State has 52,697 operational holdings, *i.e.* the per holding area is 2.11 hectares. Of the total operational area, the net sown area is only 63,254 hectares, *i.e.* 8.91 percent of the total geographical area of the State. As a large part of the geographical area comes under un-operational area (where barren land constitutes 22.55 percent), the State of Sikkim faces a huge deficit in food grains and other essential commodities. To meet its food requirement, the State depends on supplies from the Food Corporation of India and imports from other States involving a very high cost of transportation.

Social Infrastructure

During 1991-2001, the population of Sikkim grew at the rate of 33 percent. In 2001, Sikkim had a population of 5.40 lakh with a 53:47 percent male to female ratio and only 11.1 percent living in urban areas. Of the total population, the Scheduled Castes and Scheduled Tribes constitute about 5.02 percent and 20.60 percent, respectively. Density of population in the State is 76 persons per sq. Km and varies according to the district.

In 1991 and 2001, the **sex ratio** in the State was 878 and 875 females per 1000 males, which is lower than the all-India figure of 927 and 933, respectively. Female-male ratio has fallen in Sikkim whereas it has risen at the all-India level in 2001 as compared to1991 (Table 5).

Among the thirty-two States and Union Territories in India in 1993-94, Sikkim ranked fifth in incidence of **poverty**. The proportion of people below the poverty line was exceptionally high at 41.4 percent. However, this has since seen a drastic decline to 19.33 percent in 2006-07[4]. The incidence of poverty was the highest in the West district of the State.

According to the 2001 Census, the **literacy rate** of the State has improved significantly from 57 percent in 1991 to 70 percent in 2001, as against the all-India literacy rate of 65 percent. However, the literacy rates for male is 76.73% as compared to the female literacy rate of 61.46%. This is higher than the all-India literacy rates of 75.85% for males and 54.16% for females. According to 1997 estimates, literacy rates of Scheduled Castes (SC) and Scheduled Tribes (ST) population were recorded as 61.05% and 60.02%, respectively.

Challenging Features of Sikkim

The basic economic challenge is that of obtaining a reasonable growth in output and employment on a sustainable basis by making the best possible use of available resources. This will help the State of Sikkim to combat the critical features of the North-Eastern regions.

Strategy for Social Sector

Although **literacy** has increased in Sikkim, and the State now has a literacy rate of over 75 percent literacy rate (which was 69.80 in 2000-2001 against the all-India average of about 65%), another variable, *viz.* student enrolment in schools indicates relatively low educational achievement. This is mainly because of a **lack of access to schooling** and a very high rate of drop-outs.

[4] State Socio-Economic Census 2006.

Sikkim needs to increase the access to schools, provide good quality teachers' training, and bring an improvement in the curricula. These changes are crucial for achieving the medium-term goals of the economy. This will greatly improve the employability of the school graduates. Also, skill based secondary education and a well targeted vocational training programme will support the thrust areas in the economy and help the State to ensure a high rate of economic growth. The immediate introduction of compulsory computer training courses in schools will lay the groundwork for a computer-literate workforce in the near future.

There has been enough improvement in the status of basic **medical health** care services resulting in the reduction in the rates of infant mortality and the birth and death rates. Also, there has been some increase in life expectancy. While the infant mortality rate has come down to 33 per thousand as against the national figure of 60, the birth and death rates have come down to 21.9 and 5 per 1000 population as against the all-India figures of 24.8 and 8, respectively. Over 85 percent of the identified habitations have been provided with drinking water supply. On the whole, with the efforts of the State, the human development index has recorded a marked improvement from 0.454 in 1991 to 0.532 in 1998.

In keeping up with the policy of private sector participation, a range of educational and professional institutions are being set up with the support of the State Government. Basic health care services are being provided free of cost through the well established network of hospitals and health centers spread throughout the State. Despite these positive trends **greater focus is required in the area of child mortality with particular reference to the mortality rate in respect of the female child. The quality of services is deteriorating and needs to be improved. Also, the vast infrastructure for education and health is decaying in the absence of maintenance due to inadequate resources.**

Horticultural and agricultural yields are low in the State and cultivation costs are high because of the use of outdated farming practices, high costs and inadequate supply of inputs like seeds and seedlings. By and large, the operational holdings are small. Therefore, the farming operations in the State are on a small scale. There is a shortage of well-trained, specialised staff on government farms to disseminate information on good farming practices and modern techniques. Only a small percentage of the cultivated area is irrigated. With limited irrigation facilities, farmers prefer to cultivate their agricultural land mainly during the monsoons.

The development of horticulture is essential to fully exploit the employment and income generating potential of the State. This, however, requires strengthening of the infrastructure mainly at four stages: production, procurement/transportation, marketing and distribution. Yields can be vastly improved by encouraging **modern farming practices, ensuring the timely supply of inputs like seeds and irrigation facilities, and through better linkages between farmers and the market** to help them to correctly assess prices and consumers' needs. The marketing is one of the weakest links in the value chain for horticulture. The cardamom crop is a prime example of where the private traders eat away the farmer's profit margins.

Animal husbandry also forms an integral part of the household economy of the State. The importance of animal husbandry in Sikkim is evident from the fact that 50 percent of total area is under livestock farming as against only 11 percent of the area under cultivation. However, the increase in the output of livestock products has not kept pace with the demand. In addition, the quality of animal stock is poor and animal health care facilities are inadequate There is **an acute shortage of feed and fodder.**

Animal husbandry also stands to gain considerably from the application of modern technology- more scientific farming techniques, *viz.* breeding and animal health services, improved inputs and access to marketing information through better communication facilities. Also, the government is attempting to become a facilitator to encourage private sector activities in the identified sectors

Apart from the private sector, producers' co-operative societies can also supplement direct government involvement in a host of areas such as input and credit supplies, as well as in the marketing network. While the government has to act as a catalyst (without financial exposure) in energizing and promoting co-operatives, the latter will have to bear all the risks and aim to become commercially viable ventures.

Tourism is an area that has, so far, remained underdeveloped in the State. Statistics on tourist traffic (Table 6) reveal that the growth in the flow of visitors has been steady. However, this limited growth of tourism is a reflection of the lack of awareness of the tourist opportunities in Sikkim, **inadequate tourism infrastructure and poor connectivity of the State.** To exploit the tourist potential of the State, it is important that the government formulates policies to promote environmentally sustainable tourism in Sikkim. Tourism can get a further boost by assigning a greater role to the Sikkim Tourism Development Corporation, and from the **development and promotion of special types of tourism such as travel to cultural and religious heritage sites, adventure tourism and business tourism.** All these will bring about a boom in the tourism industry.

Although over 90 percent of the villages have been electrified, the State suffers from **power** shortages. This is primarily due to the fact that the power potential has not been fully utilised. Power generation in the State is only 30 MKW which does not meet the power demand of the State. The State, however, has tremendous hydel-generation potential, given the major *Tista* and *Rangit* river systems in the State. Also, the existing supply of electricity is affected by high administrative expenses.

On the recovery front, however, the power tariffs are below cost. This has created serious financial constraints for the power sector. Transmission and distribution (T&D) losses are also phenomenally high in the State. In order to meet the shortfall in the energy demand, power is being purchased from the Central Power pool. Sikkim is sustaining substantial losses in the power sector (Table.7). Due to all these factors, *viz.* T&D losses, subsidized power rates, and the free provision of light to certain sections of the population, the non-tax revenue from this source is very meager.

Roads are the lifeline of the State. The State being landlocked, roads are a critical input for the growth of all the sectors. The absence of a rail network and commercial air services into the State makes roads the only means of access to the State. National Highway 31A is the only main transport link of Sikkim with the rest of the country. Unfortunately, the topography and climate of the region make the terrain vulnerable to landslides and erosion, and the roads are in a continuous state of disrepair. Poor maintenance of the roads has further exaggerated the problem of poor connectivity. This causes tremendous hardship in the movement of goods and passenger traffic, both along the National Highway as well as on the State Highways. Restoration of damages caused by such natural calamities entails massive human effort as well as huge investments.

The **industria**l activity in the State is not significant due to various reasons including geographical location, lack of infrastructure and some of the government provisions regarding industries.

The Indian Companies Act and the Industrial Disputes Act do not apply to the State. Companies registered under the Registration of Companies Act, Sikkim, 1961, are not permitted to raise equity capital from the domestic market.

The Sikkim Industrial Development and Investment Corporation (SIDICO) has been set up to accelerate industrial development by providing financial assistance, technical consultancy, marketing assistance and better distribution of technical inputs to small and micro enterprises. Several concessions and subsidies have been given to private entrepreneurs under the Industrial Policy of 1996. However, these have not resulted in any noticeable increase in industrial activity

Recently the State has been able to make a big dent on the private investment front. It held investor’s forum meetings in major cities like Delhi and Calcutta and has operationalised the North East Industrial Policy. As a result many national and international investors have shown their interest in new ventures in Sikkim. The State in the last few years has private ventures including that of Labot Glass Bottles Factory, Mount Distilleries, Ayurvedic units of BK Crests and Chaudhary Group of Nepal.

In spite of all these positive developments, the State is still confronted with problems of lack of infrastructure, poor standards of delivery of public services and special economic problems. These problems of the State of Sikkim need to be given due importance by the Thirteenth Finance Commission while awarding grants to the State.

Table 2.1: Sikkim : Basic Indicators

Area (sq. kms.)	7,096
Population 2001	540,851
Urban Population (%)	11.1
Rural Population (%)	88.9
Decennial growth rate 1991-2001	33.1
Population density (per sq. km)	76
Districts (no.)	4
Sub-divisions (no.) (2001)	9

Zilla Panchayat wards (no.)	95
Gram Panchayat units (no.)	163
Gram Panchayat wards (no.)	891
Revenue blocks/ villages (no.)	411
Towns (no.)	8
Households (no.) 2001	114,223
Literacy rate 2001	69.68
Males	76.04
Females	60.40
Total main workers (%) 2001	39.40

Table 2.2: Physical Features of Sikkim

Table 2.2.(a): Important Rivers of Sikkim & their Tributaries

Rivers	Tributary
Rangit	Rangbhang, Relli, Rathong & Kalej
Tista	Dikchu, Rangyong, Bakchachu, Rongpochu, Zemu Chu, Lachung Chu

Table 2.2.(b): Important Mountains of Sikkim

Sl.No	Name of Mountain	District	Height
1	Mt. Kanchendzonga	West	28156 Ft.
2	Mt. Kabru	West	24215 Ft.
3	Mt. Talung	North	24200 Ft.
4	Mt. Siniolchu	West	22600 Ft.
5	Mt. Simvo	West	22476 Ft.
6	Mt. Pandim	West	22100 Ft.
7	Mt. Rathong	West	22100 Ft.
8	Mt. Paunhri	East	22000 Ft.
9	Mt. Kokthang	West	20162 Ft.
10	Mt. Lamaongden	East	19366 Ft.
11	Mt. Masunyange	East	19300 Ft.

Table 2.2.(c): Important Passes with their Altitude

Passes		Altitude (ft)
1	Nathu-La	14,400
2	Jelep-La	14,500
3	Batang-La	13,000
4	Cho-La	-
5	Chiwabhanjang	10,300
6	Chorten Nyima-La	19,000
7	Kongra-La	-
8	Lungma-La	-
9	Donkia-La	18400

Table 2.2.(d): Name of Important Lakes in Sikkim

Name of Lakes		Districts
1	Khe-cheod-Palri (Khecheoperi)	West
2	Gurudungmar	North
3	Lam Pokhari	West
4	Changu (Tsomgo)	East
5	Laxmi Pokhari	West
6	Cholamu	North
7	Bidang Cho	East
8	Menmecho	East
9	Majaur Pokhari	West
10	Sima Choka	North
11	Dud Pokhari	West
12	Samiti Lake	West
13	Ram-laxman (Twin lake)	West

Table 2.2.(e): Important Hot Springs

	Name of Hotsprings	District
1	Phurchachu	West
2	Yumthang	North
3	Borong	South
4	Ralong	South
5	Yumey Samdong	East

Table 2.2.(f): Name of the Important Glaciers

Name of Glaciers		District
1	Zemu Glacier	North
2	Rathong Glacier	West
3	Lonak Glacier	North
4	Hidden Glacier	North
5	Talung Glacier	North
6	North Lonak Glacier	North
7	South Lonak Glacier	North
8	Tista Khangse Glacier	North

Table 2.2 (g): Area of National Parks and Wildlife Sanctuaries in Sikkim – 2007

National Parks & Wildlife Sanctuaries	District	Area in Sq. Km.	Main Species Protected
Kanchendzonga National Park	North	1784	Snow Leopard Shapi/ or Him Tahr
Singba Rhododendron W/L Sanctuary	North	43	Musk Deer, Nepal Langur
Barsey Rhododendron W/L Sanctuary	West	104	Red Panda & Blood Pheasant
Maenam W/L Sanctuary	South	35.34	Satyr Tragopan & Red Panda
Fambonglho W/L Sanctuary	East	51.76	Rusty Bellied Shorwing and Satyr Tragopan
Kyongnosla Alpine W/L Sanctuary	East	31	Him Monal & Blood Phesant
Pangolakha W/L Sanctuary	East	128	Monal, Takin, Gaur, Tiger
Kitam Bird Sanctuary	South	6	Blue Peafowl

Source: Sikkim: A Statistical Profile 2006-07

Table 2.3: Sikkim : Estimates of Gross Domestic Product and Per Capita Income at Current Prices

Year	GSDP (Rs. Crore)	% Change over Previous Year	Per capita GSDP (Rs.)	% Change over Previous Year
Base 1993-94				
1993-94	402.70		9300.00	
1994-95	440.34	9.35	9918.00	6.65
1995-96	520.39	18.18	11412.00	15.06
1996-97	592.46	13.85	12632.00	10.69
1997-98	679.96	14.77	14078.00	11.45
1998-99	787.08	15.75	15805.00	12.27
Base 1999-00				
1999-2000	895.80	13.81	17428.00	10.27
2000-2001	1013.69	13.16	19054.00	9.33
2001-2002	1136.04	12.07	20580.00	8.01
2002-2003	1275.91	12.31	22989.00	11.71
2003-2004 (PE)	1429.72	12.05	25395.00	10.47
2004-2005 (QE)	1602.17	12.06	28108.00	10.68
2005-2006 (AE)	1803.11	12.54	31196.00	10.99
Notes : PE – Provisional Estimate; QE – Quick Estimate ; AE - Advance Estimate				

Table 2.4: Sikkimese Economy : Structural Change in the Gross Domestic Product

						(Percentage share)
Sectors	**1980-81**	**1985-86**	**1990-91**	**1995-96**	**1999-00**	**2004-05 (QE)**
Primary	51.59	50.96	46.49	39.41	25.52	20.54
Secondary	18.11	16.46	12.97	18.8	19.73	30.22
Tertiary	30.3	32.58	40.54	41.79	54.75	49.24

QE : Quick Estimate

Table 2.5: Profile of Sikkim and India

Items	Year	Unit	Sikkim	India
Population	1991	Number	406457	846302688
	2001		540851	1028737436
Poverty	1991	Percentage	41.43	35.97
	2001		19.33	26.1
Literacy Rates	1991	Percentage	56.94	52.21
	2001		69.68	64.8
Sex Ratio	1991	Females per '000 Males	878	927
	2001		875	933

Source: Sikkim Census of India 2001

Table 2.6: Sikkim : Tourist Arrival

	Domestic	Foreign	Total (nos.)
1981	19,115	2,739	21,854
1991	61,360	6,187	67,547
1994	92,435	6,888	99,323
2002	1,59,342	8,566	1,67,908
2005	2,41,697	16,518	2,58,215
2006	2,92,486	18,059	3,10,545

Table 2.7: Power: Installed Capacities

Power House	Installed Capacity at Year-end (Kw)
Lower Lagyap (H)	12,000
Jali Power House (H)	2,100
Rimbi- I (H)	600
Rongnichu-II (H)	2,500
Chaten (Lachen) (H)	100
Rimbi-II (H)	1,000
Lachung (H)	200
Mayongchu (H)	4,000
Upper Rongnichu (H)	8,000
Kalez K.H.E.P (H)	2,000
Rothak (H)	200
Rabomchu (H)	3,000
Diesel (D)	5000

Note: H: hydel; D: diesel

CHAPTER 3

STATE FINANCES: AN OVERVIEW

Sikkim is a small State on the eastern border of the country and has a hilly terrain. The State is besieged with several problems due to its strategic location in the North-East corner of the country. The economy of the State, as presented in the previous chapter, is agrarian in nature with very limited industrial activities and a poor base of infrastructure. The State of Sikkim has a low tax base and is categorized as a special category State whose finances are heavily dependent on Central transfers.

As in many other States, the fiscal health of Sikkim has deteriorated during the last decade, especially from the year 2004-05 onwards. This was primarily due to (i) the adoption of Central pay scales for the State Government employees, (ii) the declining Central transfers; and (iii) the growing debt servicing burden[5].

The State Government has made sincere efforts to mobilize the State's own revenues by revision of rates of taxes, duties and non-tax items. It also attempted to economize on the non-plan revenue expenditures by using the debt swap facility to reduce the interest burden. However, all these measures did not have any substantial impact in improving the finances of the State Government. The State still remains heavily dependent on Central transfers.

Non-Plan Revenue Receipts

Non-plan revenue receipts have increased over the years at the rate of 8.72 percent (Table 3.1). The composition of its different components indicates that less than half of the revenue receipts came from the State's own revenue receipts (except in the year 2006-07) and more than half was realized from Central transfers.

State's Own Tax Revenue

The non-plan revenue receipts of Sikkim, like in other special category States, are little higher than the Central devolutions. However, the State has made efforts to improve its own tax base. Consequently, the State's tax base has increased in recent years. The State's own tax revenues have increased from Rs. 80.39 crore in 2001-02 to Rs. 164.16 crore in 2006-07, exhibiting an impressive growth rate of 14.42 percent per annum. As a result, its percentage share in GSDP has also gone up to 8.05 percent in 2006-07. Since 2003-04, the ratio of own taxes to the GSDP has been hovering around 8 percent as compared to an all-States ratio of around 6 percent. The State's own resources (SORs) have started increasing since 2006-07.

Although there is considerable scope for widening the tax base by covering commercial crops, urban utilities and services (including professional activities), further increases in revenue receipts will depend a great deal upon the availability of infrastructure in the State. As the road conditions improve, there will be scope for levying road tolls. A far more important source of

[5] National Institute of Public Finance and Policy- *Capacity Building for Fiscal Reforms in Sikkim* (Final Report), 2005, New Delhi.

revenue earnings will accrue from the new mini and mega hydel projects being set up in the power sector. A majority of the planned hydel projects will be completed in the next few years. Also, there are many schemes that the Government wants to implement in the tourism sector but has not done so due to lack of funds. It is hoped that the three major new sources of revenue, *viz.* (i) the reopening of the Nathu La trade route, (ii) the commissioning of a number of small and mega hydel projects, and (iii) the State's major foray into floriculture, horticulture and tourism activities will change the entire composition of revenue collection in the State.

The sales tax/VAT and the State excise duty have been the major contributors to the State taxes. Up to 1999-2000, these two taxes contributed about 55 percent to SOTR. The combined share of these two taxes ranges between 60 and 70 percent during 1999-2000 to 2005-06. The sales tax/VAT grew at the rate of 22.8 percent p.a., while revenue from the State excise duty exhibited a growth rate of 14.7 percent p.a. during the period 1999-2000 to 2006-07. These growth rates are linked to the growth rate of GSDP.

The other sources of the State's own revenue are stamp duties & registration fees, and taxes on vehicles. These contribute a very meager share to the total revenue and this share is lower than that in many other States. However, both recorded a high growth rate of about 23.4 percent and 15.4 percent per annum, respectively. Land revenue, on the other hand, grew at the rate of about 8 percent only and has not been as buoyant as the rise in the State's income.

State's Own Non-Tax Revenues

Non-tax revenue in Sikkim, as in the other States, is characterized by a varied mix of receipts, *viz.* interest receipts on loans given by the State government; dividends on equity investments; user fees and tariffs on services provided by the State government in the social and economic sectors; royalty on mines and minerals; receipts from forestry and wildlife; lottery income and other miscellaneous receipts.

Sikkim has maintained a growth rate of 11.67 percent per annum in non-tax revenue during the period 2001-2002 to 2006-07. In 2006-07, non-tax revenue was Rs. 171.00 crore as compared to only Rs. 71.12 crore in 2001-02. The non-tax to GSDP ratio of the State has remained around 6 to 7 percent as compared to the All-States average of less than 2 percent. However, its share in the State's own revenue has been fluctuating in the range of 44% to 57.6% during the period.

In Sikkim, a major portion of the non-tax revenue comes from general services and economic services. On an average, both contribute 45 and 46 percent, respectively. Of the general services, income from lottery is the most important source of revenue; however, this has not proved to be a stable source of revenue. Similar is the case with revenue from the police department. The receipts under the head 'police' accrue due to lending of the services of the Sikkim Police to other States. This is not a regular and assured source of income. However, when the hydel projects are completed, the revenue from the sale of electricity to other States will certainly give the Sikkim State a steady source of income.

Dividends earned from most of the PSUs in the State are highly insignificant. The average return from the State Government's investments during the last seven years is a mere 0.71 percent.

Public provision of services in social and economic sectors, *viz.* education, health, water supply and sanitation, agricultural services, roads and bridges assume significance in a State like Sikkim. However, the low user charges for such services have affected the cost recovery resulting in the imposition of significant implicit subsidies which again put a financial constraint for increasing these services.

Central Devolution to the State

In a State with a limited tax base, the devolution of Central taxes and grants form a significant portion of the revenue. The transfers received by the Government of Sikkim have been more than 50 percent of the total non-plan revenue receipts of the State in all the years except 2006-07. The share declined to 46.13 percent in 2006-07 due to the recommendations of the Twelfth Finance Commission. It is important to note that the Twelfth Finance Commission recommended 30.5 percent of the net proceeds of the common shareable Central taxes and duties to be devolved to the States as against 29.5 percent recommended by the Eleventh Finance Commission. Of the 30.5 percent, the share of the State of Sikkim in the Union taxes was 0.227 percent. However, this was higher than its share of 0.184 percent recommended by the Eleventh Finance Commission and 0.126 percent by the Tenth Finance Commission. However, the grant component, as awarded by the Twelfth Finance Commission, was much lesser (even in absolute terms). This has resulted in a fall in the Central transfers to the State of Sikkim[6].

Central Non-Plan Grants

The magnitude of non-plan grants has also come down considerably over the years. The quantum of non-plan grants in 2002-03 was Rs. 21386 lakhs. This was 73.48 percent of the non-plan grants (i.e. total grants minus plan grants) from the Centre. Over the years, the non-plan grants have been reduced to a mere Rs. 6426 lakh, which is only 22.4 percent of the total non-plan Central grants. This is primarily due to the adverse impact of the award of the Twelfth Finance Commission.

Non-Plan Revenue Expenditure

The trend in non-plan revenue expenditure of the State indicates that it has grown over the years at the rate of 9.42 percent per annum (Table 3.2). However, the growth in the recent years has been much higher.

With regard to the composition of expenditure- salary, pension liabilities and interest payments together accounted for 76 percent of the non-plan revenue expenditure in the year 2001-02. This gradually increased to 78.76 percent in 2006-07. Salary payments are at a very high level and constitute about 50 percent of the non-plan revenue expenditure. Pension, on the other hand, constitutes only 5 to 7 percent of the total non-plan revenue expenditure. It is the fastest growing component of non-plan revenue expenditure, exhibiting an average growth rate of 18.6 percent (Table 3.3). The exponential growth rate of pension liabilities is a cause for major concern.

[6] For details of this analysis see *supra* Chapter 7 on Public Debt.

Interest payments have been growing at a rate of 6.0 percent and constitute about 17.12 percent of the non-plan revenue expenditure.

Revenue Deficit

Revenue expenditure of Sikkim grew at an annual rate of 9.5 percent whereas the annual growth rate of revenue receipts has been 8.93 percent. The growth rate of revenue expenditure is higher than the growth rate of revenue receipts (Table 3.4).

There has been huge non-plan revenue (NPR) deficit in the years 2001-02 and in 2004-05. The NPR deficit finally turned into surplus of Rs. 73.78 crore in 2002-03. However, this surplus could not be sustained for long; the following two consecutive years witnessed a NPR deficit. However, fluctuations continued in the successive years (Table 3.2).

Over-all Revenue Receipts, Expenditure and Deficit

The trends in overall revenue receipts, revenue expenditures and deficit (surplus) are given in Table 3.4. These indicate that there was a revenue surplus in the State during the period under consideration. This was primarily due to the plan grants that formed a major chunk (75 to 80 percent) of the normal Central assistance and the additional Central assistance. This surplus constituted only 19.06 percent of revenue receipts in 2001-02. However, it gradually declined in the later years. In fact, the revenue surplus fluctuates through out period.

One of the notable achievements of the State of Sikkim is that it has the highest capital outlay/GSDP ratio. Capital outlay was 60% of GSDP from 2003 onwards[7]

Fiscal deficit: indicates the trend in the State finances and reflects the health of the State (Table 3.5). While the fiscal deficit in Sikkim was Rs. 66.9 crore in 2001-02, with the efforts of the State Government, this deficit was reduced to a low of Rs. 13.9 crore in 2002-03. However, this declining trend could not be sustained and the fiscal deficit increased to a whopping Rs. 186.46 crore in 2004-05. Such a high fiscal deficit was not sustainable and needed urgent corrective measures. Several measures initiated by the State Government resulted in increase in revenue income and a reduction in revenue expenditure. As a result, the fiscal deficit in 2005-06 fell down to Rs.149.9 crore and further declined to Rs. 106.6 crore in the year 2006-07.

Primary deficit: There was no primary deficit since 2001-02. The same trend continued upto 2003-04. However, primary deficit of Rs. 87.3 crore appeared in the year 2004-05 which declined to Rs.47.3 crore in the year 2005-06. On the whole, the State faced a huge fiscal deficit primarily due to the unfavorable award of the Twelfth Finance Commission. In fact, **the Twelfth Finance Commission’s award was a mere Rs. 188.67 crore; just 5 percent of the projected non-revenue deficit grants for the period 2005 to 2010.** Such an award was probably due to the overestimation of projected tax revenue due to inclusion of lottery revenue, exclusion of working deficits of Power and Transport which are the regular departments of the state Government and many other such variables.

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[7] RBI Bulletin, State Finances: A Study of Budgets of 2007-08, Reserve Bank of India, Mumbai, *pp* 44-46.

Fiscal Reforms and Additional Resource Mobilization

Despite the deteriorating fiscal situation, the State of Sikkim is one of the few States that has managed to follow progressive reformist policies. Sikkim has made consistent efforts towards attaining self sufficiency. The State initiatives include efforts in additional resource mobilization, capacity building in administration and also proficiency in e-governance, as is given below:

Efforts at Introducing VAT

In order to start the process of fiscal reforms, the State Government constituted a Project Management Team (PMT) to prepare an agenda for the gradual introduction of Value Added Tax (VAT) in the State on 27th March, 2001. The PMT was reconstituted in November 2004 to give a fresh impetus to the implementation of VAT (copies of the related documents given in Annexure I). The PMTs charted the time path and the *modus operandi* for the introduction of VAT in the State of Sikkim. In addition, the State Government organized

- Various awareness programmes in Gangtok and in the South/West Districts to familiarize and disseminate information about VAT system of taxation among the politicians, bureaucrats, technocrats, businessmen, industrialists and other stakeholders;
- VAT training programmes for the officers of the VAT Department were conducted by the NIPFP;
- A one day seminar on VAT was organized for the benefit of the members of the Trading Associations, Confederation of Industries in Sikkim, Public Sector undertakings and private enterprises.
- A study tour by five officers of the Commercial Tax wing of the Tax Division to Thailand (from 15th to 19th January 2007) was conducted with the technical assistance of ADB to facilitate fiscal reforms in the State of Sikkim.

The above initiatives ultimately culminated in the timely implementation of the Value Added Tax in the State with effect from April 1, 2005.

Land Revenue

In 2005-06, the State increased the existing rates of this tax levied on different categories of rural land. The local rate for land revenue was initially Rs.5 per annum for dwelling houses. This has been raised to Rs.5, Rs.10, and Rs. 20 per annum for thatch house, *Egra* House and RCC building, respectively. Similarly, the land rent has also been increased considerably for different circles of revenue blocks and further categories of land.

Stamp Duty and Registration Fee

In 2005-06, Sikkim increased the registration fee for gifting land to 5 percent of the valuation of the land as per the rates approved by the Government for land acquisitions. The registration fee of land has also been revised to 5 percent from 4 percent in 2007. Along with this, the Government also revised the registration fee on property mortgages and deeds.

State Excise Duty

In 2004-05, the Government of Sikkim revised the rate of import pass fee and export pass fee on all brands of Indian Made Foreign Liquor (IMFL). Also, in the same year, the duty on beer imported from other States, as well as beer manufactured in Sikkim but exported to other States, was increased. Further, in 2005-06, Sikkim increased the excise duty on all brands of IMFL manufactured/bottled by the local companies; all brands of IMFL owned by the companies located outside the State of Sikkim and bottled by local companies; IMFL imported from other States, and beer manufactured in Sikkim and imported to other States. Further, in 2007-08, the Sikkim Government imposed import pass fee on portable foreign liquor, *viz.* whisky, brandy, rum, vodka, gin, cordials, bitters, wine, beer etc.

In addition, the Government has rationalized the State excise policy by framing rules with regard to Sikkim Excise (IMFL manufactured in Sikkim) Licensing of Warehouse Rules, 2005; Sikkim Excise (IMFL imported from other States) Licensing of Warehouses Rules, 2005; Sikkim Excise (Licensing for retail sale of Liquor and Country Liquor) Rules, 2005; Sikkim Excise (Licensing for Foreign Liquor bar shop) Rules, 2005; and Sikkim Excise (Licensing for sale of Pachawai) Rules, 2005.

Profession Tax

In 2006-07, Sikkim imposed a tax on professions, trades and employment to raise additional resources for the benefit of the State.

Cesses/ Surcharges

The Excise department in Sikkim has started levying 'The Sikkim Educational Cess on Alcoholic Beverages Act, 2007' on IMFL and Beer. The educational cess is levied at the rate of Rs.2.70 per bulk litre on foreign liquor and Rs. 1.60 on bulk litre of beer manufactured in Sikkim and imported from other States for consumption in civil and army units within Sikkim. The cess collected is utilized specifically for the maintenance of school buildings in addition to the existing level of expenditure on such maintenance.

The Sikkim Ecology Fund and Environment Cess Act, 2005, have been enforced since April, 2007. The Act focuses on improving the quality of the environment by controlling and abating pollution and restoration of ecological balance in the State.

Bus Fare

Due to the increase in the cost of HSD and other operational costs, the Sikkim Government has recently (April 2008) revised and re-fixed the passenger fares on Sikkim's Nationalised Transport buses. Minimum chargeable fare has been kept at Rs.5 per passenger. No revision in fare structure was made during 2002-03 to 2006-07.

Measures to Reduce Expenditure

The State has initiated several measures to reduce expenditure as indicated below:

(a) The State Government introduced VRS in 2002-03. This scheme was open to all State Government employees who had completed 20 years of regular service. The scheme was introduced with the objective of trimming down the Government workforce as a part of the fiscal reforms programme. An amount of Rs. 7 crore was spent specifically for this scheme by the State Government out of the State Plan. The posts of the Government servants who were given VRS (138 during 2002-03) were also abolished.

(b) The Sikkim Government amalgamated various departments to ensure administrative re-organization and curtailment of expenditure so as to improve the service delivery and efficiency of government officials.

(c) Introduction of conveyance allowance in lieu of government vehicle as an option for entitled officers.

(d) Introduction of contributory pension scheme for fresh appointments w.e.f. 1.4.2006.

(e) To reduce the high and unsustainable subsidy in many social sectors, the Government attempted to reduce the same by focusing this on deserving target groups.

(f) The State Government has already succeeded in entering into public-private partnership for the financing of two major hydroelectric projects. This obviates the need for raising loans for these projects.

Administrative Reforms Measures

Following are the measures undertaken by the Government of Sikkim to improve its administrative efficiency:

Computerisation of the State of Sikkim:

Administration of VAT was fully computerized under the turnkey Project undertaken by the National Informatics Centre (NIC). The Central Government has provided the VAT Division with computers, printers, V SAT facilities etc.

Capacity Building for E-governance

Efforts have been made to improve Sikkim's Government administration through efficient e-governance. This will transform governance in the State of Sikkim into a smart, efficient, and transparent system. Earlier, the Government had initiated State Wide Area Network (SWAN) with the help of the Government of India. This envisages inter-connectivity of all districts, sub-divisions, blocks and important commercial towns in the State. Also, de-centralization of financial powers to Panchayati Raj was implemented in August, 2003. This was done with the basic aim of delegating more administrative and financial powers to Panchayats at the Zilla and Gram levels. A Committee was set up to look into the details of the PSEs and recommended ways to improve the efficiency of the PSEs. Concerned administrative departments have been providing continuous supervision to promote the functioning of the PSEs. Timely auditing of accounts is being undertaken. Finally, a single window system has been introduced in many departments. This has brought tremendous improvement in service delivery, efficiency, cost reduction and convenience to the general public.

Table 3.1: Components of Non-Plan Revenue Receipts (Rs. In Lakh)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	Growth Rate
Total Non-Plan Revenue Receipts	36937	53589	46509	49066	60087	62219	8.96
States own Revenue	15151 (41.02)	24483 (45.69)	20231 (43.50)	22739 (46.34)	26002 (43.27)	33515 (53.87)	12.97
Own Tax Revenue	8039 (53.06)	10323 (42.16)	10801 (53.39)	11695 (51.43)	14722 (56.62)	16416 48.98)	14.42
Own Non-Tax Revenue (net of lottery)	7112 (46.94)	14160 (57.84)	9430 (46.61)	11044 (48.57)	11280 (43.38)	17099 (51.02)	11.67
Central Trans-fers Non -Plan Grants	21786 (58.98)	29106 (54.31)	26278 (56.50)	26327 (53.66)	34085 (56.73)	28704 (46.13)	5.44
Share in Central Taxes	8483 (38.94)	7720 (26.52)	11233 (42.75)	10735 (40.78)	18213 (53.43)	22278 (77.61)	23.39
Non-Plan Grants	13303 (61.06)	21386 (73.48)	15045 (57.25)	15592 (59.22)	15872 (46.57)	6426 (22.39)	-12.06

Note: Figures in bracket are percentage of their respective heads

Table 3.1a: Percentage change of Components of Non-Plan Revenue Receipts over last year

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Total Non-plan	5.25	45.08	-13.21	5.50	22.46	3.55
States own Revenue	15.64	61.59	-17.37	12.40	14.35	28.89
Own Tax Revenue	22.94	28.41	4.63	8.28	25.88	11.51
Own Non-Tax Revenue	8.37	99.10	-33.40	17.12	2.14	51.59
Central Transfers - Non-Plan grants	-0.93	33.60	-9.72	0.19	29.47	-15.79
Share in Central Taxes	17.49	-8.99	45.51	-4.43	69.66	22.32
Non-Plan Grants	-9.94	60.76	-29.65	3.64	1.80	-59.51

Table 3.2: Non-Plan Revenue Receipts, Expenditure and Deficit

(Rs. in Lakh)

Year	NPRR	NPRE	NPR Deficit/Surplus
2000-01	35093	38,399	-3,306
2001-02	36937	41,449	-4,512
2002-03	53589	46,211	7,378
2003-04	46509	49,236	-2,727
2004-05	49066	60,434	-11,368
2005-06	60087	59,721	366
2006-07	62219	63,759	-1,540
Growth Rate	9.74	9.42	

(-) indicates deficit

Table 3.3: Components of Non-Plan Revenue Expenditure

(Rs. in lakhs)

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Total Non-Plan Revenue Expenditure	39,741	38,399	41,449	46,211	49,936	60,434	59,768	63,759
of which								
Salary	20,663 (51.99)	19,686 (51.27)	20,978 (50.61)	22,182 (48.00)	23,872 (47.81)	26,928 (44.56)	31,821 (53.24)	33,768 (52.96)
Pension	1,626 (4.09)	1,826 (4.76)	2,129 (5.14)	2,917 (6.31)	3,982 (7.97)	3,077 (5.09)	4,152 (6.95)	4,924 (7.72)
Interest Payment	6,792 (17.09)	7,867 (20.49)	8,416 (20.30)	8,954 (19.38)	9,250 (18.52)	9,919 (16.41)	10,260 (17.17)	11,527 (18.08)
Others	10,660 (26.82)	9,020 (23.49)	9,926 (23.95)	12,158 (26.31)	12,832 (25.70)	20,510 (33.94)	13,535 (22.65)	13,540 (21.24)

Table 3.3a: Percentage change of components of Non-Plan Revenue Expenditure

(Rs. in lakhs)

	2001-02	**2002-03**	**2003-04**	**2004-05**	**2005-06**	**2006-07**
Total Non-Plan Revenue Expenditure	7.94	11.49	6.55	22.74	(1.18)	6.76
of which						
Salaries	6.56	5.73	7.62	12.82	18.18	6.11
Pension	16.59	4.13	48.04	(6.25)	33.41	19.95
Interest payment	6.98	6.39	3.29	7.24	3.44	12.35
Others	10.04	29.57	(0.19)	59.78	(34.02)	0.06

Table 3.4: Revenue Receipts and Revenue Expenditure

(Rs. in lakhs)

Year	**Revenue Receipts (RR)**	**Revenue Expenditure (RE)**	**Revenue Surplus (RS)**	**RS as % of RR**
2001-02	75,008	60,715	14,293	19.06
2002-03	90,398	71,013	19,385	21.44
2003-04	89,820	73,868	15,952	17.76
2004-05	101,037	84,237	16,800	16.63
2005-06	108,705	89,141	19,564	18.00
2006-07	119,347	97,424	21,923	18.37
Growth Rate	8.93	9.50	6.54	

Table 3.5: Fiscal and Primary Deficit: Sikkim

(Rs. in lakhs)

Year	Fiscal Deficit	As % of GSDP	Primary Deficit	As % of GSDP
2001-02	6,685	5.88	-1,731	-1.52
2002-03	1391	1.09	-7,563	-5.93
2003-04	5,098	3.57	-4,151	-2.90
2004-05	18,646	11.64	8,727	5.45
2005-06	14,993	8.32	4,733	2.62
2006-07	10,661	5.22	-866	-0.42

Annexure 3. I

GOVERNMENT OF SIKKIM
INCOME & SALES TAX DEPARTMENT
GANGTOK 737101 SIKKIM

No 680/44(33) IT & CT/2000 Dated the 27.03.01

NOTIFICATION

The Government of India has plans to introduce Valued Added Tax (VAT) to replace the existing system of Sales Tax, with effect from 1st. April 2002.

In pursuance of this decision, the State Govt. has decided to form a Project Management Team (PMT) to prepare proposal for gradual introduction of VAT in the State with the following as members:-

1.	Commissioner-cum-Secretary (Finance Department)	:	Chairman
2.	Additional Secretary (IT & CT Office)	:	Member Secretary
3.	Dr. Mahesh C. Purohit Professor, NIPFP and Member Secretary, Empowered Committee of State Finance Ministers to Monitor Sales Tax Reforms	:	Member
4.	Tax Recovery Officer (IT & CT Office)	:	Member
5.	Deputy Secretary, (N/E) (IT & CT Office)	:	Member
6.	Deputy Secretary (ITO) (IT & CT Office)	:	Member
7.	Deputy Secretary (ITO) (IT & CT Office)	:	Member

The Terms of Reference of the team will be as follows:-

1. Finalize the design of VAT for Intra-State Transaction and Inter-State Transactions.
2. Prepare draft Legislation of VAT. Finalization of procedures for VAT administration including registration of VAT payers. Collection procedures, processing of returns (Challan), registration forms.
3. Organise Workshop/Seminars on Business Process and Computerization for VAT administration, determine system's design and identify resource requirements.
4. Identify training venues to train officers and officials, finalize training strategy and the course content on VAT.
5. Design brochures, articles and leaflets on VAT to educate the tax payers and the people about VAT through advertisements and media.
6. Develop computer software/hardware package on VAT with a view to fully computerize the system of tax administration and collection.

The Team will submit its proposal within 31st. December 2001.

(T.T. Dorjee) IAS
Finance (IT & CT) Department
Govt. of Sikkim, Gangtok

GOVERNMENT OF SIKKIM
INCOME & SALES TAX DEPARTMENT
GANGTOK 737101 SIKKIM

No 44(33) IT&CT/2001/687 Dated the 27.03.2001

NOTIFICATION

This has reference to the notification no. 680/44(33)/IT&CT/2000 dated 27/03/2001 on the formation of a Project Management Team (PMT) to introduce VAT. As evident from the notification we have inducted you as a member of the Management Team to undertake the following task:-

TAX RECOVERY OFFICER (S.T. GYATSO):-

1) Prepare draft legislation for Vat.
2) Finalise procedure for VAT administration including registration of VAT.
3) Design forms and indicate collection procedure and processing of returns.
4) Design registration forms for VAT payers.

DEPUTY COMMSSIONER (N/E):-

1) Organize Workshop/Seminars on Business Process and Computerization for VAT administration.
2) Determine system's design and identify resource requirements.
3) Identify training venues to train officers and officials, finalize training strategy and the course content on VAT.

DEPUTY SECRETARY (ITO) J.D. BHUTIA:-

1) Develop Computer Software/Hardware, package on VAT.
2) Develop a system and procedure to fully computerize the system of tax administration and tax collection.

DEPUTY SECRETARY (ITO) N.T. SHERPA:-

1) Design brochures, articles and leaflets on VAT to educate the tax payers and the people.
2) Incorporate visual media & advertisement to create awareness on VAT.
3) Finalize the design of VAT for Inter-State Transaction and Intra-State Transactions.

The proposals/drafts should be submitted within 31st December 2001.

Annexure 3. I (contd.)

NOTIFICATION

No. 44(33) IT & CT/2000/100 Dated the 25.11.2004

Consequent upon the decision of the Empowered Committee of State Finance Minister to introduce Value Added Tax (VAT) w.e.f. 01.04.2005 to replace the existing system of Sales Tax, the State Govt. hereby reconstitutes the Project Management Team (PMT), with the following as members, to prepare and take up the task of introducing Value Added Tax in the State. This supersedes Notification no. 680/44(33)/IT&CT 2000 dated 27/03/2001.

1)	Shri. T.T. Dorjee, Pr. Secretary (Finance Department)	Chairman
2)	Dr. M.C. Purohit, Director, Foundation for Public Economics & Policy Research, New Delhi	Member
3)	Shri. K.N. Bhutia, Special Secretary (IT&CT Division)	Member Secretary
4)	Shri. D. Lepcha, Addl. Commissioner (I) (IT&CT Division)	Member
5)	Shri.H.B. Rai, Addl. Commissioner (II) (IT & CT Division)	Member
6)	Shri. S.T. Gyatso, Jt. Commissioner (I) IT & CT Division)	Member
7)	Sushri Sarala Rai, Jt. Commissioner (II) (IT & CT Division)	Member
8)	Smt. T. Kizom, Dy. Secretary (Sr. ITO) (IT & CT Division)	Member

The Terms of Reference of the team will be as follows:-

1). Finalize the design of VAT for Inter-State and Intra-State Transaction and take care of transitionalissues.
2) Prepare draft legislation of VAT; finalize procedures for VAT administration including registration of VAT payers, collection procedures, processing of returns (Challan), registration forms and design of these forms and procedures.
3). Organize Workshop/Seminars on business process and computerization for VAT implementation/administration, determine system's design and identify resource requirements and also conduct awareness/educational programmes for the dealers/stakeholders.
4) Identify training venue and train officers and officials; finalize training strategy and the course content on VAT and focus on creation of Institutional infrastructure.
5). Design brochures, articles and leaflets on VAT to educate the taxpayers and the people about VAT through print and visual media.
6) Develop computer Software/Hardware package on VAT with a view to fully computerize the system of tax administration and collection.
7) Reassess staff needs and staffing pattern with the view to restructure the tax office and look into the needs of re-engineering the tax office.

The Committee should complete its task by 15th. March 2004.

(T.T Dorjee)
Principal Secretary,
Finance, Revenue & Expenditure Department

Annexure 3. I (contd.)

OFFICE ORDER

No. 44(33) IT & CT/2001/139/142 Dated 25/11/04

The specific tasks assigned to the members of the reconstituted Project Management Team as notified vide Notification No. 44(33)IT & CT/2000/100 dated 25/11/04 are as under. Members will complete their task within 15th. March 2005.

1)	Shri. K.N. Bhutia, Special Secretary	As Member Secretary, he will Convene VAT meetings and Supervise and monitor the progress of work entrusted to each member of the PMT.
2)	Dr. M.C. Purohit, Director EPEPR, N. Delhi	For advice and guidance as and when required.
3)	Shri. D. Lepcha, Add. Commissioner (I)	a) Design brochures, articles and Leaflets on VAT to educate the Taxpayers and the people about VAT. b) Incorporate visual and print media advertisement to create awareness on VAT. c) Organise VAT awareness progammes for the benefit of dealers.
4)	Shri. H.B. Rai, Addl. Commissioner (II)	a) Deal with matters relating to Computerization and related Training of the Officers/Officials to make them computer Literate. b) Administrative re-structuring and infrastructure development. c) Deal with matters concerning VAT Audit issue.
5)	Shri. S.T. Gyatso, Jt. Commissioner (I)	a) Prepare VAT legislation and Design the various forms. b) Finalize procedure for VAT administration, registration and allotment of TIN number. c) Act as Nodal officer for VAT Project.
6)	Sushri Sarala Rai, Jt. Commissioner (II)	a) Organize Workshop/Seminars on business process and the System. b) Identify training venue and organize training programmes for officers/officials and dealers n VAT processes and procedures.
7)	Smt. T. Kinzom, Deputy Secretary	a) Focus on transitional issues and any other tasks not entrusted to the team members.

By Order,

(T.T. Dorji)
Principal Secretary
Finance, Revenue & Expenditure Department.

DEPARTMENT OF INFORMATION TECHNOLOGY
GOVERNMENT OF SIKKIM, ANNEXE-I TOP FLOOR, GANGTOK
PHONE – (91) – 3592 - 202601

Note on Fiscal Reforms undertaken in the State during the last five years.

With an aim to provide quality e-Governance services to the citizens of Sikkim the Department of Information Technology has formulated for itself an "e-Government Vision Statement and E-Governance Mission"

The e-Government Vision Statement: "Sikkim will transform into a smart, efficient, transparent, reliable, modern and citizen friendly government by utilizing the power of Information and Communication Technology to improve the economic condition of the state, empower its citizens and bridge the digital divide"
E-Governance Mission:

- Provide a networked environment to all stakeholders
- Create simple, easily accessible citizen centric services
- Create a centralized Data Repository to provide the right information at the right time
- Provide feedback mechanism to the citizens for grievance redressal.
- Facilitate income and employment generation.
- Improve productivity in the Government Departments through Computerization.
- Improve workplace administration by eliminating non-value added processes
- Build capacity in the government by providing IT training to all Government employees.
- Map the resources of the state.
- Capture citizen details in smart cards.
- Archive the rich heritage of the state.
- Provide hassle free transactions to business community.

To achieve the e-governance Mission the Department has already the completed Detailed Project Reports on e-Governance of the following:

E-Governance & Capacity Building Road Map for Sikkim, Social Welfare Department. Health Department. Animal Husbandry Department. Horticulture Department. Tourism Department. Urban Development & Housing Department. Food and Civil Supplies Department. Transport Department.

These DPR's have already been forwarded to the Government of India for funding of these projects as the sectors mentioned above fall into the Mission Mode Projects of the National E-Governance Plan of India.

Detailed Project Reports for the following Department is currently being prepared:

1. Election Department.
2. Rural Management & Development Department

A Study conducted by NCAER who have been appointed by the Ministry of Information Technology to conduct surveys on e-readiness of all State in India has been rating the e-readiness of the Sikkim State among the average achiever States. E-readiness of Sikkim has been gradually climbing up as stated by the yearly survey. Copies of the findings are enclosed for kind reference.

A high powered Apex Committee headed by the Chief Secretary and comprising of the following members has been constituted to oversee the implementation of e-governance in the State.

Principal Secretary-cum-Development Commissioner
Commissioner-cum-Secretary DIT
Secretary RM & DD
Secretary Tourism Department
PCE-cum-Secretary Energy & Power
Secretary Food Security & Agriculture Development Department
Secretary Health Care, Human Services & FW Department
Director DIT
Joint Secretary DIT
SIO NIC

Committees for the Sikkim State Wide Area Network Project, State Data Centre Project have also been constituted. Relevant Notifications have been enclosed.

Citizen Centric Websites for various Departments in the Government of Sikkim have been designed and launched by DIT. Transfers & Promotions in the Government are made available as quickly as possible in the Official Website of the Government of Sikkim. The website contains a plethora of information's pertaining to the Sikkim Government and its activities.

DEPARTMENT OF INFORMATION TECHNOLOGY
GOVERNMENT OF SIKKIM
ANNEXE 1, TOP FLOOR, KAZI ROAD
GANGTOK – 737101 (SIKKIM)

Ref. No. 60/414/IT. Date: 21/01/06

CIRCULAR

The Government of India has approved Sikkim State Wide Area Network (SWAN), which envisages interconnecting all districts, Sub-Division's, Block Development Office's and some important commercial towns of Sikkim on Broadband. Sikkim SWAN would be helpful in facilitating not only Government to Government (G2G) services but also will prove very beneficial in providing Government to Citizen (G2C) services. Through Sikkim SWAN, all the Government offices would be networked into one.

The State Government has constituted a Committee consisting of the following for proper implementation and monitoring of the Sikkim SWAN project.

1.	Mr. M.G. Kiran, Secretary, Department of Information Technology	-	Chairman
2.	Mr. R. Verma, Director, Department of Information Technology	-	Member
3.	Mr. S.K. Sharma Director, Finance, Revenue & Expenditure Department	-	Member
4.	Mr. Sonam Y. Lepcha,Joint Secretary, DPERNECA Department	-	Member
5.	Mr. H.K. Chhetri Deputy Secretary, DIT	-	Member
6.	Mr. B. Chhetri, SIO, NIC Gangtok	-	Member
7.	Representative from MIT, GOI	-	Member
8.	Representative from Finance Division, MIT,GOI	-	Member
9.	Representative from NICSI	-	Member
10.	Representative from BSNL Gangtok	-	Member
11.	Representative from NIC, Delhi	-	Member

By Order

Sd/-
Secretary
Department of Information Technology

GOVERNMENT OF SIKKIM
HOME DEPARTMENT
GANGTOK.

No. 36/HOME/2002 Date: 07.09.2002

N O T I F I C A T I O N

The Governor, with an objective of introducing E-Governance and Management Information System in the Government, is pleased to set up a Steering Committee under the Chairmanship of Chief Secretary Comprising of the following:-

1.	Chief Secretary	-	Chairman
2.	Development Commissioner, Planning & Development	-	Member
3.	Principal Secretary, Finance	-	Member
4.	Secretary, Health & FW	-	Member
5.	Comm - cum- Secretary, RDD	-	Member
6.	PCE-cum-Secretary, Power	-	Member
7.	Secretary, Agriculture	-	Member
8.	Comm -cum-Secretary, Tourism	-	Member
9.	Secretary, Information Technology	-	Member
10.	Additional Director, Information Technology	-	Member Secretary

The Committee shall monitor the efficient and effective delivery of government services and authorized forms to the public in electronic forms from 40 Community Information Centres located in various parts of the State.

It would also monitor various schemes and projects being implemented by various Departments.

BY ORDER

Sd/-
(K.N. LEPCHA)
SPECIAL SECRETARY,HOME
F.No.175/IT/2002.

CHAPTER 4

FORECAST OF REVENUE AND EXPENDITURE FOR SIKKIM

By virtue of Article 280(1)(b) of the Constitution of India, the Finance Commission has been assigned the tasks of identifying the States which are to be provided with grants-in-aid out of the Consolidated Fund of India as well as recommending its *inter se* distribution amongst the States.

To determine whether a State should be given such a grant and if so, the magnitude of the same, it has to examine not only the current fiscal situation of the State but also make an estimate of its fiscal situation during the period for which the award is to be given by the Commission. In doing so, the Finance Commission has to base its forecasts on certain assumptions, variables and parameters. This chapter, therefore, presents forecasts of revenues and expenditures of the State of Sikkim for the period 2010-11 to 2014-15.

Methodology of Forecast

Projections of revenue as well as expenditure presented in this chapter are based on the methodology and the guidelines suggested by the Thirteenth Finance Commission (TFC) (Annexure I). On the basis of these guidelines, two methods can be used to forecast revenue and expenditure, *viz.* **Compound Growth Rate (CGR) Method** and **Buoyancy Method**. The details of these two methods are given below:

Forecast Based on Growth Rate

The conventional approach to the theory of economic forecasting is to estimate growth rate of different budgetary parameters such as revenue and expenditure and other variables in the fiscal domain.

With the help of these growth rates, estimates can be made with reference to the preceding year or the preceding time period, *i.e.* over a period of time. If the estimate is made with reference to the past year, it is calculated as a percentage change vis-à-vis that year. **This is calculated as $\Delta R/R$, where Δ represents the change over the past year and R represents revenue collections**.

To find out the growth rate over a period of time, the variable is regressed against time using the following equation:

$$R = ab^t$$

where R = revenue, t = time period and

$b = (1 + r)$…where r is the growth rate of R, and t varies from 1 to n.

This method is used to estimate the **Compound Growth Rate (CGR)**.

This is the simplest method of estimating revenue and expenditure for the forecast period. However, this method does not take into account causal relationships that influence the contribution of a particular variable to the CGR. This is especially true of variables such as price change, tax effort, or variation in GSDP which have an impact on this growth rate.

Forecast based on buoyancy

Another method to project the future stream of revenue or expenditure relates to the coefficient of buoyancy of the revenue or expenditure with respect to GSDP. This method takes into account the relative changes in revenue with respect to relative changes in the GSDP. This method computes the percentage change in revenue (or expenditure) as a result of the one percent change in GSDP. Such a measure is known as buoyancy. This method thus estimates the responsiveness of the tax revenue or expenditure to changes in the base (such as income), including the effect of changes in the structure of the tax.

As stated above, the growth rate method is the conventional method and the most convenient method for forecasting revenue (or expenditure). It estimates revenue performance independent of any other factor that might contribute to growth in revenue. On the other hand, the forecast based on buoyancy method is estimated in relation to independent quantifiable economic variables (such as national income or GSDP). Buoyancy relates the growth rate of revenue to the growth of the base of the revenue sources, which is normally GSDP. It attributes the growth rate of revenue to the responsiveness of the revenue base (that is, the normal growth in revenue which will occur due to the growth in the tax base/rate).

Symbolically, this could be expressed as $\Delta R/R \div \Delta Y/Y$. If this coefficient comes out to be greater than unity, revenue is said to be buoyant. The revenue performance of the State Government is said to be productive, *i.e.* getting higher revenue from taxes as GSDP grows.

The functional form used to measure buoyancy is as given below:

$$R = aY^b$$

When this exponential form is transformed into a logarithmic form, it changes into the following equation:

$$\log R = \log a + b \log Y$$

where

R = revenue

Y= GSDP and

b=buoyancy coefficient.

This relationship shows the percentage change in revenue with respect to the percentage change in GSDP.

Choice of Methods

Though both methods were used to forecast the revenue and expenditure for Sikkim, this study adopts the buoyancy method for forecasting revenue and expenditure. The buoyancy method is superior to the method of compound growth rate for forecasting revenues and expenditures as it relates the changes in revenue to the changes in the base of the revenue sources (normally GSDP or its component), and attributes the growth rate of revenue to the responsiveness of the revenue base. For other components, we have adopted the compound growth rate method.

Details of Adjustments and the Methodology of Forecast

Both the methods required some adjustments to be made in the data. The details of the adjustments and the methodology adopted for the forecast are given below:

Adjustments in Tax and Non-tax Revenues

1. When the CGR during the period 2002-03 to 2007-08 is abnormally high (as seen in land revenue and in 'other taxes on income'), the CGR of 2007-08 and 2008-09 has been used. However, if this growth rate (*i.e.* 2007-08 to 2008-09) is lower than the GSDP growth rate, the latter is used.
2. If, on the other hand, the CGR is negative, the estimates for 2010-11 to 2014-15 have been fixed at the 2007-08 level as the negative value of the growth rate implies a fall in revenue and this decline in revenue will not be acceptable to the State.
3. Outliers (one time high receipts) in a particular year from a specific item have been excluded and the normal interpolated values have been used for determining the trend rate. Such outliers are seen in stamp duties, registration fees and other taxes.
    - 3.1 In 2002-03, revenue from stamp duties & registration fees was Rs. 3.09 crore (this was due to the inclusion of an unusual one-time receipt of Rs. 2.30 crore). Therefore, this amount has been netted out and an amount of Rs. 0.79 crore has been used for estimating the trend in the growth rate.
    - 3.2 In the case of sales tax, an amount of Rs. 0.43 lakh has been deducted (under the heading "Deductions") from the total sales tax revenue of Rs.26.74 crore in2006-07.
    - 3.3 Under the head "Other taxes and duties on Commodities and Services", the amount accruing from "Funds" has been added. In 2006-07, an amount of Rs 6.69 crore came from the Sikkim Transport Infrastructure Development Fund (STIDF); in 2007-08, an amount of Rs 7.50 crore was from STIDF and Rs 1.50 crore from the Sikkim Ecology Fund (SEF). In 2008-09, revenue from STIDF and SEF was Rs 8 crore and2 crore, respectively. Since, these "Funds" are not a source of regular income; these have not been taken into account while estimating the growth rate under this head.
4. In the case of income tax, the revenue has been shown as nil on the basis of incorporation of sub-section 26AAA under Section 10 of the Indian Income Tax Act 1961 as per the Finance Bill 2008, the State (Sikkim) Income Tax Manual 1948 (under which taxes were imposed during the earlier years and were still being implemented), will no longer be enforced in the State.
5. In the case of State lotteries, the revenues have been shown as a net figure (receipts minus expenditure). This is due to the fact that the revenue figures are rather misleading as these do not take into account current expenditures, which have been rising year after year. Also, for projecting this component, the revenue has been

frozen at the level of the receipts in 2007-08 as this was the 'normal' revenue during the last four years. The State may find it difficult to realise the forecasted revenue on this account in view of the ban imposed by different State Governments and proposed ban that may be imposed by the Central Government on the sale of lottery tickets. [8]

6. A different approach was used for minor irrigation, police, and interest receipts. In the case of minor irrigation, the CGR being extremely high, the rate of change between 2007-08 and 2008-09 (as submitted to the Planning Commission) has been applied.
7. Income on account of interest accruing on short-term deposits of cash balances is not an assured flow of income. Therefore, this income cannot be estimated and the 2008-09 (BE) level has been frozen.
8. The receipts under the head "Police" accrue due to the lending of services of the Sikkim Police to agencies other than the Government of Sikkim. These services are primarily hired by the Government of NCT of Delhi and also by the agencies of power generating projects operating in the State. This is not a regular and assured source of income; the receipts from these receipts have been frozen at the 2007-08 levels.
9. In the power sector, the Government has entered into an agreement with power generating agencies to have a share in the total power generated by these agencies. This share may be either consumed locally or may be sold outside the State. Therefore, as an ARM, the Government envisages additional revenue receipts by sale of this share of power. These amounts are shown as indicated in the contracts.

Forecasting Capital Receipts

This is based on the average ratios of capital receipts to capital disbursement for the period 2002-03 to 2008-09.

Forecasting Non-Plan Revenue Expenditure

The projections of non-plan revenue expenditures were made using the buoyancy method for each expenditure item for the period 2002-03 to 2007-08 (RE). The buoyancy coefficient has been applied to all the items except those for which estimates have earlier been submitted to the Planning Commission by the Sikkim Government.

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[8] Revenue from lotteries has been shown as a net figure (receipts minus expenditure). This is due to the fact that the net revenue from this item is very small in recent years. The net revenue in the year 2002-03 and 2006-07 is abnormally high, as shown below:

(Rs. in crore.)

Year	2002-03	2003-4	2004-05	2005-06	2006-07	2007-08	2008-09
Receipts (Gross)	1,256.62	473.67	912.27	898.35	963.30	1,243.29	943.36
Expenditure (Gross)	1,172.48	442.25	881.11	876.16	913.29	1,213.29	913.36
Receipts (Net)	84.14	31.42	31.16	22.19	50.01	30.00	30.00

Thus, these two years (*i.e.* 2002-03 and 2006-07) have been treated as outliers and have not been considered for forecasting. The average of non-outliers (viz. 2003-04, 2004-05, 2005-06 and 2006-07) has been taken and this has been stabilized for the years 2010-11 to 2014-15.

In addition, a differential method has been adopted in the following exceptional cases:

First, when there is a declining trend in expenditure (e.g. interest on loans and advances from Central Government), the values have been frozen at 2007-08 levels.

Second, when the CGR is very high, at a 12.42% rate, then the observed CGR of GSDP has been applied to items such as stamp duty and registration fee.

Besides these exceptions, a few more adjustments have been made.

1. **State Lotteries:** The Lotteries have been shown as net figures in the receipts. Hence, no expenditure has been shown.
2. **Administration of Justice and Council of Ministers**: The CGR of State legislature as submitted to the Planning Commission is 7 percent and this has been applied to these items.
3. **Interest Payments on Internal Debt/Interest on Market Loans:** A higher growth rate has been applied because a higher level of internal and market loans entails more interest liabilities.
4. **Appropriation for Reduction or Avoidance of Debt:** Due to heavy demands for development in the State, it has to raise a large amount of loans from the market and other internal sources. It is estimated that by 2010-11, an amount of Rs 500 crore may be needed by the State and this is likely to increase annual debt by at least 10%. The State has also to maintain a Consolidated Sinking Fund @ of 3% of fresh borrowings annually.
5. **Interest on Small Savings**, **Provident Funds etc**.: This has been estimated using 2008-09 as the base.
6. **Relief on account of Natural Calamities:** In 2007-08, a one-time expenditure was incurred and this was to the tune of Rs 13.64 crore. This expenditure has been netted for projection purposes.
7. **Floods, Cyclones etc.** Expenditure under this head is sometimes more than the major Head total. This is because the transfers listed under the Calamity Relief Fund (head number 05) are not factored into totals.

The following items have been separately estimated by respective departments and put as a row in the given format:

- i) Proposed expenditure on municipalities
- ii) Impact of pay revision due to Fourth State Pay Commission
    - Pay Revision
    - Arrears due to pay and pension revision
    - Pension
    - Revision of wages
- iii) Committed liabilities of Eleventh Five Year Plan

iv) Liability due to PRI devolution

Plan Revenue Expenditure

The estimated CGR has generally been used for forecasting Plan Revenue Expenditure. However, the growth rate of GSDP (12.42%) has been applied to those items that have shown a very high growth rate in expenditure over the years. These items include: technical education, sports & youth services, rural health services, housing and urban development, welfare of SCs /STs/ OBCs, labour & employment, nutrition, agricultural research and education, other agricultural programmes, other rural development programmes, surface water, flood control and drainage, power, village & small industries, industries, tourism, and other general economic services.

Plan Revenue Expenditure on CSS/CPS Schemes:

Normally, the observed CGR has been used for forecasting plan revenue expenditure on CSS/CPS Schemes. However, in some sectors the growth rate is abnormally high due to the introduction of these schemes during the period. These sectors are secondary education, welfare of SCs /STs / OBCs, animal husbandry, special programmes for rural development, and tourism. Hence, the GSDP growth rate of 12.42% has been used to estimate the Plan Revenue Expenditure.

Capital Expenditure: Plan

The CGR has generally been applied for forecasting capital expenditures. However, in some cases where the CGR is negative (showing a downward trend) or where the CGR is abnormally high (higher than 50%), a growth rate of 12.42% of GSDP has been applied to make the estimates. This GSDP growth rate has been used in water supply and sanitation, housing, urban development, welfare of SCs/STs/OBCs, forestry and wild life, other rural development programmes, other special area programmes, village & small industries, civil aviation, roads & bridges, other scientific research, and tourism. In addition, special treatment is given to the financial requirements of the State for upgrading certain sectors/activities.

Capital Expenditure: CSS+CPS

As the CGR is very high, a growth rate of 12.42% of GSDP has been applied to fisheries; power projects; and tourism.

Results of Forecast

The summary of the forecast of revenue and capital account based on the buoyancy method for the period 2010-11 to 2014-15 is shown in Table 4.1[9] while the forecasts based on the CGR method are shown in Table 4.2. The latter Table gives estimates with ‘pay revision’ as well as ‘without pay revisions’. Complete details of the forecasts for each and every item are given in Statements 1 to 4 submitted separately in the Thirteenth Finance Commission with all other “Statements”. The summary of revenue account is given in Statement 1 and that of capital account is given in Statement ST-1A. The statement ST 2 gives the forecast for revenue receipts. Revenue expenditure estimates based on buoyancy method (non-plan) and compound growth

[9] The details of the calculations have been submitted to the Commission in the Statement ST 1.

rate method for plan, CSS, and CPS is given in ST 3. Finally, forecast of capital expenditures based on the compound rate of GSDP has been given in ST 4.

Table 4.1: Summary of Forecast of Revenue and Expenditures of Sikkim

(Rs. in Crore)

As per Buoyancy-based Growth Rate

	With Pay Revision etc.	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**5-Year Total**
1	Non-Plan Revenue Expenditure	1,334.52	1,471.31	1,942.81	2,167.13	2,420.82	**9,336.59**
2	Own Source Receipts	354.98	369.48	385.35	402.76	421.86	**1,934.43**
3	***Revenue Gap (Exp-Rec)***	979.54	1,101.83	1,557.46	1,764.37	1,998.96	**7,402.16**
	Without Pay Revision etc.						
1	Non-Plan Revenue Expenditure	1,008.02	1,130.81	1,270.60	1,429.94	1,611.81	**6,451.17**
2	Own Source Receipts	354.98	369.48	385.35	402.76	421.86	**1,934.43**
3	***Revenue Gap (Exp-Rec)***	653.04	761.33	885.25	1,027.18	1,189.95	**4,516.75**

Note: Buoyancy is the estimate of percentage change in tax/expenditure vis-à-vis one percent change in GSDP in that year. Buoyancy-based growth rate is the product of buoyancy coefficient with growth rate of GSDP.

Table 4.2: Summary of Forecast of Revenue and Expenditures of Sikkim Base on Growth Rate

(Rs. in Crore)

Based on Compound Growth Rate

	With Pay Revision etc.	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**5-Year Total**
1	Non-Plan Revenue Expenditure	**1,336.32**	**1,473.40**	**1,945.34**	**2,170.25**	**2,424.75**	**9,350.06**
2	Own Source Receipts	**359.11**	**373.71**	**389.73**	**407.33**	**426.70**	**1,956.58**
3	***Revenue Gap (Exp-Rec)***	977.21	1,099.69	1,555.61	1,762.92	1,998.05	**7,393.48**
	Without Pay Revision etc.						
1	Non-Plan Revenue Expenditure	***1,009.82***	***1,132.91***	***1,273.12***	***1,433.06***	***1,615.74***	**6,464.65**
2	Own Source Receipts	**359.11**	**373.71**	**389.73**	**407.33**	**426.70**	**1,956.58**
3	***Revenue Gap (Exp-Rec)***	650.71	759.20	883.39	1,025.73	1,189.04	**4,508.07**

Annexure 4. I

Basis of Norms for Forecasts or Projections

The Commission has given the following guidelines to forecast (or project) the receipts and expenditure of the State:

1. The rate of growth of revenue should not be less than the rate of growth in the years 2007-08 and 2008-09 of the Eleventh Five Year Plan. Similarly, the rate of growth of expenditure should not be more than the assumed rate for the Eleventh Five Year Plan. Any difference should be fully explained.
2. The tax and non-tax figures may be projected using the 2007-08 level of taxes and the yield from the tax measures likely to be enforced in 2008-09 and 2009-10 may be added subsequently.
3. Dearness Pay, DA and terminal benefits sanctioned up to 31.03.2008 may be taken into account while projecting the expenditure figures. Additional liabilities, if any, on account of Dearness Pay, DA revision sanctioned/to be sanctioned after 1-04-2008 to 2009-10 and impact of the recommendations of the Sixth Pay Commission may be shown separately under the head “Fresh Expenditure”, with suitable explanatory notes.
4. The State Government would have submitted data/information in respect of State resources to the Planning Commission for the formulation of the Eleventh Five Year Plan. Any deviation from the figures given to the Planning Commission should be indicated in a separate note attached to the explanatory note.
5. The projections should be in conformity with the projections made under the Fiscal Responsibility Legislation. Any deviation from the projections should be clearly explained.

CHAPTER 5
TAX SHARING

Fiscal federalism in India is passing through a challenging and exciting phase. Evolved over time, the Center and State fiscal relations have constantly strived to find the balance between unity and diversity through political, institutional and functional changes

However, "the very dynamism of the system with all its checks and balances brings in its wake problems and conflicts in the working of the Union-State relations. It is, therefore, necessary to attune the system to the changing times so that propelled by a spirit of common endeavour and cooperative effort, it takes the country forward towards the social welfare goals set out in the Constitution."[10]

Significance of the Tax Sharing

To achieve these goals framed in the Constitution, the Finance Commission (FC), a Constitutional body, is enabled to take a comprehensive view of the public finances in the country so as to make recommendations regarding the sharing of taxes between the Centre and the States, and to resolve the issue of maintaining vertical and horizontal equity. These problems exist primarily due to the fact that there is a mismatch between the responsibilities of the Centre and States and in their ability to raise adequate resources due to the heterogeneity and disparities that exist amongst them.

In this context, the Presidential Order, under Para 4 of the Terms of Reference, mandates that the Thirteenth Finance Commission shall make recommendations on *"**the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under Chapter I Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds**"*.

The Finance Commission is, therefore, required to determine the shares of the States from the shareable pool of Central taxes. The main issues before the Commission relate to :

- determining the proportion that would be shared between the Centre and the States;
- specifying criteria for its *inter se* distribution to be used for deciding shares of the individual States; and
- determining the weights attached to the different allocation criteria.

Thus, the Finance Commission functions as a balancing device between the Centre's resources and its functions, and the States' resources and their responsibilities.

By endowing the Centre with the most elastic and buoyant sources of revenue (for equity and efficiency), and assigning the States with a wide range of expanding functions without matching resources (to ensure that money is spent as per the local priorities), the Constitutional framers

[10] Government of India (1988), Report of the Commission on Centre-State Relations, Chairman: Justice R. S. Sarkaria, New Delhi.

created a built-in imbalance between the allocation of financial resources, and the responsibilities of the Centre and the States. Thus, the whole system of allocation of financial powers between the Centre and the States lead to inherent fiscal imbalances and made the States dependent upon the Central Government. The States today make approximately 53 per cent of total expenditure while they collect only 37 per cent of the total tax revenue.

The role of the Finance Commission, as enunciated in the Constitution, is to ensure a just and equitable distribution of national revenues between the Centre and the States. Given this responsibility, the Thirteenth Finance Commission must devise a mechanism of financial devolution so that it ensures balanced and healthy regional growth and also provides the States with adequate finances to fulfill their fiscal obligation of balancing resources and expenditure.

Evolution of the Pool for Tax Sharing

Prior to the 80th Constitutional Amendment, only two main Central taxes were shared with the States, *viz.*, income tax (other than corporation tax) and the Union excise duties. There were also two tax rental arrangements with the States, where the Union government collected some of the existing taxes on behalf of the States and then distributed the proceeds among the States in accordance to the principles and shares recommended by the Finance Commission. These receipts were from the additional excise duty in lieu of sales tax on textiles, tobacco and sugar, and grant in lieu of the tax on railway passenger fares.

Under the 80th Amendment of the Constitution, all Central taxes were brought into a shareable pool and it became mandatory to assign a share from each Central tax to the States. The amended Article 270 provided for the sharing of all Central taxes, except taxes under Articles 268 and 269, and the earmarked cesses and surcharges under Article 271. Only the “net proceeds” are to be shared between the Centre and the State. More recently, the Constitution has again been amended, and services have now been added to the Union List in the Seventh Schedule of the Constitution under the purview of Article 268 A.

The Magnitude of Sharing

Under this scheme, the States’ share as recommended by the Tenth, Eleventh and Twelfth Finance Commissions was 29%, 3o%, and 30.5% of the proceeds, respectively. This percentage share included devolution on account of additional excise duty levied in lieu of sales tax as well as the grant in lieu of tax on railway passenger fare.

The Issues

Thus, the States have a share of 30.5% in all the Central taxes (except taxes under Articles 268 and 269, and the earmarked cesses and surcharges under Article 271) However, the State of Sikkim strongly feels that sharing of the proceeds from the taxation of services has a great bearing on the size of the vertical transfers and that this will have considerable potential to impart additional buoyancy to tax revenues. The 88th Amendment to the Constitution (Article 268A) provides that “Taxes of services shall be levied by the Government of India and such tax can be collected and appropriated by Government of India and the States”. It also further specifies that the principles of collection and appropriation will be determined by Parliament. However, revenues from taxation of services that are taxed by the Centre under article 268A (rather than those taxed under article 270) would be excluded from the purview of the Finance Commission.

It may be noted that hitherto items under articles 268 and 269 were subjects that were generally of an inter-State nature, with limited revenue importance. These were wholly assigned to the States. In this context, it needs to be stressed that any legislation passed by Parliament with respect to appropriation of service tax proceeds must take care to ensure that if the service tax is not part of the sharable pool, the revenue accruing to the States (through any proposed changes) should not be less than the share that would accrue to them had the entire service tax proceeds been part of the shareable pool.

The State of Sikkim suggests that revenue from service tax must remain in the shareable kitty. This is important as the award of the Thirteenth Finance Commission will see the introduction of Goods and Service Tax (GST)-- a tax that will subsume the Union Excise Duty and the Service Tax in it. It is, therefore, of paramount importance that this Commission visualizes the sharing of GST (inclusive of Union Excise Duty and the Service Tax). The inclusion of service tax in the divisible pool will not affect the alternative scenario that will arise when the Thirteenth Finance Commission recommends the award to the States when the GST is put in place and this affects the overall divisible pool.

Criteria and Weights Used for Tax Sharing: A Critique

In deciding different criteria for transfers under tax devolution, all the Commissions have adopted their own approach. The various criteria and weights adopted by the last twelve Finance Commissions, as given in Table 5.1, indicate that some of the important criteria were: population, contribution, backwardness, income distribution, inverse per capita income, and poverty. These criteria with assigned weights have to be kept in perspective as they will determine transfers under tax devolution.

Taking different criteria and approaches, the previous Commissions partially succeeded in rectifying the vertical and horizontal fiscal imbalances in the tax structure. However, the Finance Commissions overlooked the developmental needs of the States arising from inherent problems, *e.g*. the problems faced by the hilly States which necessitate more resources, and the tax reforms and expenditure discipline adopted by States like Sikkim.

In the criteria-based distribution of Central taxes, the more recent Finance Commissions have given considerable importance to the horizontal task of redistribution by assigning a relatively larger weight to the distance factor, which reflects the difference of the per capita GSDP of a State from the highest per capita GSDP. The weight attached to this factor reflects the fiscal capacity equalization element of transfers under the tax sharing scheme. The Government of Sikkim strongly feels that with an improvement in the buoyancy of the Central taxes, and with the introduction of GST during the period of the award of the Thirteenth Finance Commission, this problem will be further eased. It may be mentioned that the balancing of resources against responsibilities will be qualitatively different with the introduction of GST, and in the future, when some governments may have a large and rising revenue deficit while the Centre and some of the better off States have a surplus.

Views of the State of Sikkim

The State of Sikkim suggests that the sharing of taxes should be based on three sets of criteria, *viz.* needs, cost disabilities, and fiscal efficiency.

Needs refer to expenditures that are required to be made but have not been made due to deficiency in fiscal capacity. Merit goods, *viz.* health and education are of prime importance in the expenditure requirements of any government.

Cost disabilities refer to the circumstances that lead to higher than average per capita costs for delivering the same level of services at an average level of efficiency. Thus, exogenous causes that are beyond the control of the State become important, *viz.* excess rainfall, hilly terrain, and large and remote areas with low density of population. Some cost disabilities arise when the size of the State is too small and some minimum expenditure has to be incurred for providing the basic administrative infrastructure.

Fiscal efficiency refers to tax effort or other fiscal performance measures. In a normative approach, fiscal efficiency is implicit because requirements are assessed taking into account only the average revenue effort. This criterion has to be re-looked in the changed circumstances. In the past, most efforts at additional resource mobilisation (ARM) were in the form of mobilizing resources through sales tax. With the institutional set up of the Empowered Committee of State Finance Ministers to oversee the implementation of VAT, the choice of the States in mobilizing resources through this tax is almost zero due to adoption of uniform rates of tax all over the country. In addition, continuation of CST has caused considerable diversion of trade in Sikkim. Siliguri (a town of West Bengal) is a favourite shopping mart for citizens of the State of Sikkim. Most consumers, as well as dealers, prefer to go down to Siliguri and buy consumer durables after paying local tax rather than buying the same in Gangtok, where they have to pay local VAT (Sikkim VAT) plus the CST (now 2 percent). Thus, the trade in most commodities in Sikkim has been almost fully diverted to West Bengal; important items in the shopping list are medicines, vehicles and all consumer durables. In fact, the State of West Bengal is practically thriving on the consumption of the people of the State of Sikkim because of the imposition of the CST. CST will be reduced to zero only by 2010. Therefore, until then the tax effort of this State will be under a severe constraint. This built in disadvantage of a landlocked State must be kept in mind while considering its fiscal efficiency. Also, the issue of uniform rates of state-VAT needs to be kept in mind while considering the issue of tax effort.

Magnitude of Devolution through Sharing of Taxes

Keeping the above aspects in view, there is a need to enlarge the divisible pool for the States. In the past, the vertical transfer recommended by the Twelfth FINANCE COMMISSION was 30.5 percent of the shareable Union tax revenue. There is a logical justification for raising the share of the States to 40% from 30.5%. This demand is justifiable given the growing development needs of the States. Also, the divisible pool of Central taxes/ duties excludes surcharges, cesses and the costs of collection. The Centre collects sizeable revenue through surcharges and cesses which are not shareable with the States. Various Commissions, including the Tenth and Eleventh Commissions, have observed that surcharges/cesses should not be levied by the Centre except to meet emergent requirements (only for a limited period) and these should not be used as a normal revenue raising measure to fill the budgetary gaps. However, the Centre has raised revenues through this measure for long periods. The State Government, therefore, is of the opinion that levy of surcharges/cesses should be treated as a normal source of revenue and should be included in the divisible pool.

States need adequate funds for (a) functioning of the local bodies(b)development expenditures and (c) infrastructural development (especially in a land locked and hilly State like Sikkim) to be at par with the other States of the country. Therefore, the Government of Sikkim strongly urges the Thirteenth Finance Commission to assign to the States a larger share in the enlarged divisible pool, *i.e.* 40% of the divisible resources. This is in fact the need of the hour.

While adopting the same criteria or some other new criteria, there is an urgent need for modifying the scheme of weights. The Government of Sikkim suggests that the weights, as given in Table 5.2, should be considered. There is a need to have a fresh look at the criteria to be used for the purpose of horizontal equity amongst the States. Such criteria could be debt-GSDP ratio, cost disability referring to availability of cultivable land in proportion to total area of the State, achievement in administrative efficiency, infrastructure distance, revenue raising capacity and tax effort etc.

Since the ToR has specifically mentioned the criteria of population size as per 1971 Census, it would be prudent to submit that in 1971, Sikkim was a different entity and only became a State in 1975. Having become the 22nd State of India in 1975, all the administrative units required in a State (like the Governor's Secretariat, High Court, State Legislative Assembly etc.) had to be established involving the recruitment of personnel etc. The population of Sikkim which was 2,09,243 as per 1971 Census (shown in Chapter 1 of the Memorandum) phenomenally increased to 3,16,385 in 1981, registering an increase of 50.77 percent[11] over the decade. The present population, as per 2001 Census, is 5.41 lakhs - a 2.5-fold increase over 1971. The Government of Sikkim is of the view that the population of 2001census should be used when population is taken as the main criteria for distribution of Central taxes.

Finally, in the *inter-se* distribution of shareable Union taxes among States, a certain percentage should be earmarked for the Special Category States to provide them with a level playing field and to enable them to come at par with the rest of the States of India.

[11] See Table 1.1 in chapter 1 of the Memorandum.

Table 5.1: Criteria and weights used for Tax Devolution through successive Finance Commissions

Finance Commission	Population	Contribution	unspecified	Backwardness	Income Dist.	Inverse per capita income	Poverty	Revenue equalis-ation	Non-plan deficit	Area	Index of infrastructure	Fiscal Discipline	Tax effort
1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**
First (1952-57)													
Income Tax: 55%	80	20											
Union Excise: 40%	100												
Second (1957-62)													
Income Tax: 60%	90	10											
Union Excise: 25%	90		10										
Third (1962-66)													
Income Tax: 66.66%	80	20											
Union Excise: 20%			100										
Fourth (1966-69)													
Income Tax: 75%	80	20											
Union Excise: 20%	80			20									
Fifth (1969-74)													
Income Tax: 75%	90	10											
Union Excise: 20%	80			6.66	13.34								
Sixth (1974-79)													
Income Tax: 80%	90	10											
Union Excise: 20%	75				25								
Seventh (1979-84)													

Finance Commission	**Population**	**Contribution**	**unspecified**	**Backwardness**	**Income Dist.**	**Inverse per capita income**	**Poverty**	**Revenue equalis-ation**	**Non-plan deficit**	**Area**	**Index of infrastructure**	**Fiscal Discipline**	**Tax effort**
1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**
Income Tax: 85%	90	10											
Union Excise: 40%	25					25	25	25					
Eighth (1984-89)													
Income Tax: 85%	22.5	10			45	22.5							
Union Excise: 45%	25				50	25							
Ninth (1989-90)													
Income Tax: 85%	22.5	10			45	11.25	11.25						
Union Excise: 40%	25				50	12.5	12.5						
Ninth (1990-95)													
Income Tax: 85%	22.5	10		11.25	45	11.25							
Union Excise: 45%	25			12.5	33.5	12.5			16.5				
Tenth(1995-2000)													
Income Tax: 77.5%	20				60					5	5	10	
Union Excise: 47.5%	20				60					5	5	10	
Eleven (2000-05): All UnionTaxes: 29.5%	10				62.5				7.5	7.5	5	7.5	
Twelfth (2005-10) All Union Taxes: 30.5%	25				50					10		7.5	7.5

Source: RBI, (2007-08), State Finances, p 116.

Table 5.2. Proposed Weights assigned to Various Criteria

Criteria		***Norm***	***Weight***	***Remarks***
1	Population		10%	
2	Debt–GDSP Ratio		20%	High weightage to be given to the State having high debt GSDP ratio
3	Cost disability			
	(i)	Area distance	5%	High weightage on the basis of strategic location of the State
	(ii)	Cost of living standard	5%	High weightage for having a high cost of living
	(iii)	Availability of facilities like road, rail & air link	10%	High weightage for having low link facility
4	Availability of cultivable land in proportion to total Area of State		15%	High weightage for low proportion of cultivable land
5	Achievement in Administration Efficiency			
	(i)	Investment in human resource development and growth in literacy rate	15%	High weightage for efficiency
	(ii)	IMR & MMR in health sector		
	(iii)	Crime rate		
	(iv)	Maintenance of peace & tranquility efficiency		
6	Infrastructure distance		10%	Every State has to maintain a minimum level of infrastructure as a result of this per capita FC transfer. The per capita expenditure in a small State with a less population is higher. The requirement of such a minimum level is to be adjusted to show the per capita FC transfer to the State vis-à-vis the per capita expenditure level of the State.
7	Revenue Raising Capacity		10%	The States having a large number of big industries have the capacity to raise high revenue. More weightage should be given to remotely located States having no such facility.

CHAPTER 6

GRANTS-IN-AID

The transfer of resources from the Centre to the States is a common phenomenon in all countries having a federal Constitution. This is so because there is always a mismatch between the responsibilities of the federal units and their ability to raise adequate financial resources. This necessitates the transfer of resources from the Centre to the States in order to correct the vertical imbalance.

Apart from this, the overall resources to be transferred to the States have to be distributed amongst them on the basis of some rational criteria of horizontal equity. This is crucial to ensure equity among the States. Historically, the horizontal imbalance has its roots in the differential tax capacities and needs of the States as well as the differences in the cost of providing services. In India, not only is the number of States large, these also differ in various respects, *viz.* area, size of population, income, tax base and mineral and forest resources. A resource gap may arise as States have inadequate capacities and deficiencies in the revenue effort (in relative terms). Of the two limitations, it is the former that needs to be taken into account for correcting the horizontal imbalance in the States.

The Issues before the Thirteenth Finance Commission

In this context, the setting up of the Thirteenth Finance Commission is important. The Commission will project a comprehensive view of the public finances in the country, and devise its own principles (normative or positive) to govern grants-in-aid to the States.

The Presidential Order, under para 4(b), mandates that the Thirteenth Finance Commission (TFC) would set out ***"the principles which should govern the grant-in-aid of the revenues of the States out of the Consolidated Fund of India and the sums to be paid to the States which are in need of assistance by way of grants-in-aid of their revenues under article 275 of the Constitution for purposes other than those specified in the provisos to clause (1) of that article."***

Under the 73rd and 74th Constitutional Amendment Acts, the grants-in-aid from the TFC assume a special significance in the process of fiscal decentralization. These amendments provide local governments a Constitutional platform and envisage them as "institutions of self-governance". In this context, the TFC has a very specific role to play in identifying the macro-level economic issues and their bearing on devolution to local bodies.

Given the mandate under the Presidential Order, the TFC will have to *inter alia* focus on the following broad areas:

First, it is of paramount importance to take into account the basic imbalance of the system arising out of the excessive elasticity in current expenditure with respect to GSDP and the buoyancy of tax and non-tax revenues. In the context of fiscal transfers, the TFC will have to take into account the supply as well as the demand for funds. It will also look into normative and gap-filling approaches for determination of fiscal transfers.

Second, in order to restore budgetary balance and maintain macro-economic stability, both at the Centre and the States, expenditure reforms will have to be given priority while giving grants-in-aid.

Third, **as stated in Chapter 4 on Tax Sharing**, a new dimension for the TFC will be to consider the pros and cons of a new tax system, *viz.* Goods and Services Tax (GST), which will be introduced with effect from 1st April, 2010. The TFC has therefore, to first estimate the impact of the proposed GST. This will change the fiscal scenario for both the Centre and the States. The revenue implications of this change will have to be studied and taken into account in recommending transfers to the States; and

Fourth, devolution to local bodies, economic and fiscal position of these bodies, and their taxable capacity are important issues that need to be addressed by the TFC.

Evolution of the Principles and Ambit of Grants-in-Aid

It may be useful to recall that each Commission, since the setting of the First Commission in 1951, has made a mark in the fiscal federal provisions in our country. These changes have taken place within the ambit of the provisions of the Constitution.

The Twelfth Finance Commission used incentives to rein in deficits and this strategy seems to have worked very well. It is now the turn of the Thirteenth Finance Commission (TFC) to use incentives to induce the States to spend their money wisely. TFC must evolve creative ways to reward those who spend effectively and penalize those who do not.

While the Constitutional provisions relating to the functions of the Finance Commissions have remained unchanged, one notable change in the framework of federal fiscal arrangements was brought out by the 80th Amendment which broadened the ambit of the sharable Central taxes. The enlargement of the sharable pool to cover all Central taxes except those listed in Articles 268 and 269, and the earmarked cesses and surcharges, has enabled States to share in the overall buoyancy of taxes. It has also provided greater stability in resource transfers by eliminating fluctuations in individual taxes.

Grants for Horizontal Equity

The main objective of giving grants-in-aid to the States in need of revenue is to have a level playing field among all the States. That is, a grant-in-aid is provided to the States to compensate them for adverse physical conditions and other disabilities that lead to higher costs in providing public services. Generally speaking, all the Special Category States face great difficulties because of their geographical, physical and environmental variations as compared to the non-Special Category States. These States also have the problem of sparse population, hilly terrain, land slides, and absolute lack of infrastructure leading to high costs in providing public services.

Principles for Grants-in-aid Adopted by Various Commissions

The award of grants under Article 275 (1) has to keep in mind the 'standard' of providing services by the States. This requires the Finance Commission (FC) to assess the need of a particular State in relation to services provided by the other States or by the 'average' State. The Commission has to work out a desirable 'norm' for all the States and then transfer resources to the States that are below the 'norm' so as to help them achieve the standard of provision of services as per the 'norm' determined by the Finance Commission. Thus, the normative approach is the kingpin in the assessment of the expenditure requirements as well as of the own revenues of the States.

Prior to the Eleventh Finance Commission, normal Central assistance and the additional Central assistance were given to the Special Category States by the Centre in the form of a 10 percent loan and a 90 percent grant. This results in the States getting deeper into debt on account of the structurally mandated borrowings. There is indeed no reason why plan grants to States should be linked to compulsory loans from the Centre. The criteria to determine the grants should be different from those relating to loans. As almost the entire plan expenditure is met by the Centre from borrowed funds, Central loans as part of the plan assistance to the States only increase the fiscal deficit of the Centre (on a stand-alone basis).

The Twelfth FC recommended the scrapping of the system of imposing a 10:90 ratio of loans and grants to provide plan assistance to Special Category States. Instead, the Planning Commission should confine itself to extending plan grants to the States, and leave it to the States to decide how much and from whom to borrow, *i.e.* from the Centre or from the open market. While this "non- intermediary" role of the Centre in the borrowing process of the States is good in principle and ensures greater fiscal discipline on the part of the non-Special Category States by removing the structural obligation to borrow from the Centre, the same is not true for Special Category States like Sikkim. **It is, therefore, important that the total transfer from the Centre to the Special Category States is financed by the Centre in the form of grants only.**

Interface with Plan Assistance

To ensure horizontal equity, *i.e.* equity amongst the States, resources are transferred by the Finance Commission under Article 275 (1). These are statutory transfers. In addition, as stated above, grants are also given by the Planning Commission for plan purposes and also discretionary grants are provided by the Central Ministries.

While it is important for the Finance Commission to take stock of the total transfers, given the multiplicity of channels of transfer, the important role of the transfers made by the Finance Commission (under Article 275 (i)) cannot be undermined. These transfers are binding on the Central Government and cannot be affected by political whims. Hence, the Finance Commission has to single out these grants for equalization of services among the States on the basis of given criteria.

A close scrutiny of recommendations of past Finance Commissions reveals that the guiding principle for the FC's award is that the grants have to be given to States even if there is no fiscal imbalance in the aggregate. It is given because some governments may be unable to finance programmes that other sub-national governments find easy to handle. These grants are, therefore, given to attain the objective of 'filling' in the fiscal gap keeping in mind the criteria of horizontal equity amongst States.

There are three links in this process that have a bearing on the tasks assigned to the Finance Commission:

First, as the borrowings increase as a part of the planning process, it gives rise to interest liabilities which are a part of the non-plan revenue expenditure.

Second, the plan process leads either to creation of posts or assets. Once the plan is over, the posts are meant to be carried onto the non-plan side of the budget. Assets created in the previous plans also require maintenance expenditure. Both of these increase non-plan expenditure in the form of committed liabilities. The distinction between plan and non-plan expenditures has progressively become blurred as the States often continue with the old plan schemes by showing it as a part of the new plan so as have a bigger plan size. As noted by the previous Commissions, especially the Tenth and Eleventh Finance Commissions, the dichotomy of expenditures on plan and non-plan schemes results in several deficiencies. It is far more important to ensure that assets already created are maintained and yield services as originally envisaged than to go on making commitments for creating new assets. This continuous transfer of plan posts on to the non-plan side has also resulted in surplus staff in many sectors, whose salaries must be paid. Surplus staff on the non-plan side is not usually absorbed in the new plan schemes. To consider a larger plan size as more development oriented and thereby, ignore maintenance is not desirable. All that this does is to present at best an optical illusion of development.

The third aspect of the interface between plan expenditure and the overall scheme of transfers is even more important. By definition, plan expenditure is 'incremental development expenditure'. It is expected that as a result of the plan intervention, the inequalities among States in incomes and services (provided by the State) would decrease. If these continue to increase, the horizontal equity criteria will compel Finance Commission transfers to become more progressive. In this context, it is useful to compare the pattern of inter-State distribution of per capita Finance Commission (FC) and non-FC transfers, *viz.* plan grants, external assistance, and other discretionary grants. By relating the comparable per capita GSDP with per capita FC transfers for 2001-02, a strong negative relationship is observed. The coefficient of correlation is (-) 0.87 for the general category States (excluding Goa). In the case of per capita non-FC transfers for this group of States, the correlation with per capita GSDP turns out to be positive (0.16). This shows lack of 'progressiveness' in the distribution of these transfers. The non-FC transfers become even more regressive when account is taken of the implicit transfers, such as those arising from procurement of food grains by the Food Corporation of India (FCI), mostly from some of the better-off States. In the case of special category States, the correlation is positive both for FC and non-FC transfers.

Trends and Issues in Fiscal Transfers to Sikkim

Grants-in-aid are large and it accounts for more than 80 percent of the total non-plan revenue account fiscal transfers (Table 6.1). Further, their contribution in aggregate non-plan revenue receipts has been around 60 to 66 percent. This shows how dependent the State has been on this kind of transfer from the Central Government. The contribution of grants under Article 275 has come down considerably since 2006-07.

The Twelfth Finance Commission recommended grants-in-aid based on the assessment of needs and developmental concerns of the States for (i) post-devolution Non-Plan Revenue deficit; (ii) Health sector; (iii) Education sector; (iv) Maintenance of roads & bridges; (v) Maintenance of buildings; (vi) Maintenance of forests; (vii) Heritage conservation; (viii) State-specific needs; (ix) Local bodies; and (x) Calamity relief.

It may be noted (from Table 6.2) that the two recent Finance Commissions have adopted different approaches. Twelfth FC did not provide any grant for the up-gradation of education and health sectors. As a State specific problem, physical connectivity of Sikkim with the rest of the country is a critical issue and a matter for concern. Bagdogra is the only point for airlifting, besides the heli-service which is quite uncertain due to the hostile weather conditions. In the event of any unrest at Bagdogra, the nearest airport, it becomes very inconvenient and difficult to maintain contacts with the rest of the country via the road connectivity. As a result, the State is completely 'cut off' from the rest of the country. Therefore, the State government has planned to construct an airport in the State. It sought an assistance of Rs.174 crore for this purpose based on the earlier Detailed Project Report (DPR) prepared by Airport Authority of India (AAI). The Eleventh Finance Commission had provided Rs.50 crore. The Twelfth Commission has provided an amount of Rs.100 crore. Since then, inflation has adversely affected the execution of this plan (The cost has now been revised to Rs 359.00 crores by AAI). Such a piece-meal approach does not help better the situation. It is also not clear whether the approach of the FC is to assist a State only in a phased manner.

Table 6.1: Non-plan Revenue Account Fiscal transfers in Sikkim

(Rs. in crore)

Item	*Actual*					*2007-08 (R.E.)*	*2008-09 (B.E.)*
	2002-03	*2003-04*	*2004-05*	*2005-06*	*2006-07*		
Actual Fiscal Transfers (Rs crore)							
Total Transfers	**659.15**	**695.89**	**782.98**	**827.03**	**858.32**	**1,325.48**	**1,391.84**
Shared Tax Proceeds from Centre	**77.20**	**112.33**	**107.35**	**182.13**	**222.78**	**261.70**	**300.89**
Grants from Centre	**581.95**	**583.56**	**675.63**	**644.90**	**635.54**	**1,063.78**	**1,090.95**
A. Non Plan Grants	**213.86**	**150.45**	**155.92**	**158.72**	**64.26**	**96.26**	**52.22**
Grant under Article 275 (1) of the Constitution	208.14	141.47	139.31	143.26	47.06	52.86	21.94
Calamity Relief Fund	5.58	8.86	16.20	13.15	5.20	27.46	14.35
Other grants	0.14	0.12	0.41	2.31	12.00	15.94	15.93
B. Plan Grants	**368.09**	**433.11**	**519.71**	**486.18**	**571.28**	**967.52**	**1,038.73**
State Plan Schemes	309.31	370.56	435.85	366.36	443.47	586.94	597.04
Central Plan Schemes.	2.39	2.03	1.49	2.71	2.57	1.86	3.00
Centrally Sponsored Schemes	56.39	52.46	58.79	96.21	101.95	297.47	368.01
NEC Schemes or Spl.		8.06	23.58	20.90	23.29	81.25	70.68

Item	*Actual*					*2007-08 (R.E.)*	*2008-09 (B.E.)*
	2002-03	*2003-04*	*2004-05*	*2005-06*	*2006-07*		
Plan Schemes							
Total Revenue Receipts	**903.98**	**898.20**	**1,010.37**	**1,087.05**	**1,193.47**	**1,633.38**	**1,765.09**
Composition of Fiscal Transfer as a percent of Total Transfers							
Shared Tax Proceeds from Centre	**11.71**	**16.14**	**13.71**	**22.02**	**25.96**	**19.74**	**21.62**
Grants from Centre	**88.29**	**83.86**	**86.29**	**77.98**	**74.04**	**80.26**	**78.38**
A. Non Plan Grants	**32.44**	**21.62**	**19.91**	**19.19**	**7.49**	**7.26**	**3.75**
Grant under Article 275 (1) of the Constitution	31.58	20.33	17.79	17.32	5.48	3.99	1.58
Calamity Relief Fund	0.85	1.27	2.07	1.59	0.61	2.07	1.03
Other grants	0.02	0.02	0.05	0.28	1.40	1.20	1.14
B. Plan Grants	**55.84**	**62.24**	**66.38**	**58.79**	**66.56**	**72.99**	**74.63**
State Plan Schemes	46.93	53.25	55.67	44.30	51.67	44.28	42.90
Central Plan Schemes.	0.36	0.29	0.19	0.33	0.30	0.14	0.22
Centrally Sponsored Schemes	8.55	7.54	7.51	11.63	11.88	22.44	26.44
NEC Schemes or Spl. Plan Schemes		1.16	3.01	2.53	2.71	6.13	5.08
As a percent to total revenue receipts							
Fiscal Transfers	**72.92**	**77.48**	**77.49**	**76.08**	**71.92**	**81.15**	**78.85**
Shared Tax Proceeds from Centre	8.54	12.51	10.62	16.75	18.67	16.02	17.05
Grants from Centre	64.38	64.97	66.87	59.33	53.25	65.13	61.81

A Special Appeal to the TFC

Concerted efforts have been made by the State of Sikkim to contain and to further reduce the non-plan expenditure. However, the revenue projections will have to obviously be made on a relatively lower base given the erosion on the revenue generating front and the higher revenue expenditure on account of inflation, which is more pronounced in the hilly areas. Therefore, **the Commission is requested to consider determining the State's fiscal requirements on a more concessional basis.**

Over the years, the efficiency-based criteria hinged on specific parameters namely tax effort, fiscal discipline, fiscal performance etc. This has been the guiding principle in determining devolution of Central taxes, allocation of grants to local bodies and in providing for debt relief. This formula is beneficial to developed States, but Sikkim is a resource 'starved' State which made a late entry into the national mainstream. Sikkim is a remote, land-locked and industrially backward State. For strategic reasons, Sikkim needs the help of the Commission to facilitate growth in the State's economy through special concessions. Stability, both economic as well as political, in this strategically located State is conducive to national security. It is, therefore, imperative that the Commission takes a sympathetic view in making its recommendations in respect of the State of Sikkim. It is apparent that the State's own Tax Revenue are almost negligible; constituting a mere 5 to 6 percent of GSDP. Therefore, the State is almost entirely dependent on Central support.

Table 6.2: Grants-in-Aid Awards to Sikkim by XIth & XIIth Finance Commissions

(Rs. in crore)

	Non-plan deficit grants	***Maintenance of***				***State specific grants***	***PRIs***	***ULBs***	***Calamity relief***	***Upgradation & special problem grants***	***Total grants***
		Roads & bridges	Public buildings	Forests	Heritage						
Twelfth Finance Commission											
2005-10	***188.67***	***18.64***	***32.15***	***8.00***	***5.00***	***100.00***	***13.00***	***1.00***	***69.74***	***0.00***	***436.20***
2009-10	0	4.66	8.04	1.6	1.25	25	2.6	0.2	14.78		***58.13***
2008-09	21.94	4.66	8.04	1.6	1.25	25	2.6	0.2	14.35		***79.64***
2007-08	52.86	4.66	8.03	1.6	1.25	25	2.6	0.2	13.93		***110.13***
2006-07	47.06	4.66	8.04	1.6	1.25	25	2.6	0.2	13.53		***103.94***
2005-06	66.81	Nil	Nil	1.6			2.6	0.2	13.15		***84.36***
Eleventh Finance Commission											
2000-05	***840.58***	***0***	***0***	***0***	***0***	***0***	***5.29***	***0.21***	***28.63***	***66.78***	***941.49***
2004-05	163.88						1.058	0.042	6.30	Nil	***171.28***
2003-04	166.44						1.058	0.042	6.00	13.06	***186.60***
2002-03	169.83						1.058	0.042	5.71	13.43	***190.07***
2001-02	170.73						1.058	0.042	5.44	13.43	***190.70***
2000-	169.7						1.058	0.042	5.18	26.86	***202.84***

01											

Source: Respective Reports.
Note: No grants for Education and Health.

Besides a good designed transfer mechanism, there should be a realistic assessment of the revenue gap to determine the award of the FC to the Sikkim State. Determination of grant-in-aid is based on the assessment of the State's revenues and expenditure requirements, computed by using the normative approach of the Ninth Finance Commission and thereafter, by the successive Finance Commissions. The extent of the State's share in Central Taxes and Duties is determined on the basis of various principles designed by the Finance Commissions. The same methodology and principles are adopted in determining the requirements of other backward hill States and the developed States, although the situation in both the categories of the States are not only incomparable but are subject to wide variations. **Given this backdrop, it is evident that generally revenues of hill States are overestimated and their expenditure requirements underestimated. The wide variations put their fiscal health in such a bad shape that even the Ministry of Finance (Central Government), Planning Commission and successive Finance Commissions have been suggesting ways to improve Sikkim's fiscal position. However, certain policy decisions have only served to further aggravate the fiscal problems facing the State.**

The State of Sikkim, therefore, earnestly requests that because of our geographical, physical and environmental features as compared to the non-Special Category States, **a small portion be carved out for special allocation to special category States. This is essential because of these States having the problem of sparse population, hilly terrain, land slides, and absolute lack of infrastructure leading to high costs in providing public services.**

As pointed out earlier in Chapter1 of the Memorandum, the indebtedness arisen due to unfavourable award by the Twelfth FC may kindly be written off.

Finally, and more importantly, the Commission should give special favourable view for the award of up-gradation grant to the hilly and less developed State for the aspects being detailed out in Chapter 9 on up-gradation and special problems of the State[12].

[12] A separate Volume on *Up-gradation of Administration and Special Problems of Sikkim, Volume V,* has been submitted to the Commission giving rationale and details of such problems.

CHAPTER 7

DEBT BURDEN AND NEED FOR SPECIAL RELIEF

More recently, one of the statutory jobs assigned to the Finance Commissions is to cover the issues related to fiscal sustainability. Accordingly, Para 5 of the Terms of Reference (ToR) of the Thirteenth Finance Commission states that "The Commission shall review the state of the finances of the Union and the States, keeping in view, in particular, the operation of the States' Debt Consolidation and Relief Facility 2005-2010 introduced by the Central Government on the basis of the recommendations of the Twelfth Finance Commission, and suggest measures for maintaining a stable and sustainable fiscal environment consistent with equitable growth".

This is primarily due to the fact that the issue of public debt is crucial for the sound fiscal health of the States. It is widely recognized that the large overhang of debt of State governments implies large interest payments that cripple the finances of the States with respect to their ability to undertake important socially necessary expenditure. Since the States are dominantly responsible for public expenditure which affects the day-to-day life of the people, ranging from law and order to basic infrastructure for health, sanitation and education, the fiscal crisis of the States has an adverse effect on these expenditures. Sikkim is also facing a fiscal crisis in the form of high debt-GSDP ratio and there is a need to restructure the debt of the State.

In this context, this chapter presents the current status of the indebtedness of the State of Sikkim and puts forth a case for debt relief, which is extremely necessary for the sound fiscal health of the State.

Debt Liability of the State

In a broad sense, public debt includes debt incurred by the State and local bodies as well as by the State Government owned entities. In the narrower and more pragmatic sense, public debt refers to debt incurred by the State and Local Governments. The management of public debt at the State level is assuming greater importance because of decentralization and the possibility of greater dependency of the States on the market. Irrespective of the narrow or broader definition, the State governmental debt is accumulated over time by spending more than its receipts.

Composition and Level of Debt

The various sources of borrowings by the State government are: (a) Loans (other than short-term) taken from the Government of India, (b) open market loans, (c) loans from LIC (for housing), (d) loans from NCDC and GIC, (e) State provident funds, insurance and pension fund trust and endowments, and (d)reserve funds, other deposits, contingency funds, and remittances.

The loans given by the Central Government to States comprise: (a) loans for State plan schemes as a part of the normal Central assistance; (b) additional Central assistance for State projects funded by external agencies; (c) the loan component of the schematic portion of several State plan schemes (State plan loans) consolidated as one loan on October 1 every year, carrying the same rate of interest and terms and conditions; (d) small savings loans comprising loans given prior to the creation of the National Small Savings Fund on April 1, 1999; (e) loans provided through the Central Ministries for centrally sponsored schemes/central plan schemes and other miscellaneous loans; (f) medium term loans given by the Ministry of Finance; and (g) the ways and means advances given by the Ministry of Finance.

From 2003 onwards, the quantum of public debt (from all these types of loans) of the Government of Sikkim has increased substantially (Table 7.1). Thus, while the total debt of the State at the end of 2003 was Rs 999.82 crore, (78.36 percent of GSDP), it is estimated to go up to Rs. 2,420.25 crore by 2010 (83.47 percent of GSDP).

Relative Priority of Sources of Debt

There is a major shift in the composition of debt of the State. The shift is from loans from the Government of India and the State Provident Fund to Open Market Loans (Table 7.1). In 2003, the debt due to Central Government loans and withdrawals from State Provident Fund was nearly 51.8 percent of the public debt. The present trends indicate that by 2010, the share of these components is likely to be only 26.86 percent of the total. On the other hand, the share of the Open Market Loans is likely to almost double from 24.09 percent in 2003 to 53.71 percent by 2010. The three components are providing around 74% to 80% of total loans.

The Sikkim Government is always in need of funds for investing in social and economic sectors to remain on the growth trajectory. As Sikkim is a hilly, non-industrial and less developed economy with tourism as the only commercial activity, the market is wary of lending to the Government. In addition, the degree of credit worthiness and fiscal sustainability affects the quantum the Government can borrow from the market. For the project-related loans, credit rating may be required and this is highly dependent on the State's fiscal health. All these factors put a limit on the access to market loans in the case of Sikkim.

The total debt taken during 2002-03 was only Rs 78.54 crore, while the debt during 2008-09 may be Rs 428.12 crore (Table 7.2). The size of the public debt will be even larger in the later years.

The high debt of Sikkim has led to an increase in its interest liabilities (Table 7.3). Interest on Internal Debts increased at an annual rate of 17.23 percent during 2002-03 to 2009-10 (estimated). The increase in the rate of interest on Market Loans is 24.66 percent while it is 3.88 percent for small savings, PF, etc. Interest liability on account of loans from the Central Government has declined over time. Interest payment as a percent of revenue expenditure has hovered around 20 percent, which is by no means a small proportion. However, the ratio of debt servicing to revenue receipts has declined from 11.12 percent in 2002-03 to 8.3 percent in 2008-09 (BE).

Table 7.1: Magnitude and Composition of Debt

(As on 31st March)

	2003	2004	2005	2006	2007	2008 (R.E.)	2009 (B.E.)	2010 (Est.)
Debt as on 31st March (Rs crore)								
1. Govt. of India Loans (Others)	280.80 (28.09)	274.15 (25.64)	316.74 (24.44)	327.68 (23.68)	324.93 (21.31)	318.33 (17.77)	307.00 (14.18)	300.00 (12.40)
2. Open Market Loans	240.81 (24.09)	295.76 (27.66)	331.68 (25.59)	420.03 (30.35)	517.43 (33.94)	754.29 (42.11)	1,082.31 (49.98)	1,300.00 (53.71)
3. Loans from LIC (for housing)	46.81 (4.68)	54.65 (5.11)	62.02 (4.79)	68.91 (4.98)	75.16 (4.93)	80.76 (4.51)	85.30 (3.94)	90.00 (3.72)
4. Loans from NCDC and GIC	1.59 (0.16)	1.50 (0.14)	1.44 (0.11)	1.38 (0.10)	1.36 (0.09)	1.77 (0.10)	1.74 (0.08)	1.74 (0.07)
5. Any other Loans	52.12 (5.21)	48.90 (4.57)	72.35 (5.58)	78.89 (5.70)	81.74 (5.36)	91.21 (5.09)	120.52 (5.57)	140.00 (5.78)
6. State Provident Funds	237.45 (23.75)	258.11 (24.14)	281.05 (21.69)	292.45 (21.13)	306.79 (20.12)	321.79 (17.97)	335.79 (15.51)	350.00 (14.46)
7. Insurance and pension fund trust and endowments etc.	8.12 (0.81)	9.34 (0.87)	10.85 (0.84)	12.44 (0.90)	14.34 (0.94)	16.45 (0.92)	18.62 (0.86)	20.00 (0.83)
8. Reserve Funds (Net)	39.61 (3.96)	52.98 (4.95)	67.46 (5.21)	83.06 (6.00)	86.43 (5.67)	89.93 (5.02)	97.83 (4.52)	102.00 (4.21)
9. Other Deposits	17.28 (1.73)	18.48 (1.73)	21.91 (1.69)	24.99 (1.81)	30.45 (2.00)	30.45 (1.70)	30.45 (1.41)	30.45 (1.26)
10. Contingency Funds	0.97 (0.10)	0.50 (0.05)	1.00 (0.08)	0.90 (0.07)	1.00 (0.07)	1.00 (0.06)	1.00 (0.05)	1.00 (0.04)
11. Remittances	74.26 (7.43)	54.98 (5.14)	129.45 (9.99)	73.14 (5.29)	85.06 (5.58)	85.06 (4.75)	85.06 (3.93)	85.06 (3.51)
Total Debt	**999.82 (78.36))**	**1069.35 (74.79)**	**1295.95 (80.89)**	**1383.87 (76.75)**	**1524.69 (74.72)**	**1791.04 (78.37)**	**2,165.62 (84.60)**	**2,420.25 (83.47)**

Note: (1) At Sr. No. 9, 'Other Deposits' includes credit figures of deposit accounts 8342, 8443 and 8448. (2) Figures in brackets are percentage to 'Total Debt' while total debt is shown as percent to GSDP.

Table 7.2:
Trends in Internal Debts and Loans from the Centre: 2002-03to 2008-09 (BE)

(Rs. in crore)

Description	***2002-03***	***2003-04***	***2004-05***	***2005-06***	***2006-07***	***2007-08 (RE)***	***2008-09 (BE)***
Total Debts	**78.54**	**137.02**	**192.98**	**145.06**	**142.74**	**301.32**	**428.12**
Internal Debt	34.81	75.96	110.32	122.07	132.22	292.6	423.26
Loans & Advances from Centre	43.73	61.06	82.66	22.99	10.52	8.72	4.86
Internal Debt as a ratio to total debt	44.32	55.44	57.17	84.15	92.63	97.11	98.86

Dependence on the Banking Sector

Although States can always borrow from the financial institutions and banks to fulfill their development plan requirements, the State of Sikkim (like other hilly States in India) could not borrow huge amounts from the banking sector (Table 7.4).Although the State is better placed in terms of the bank credit-deposit ratio *i.e.* only 55.08 percent as compared to its counterparts in the region, it is still dismally placed when compared to the general Category States having a 73.65 percent credit-deposit ratio. This shows that the State cannot depend heavily on financial institutions to fulfill its credit needs.

Table 7.3: Interest Payment and Debt Servicing: 2002-03 to 2007-08

(Rs. in crore)

	2002-03	***2003-04***	***2004-05***	***2005-06***	***2006-07***	***2007-08 (RE)***	***2008-09 (BE)***	***2009-10 (Estimate)***	***CGR (2002-03 to 2009-10)***
Interest Payment and Servicing of Debt	***100.54***	***103.49***	***110.19***	***113.60***	***127.00***	***141.00***	***146.47***	***180.43***	8.28
Appropriation for Reduction or Avoidance of Debt	11.00	11.00	11.00	11.00	11.73	11.73	11.73	13.39	2.35
Interest Payments *of which:*	89.54	92.49	99.19	102.60	115.27	129.27	134.74	167.04	8.89
Interest on Internal Debt	37.64	43.49	45.04	45.21	53.47	82.05	85.51	118.15	17.23
Interest on Market Loans	27.34	10.64	34.71	37.00	44.81	58.79	62.20	84.66	24.66
Interest on Small Savings, Provident Funds, etc.	19.84	18.88	21.50	20.33	22.50	22.88	25.07	24.55	3.88
Interest on Loans and Advances from Central Govt.	32.06	30.12	32.65	37.06	39.30	24.34	24.16	24.34	-4.48
Interest Payments as a Ratio to Total Non-Plan Revenue Expenditure (%)	***21.76***	***21.02***	***19.80***	***19.02***	***19.92***	***19.56***	***19.28***	**20.17**	
Interest Payments as a Ratio to Total Revenue Receipts (%)	***11.12***	***11.52***	***10.91***	***10.45***	***10.64***	***8.63***	***8.30***		

Approaches to Debt Relief Adopted by Previous Commissions

The Second Finance Commission was the first to handle the issue of State debt. It made recommendations on the rates of interest and the terms of repayment of Central loans made to the States from the time of Independence till the year ending 1956. From the Sixth Commission onwards, a review has been made of the level and magnitude of public debt.

All other FCs, including the Eighth Finance Commission, undertook a review of the debt position with particular reference to the Central loans to the States. These Commissions had suggested debt relief measures given the overall non-plan capital gap and the purposes for which the loans had been utilized.

The later FCs, including the Ninth Finance Commission, was mandated to review the debt position of the States. These Commissions suggested corrective measures with particular reference to investments made in infrastructure projects and linked these to improvements in financial and managerial efficiency. The Eleventh Finance Commission was required to consider the long-term sustainability of debt for both the Centre and the States. The ToR of the Twelfth Finance Commission, apart from debt sustainability, was to suggest measures consistent with the macro-economic stability of the State. In addition, recommendations were also made to relate debt with the performance of the States with regard to human development and investments.

Table 7.4: Bank Deposits and Credits in the North-Eastern States

(As on 30th June 2007)

(Rs. in crore)

1.*Group/State*		*No. of Offices*	*Deposits*	*Credits*	*Credit/ Deposit Ratio (%)*
A.	**North-Eastern States**	**1,335**	**36,254**	**14,752**	**40.69**
1	Arunachal Pradesh	53	1,589	475	29.89
2	Assam	852	22,778	9,461	41.54
3	Manipur	49	1,188	731	61.53
4	Meghalaya	134	3,404	1,236	36.31
5	Mizoram	26	1,026	552	53.80
6	Nagaland	67	1,906	655	34.37
7	***Sikkim***	***57***	***1,378***	***759***	***55.08***
8	Tripura	97	2,985	883	29.58
B.	**Other Special Category States**	**1,676**	**48,195**	**16,291**	**33.80**
9	Himachal Pradesh	695	15,113	6,514	43.10
10	Jammu & Kashmir	277	7,035	2,577	36.63
11	Uttaranchal	704	26,047	7,200	27.64
C.	**Special Category States**	**3,011**	**84,449**	**31,043**	**36.76**
D.	**Non-Special Category States**	**46,803**	**1,793,268**	**1,320,816**	**73.65**
E.	**All-India**	**49,814**	**1,877,717**	**1,351,859**	**71.99**

Source: Economic Survey 2007-08

Thus, in the past, the Finance Commissions have attempted to review the problem of States' debt and the fiscal measures necessary for maintaining debt at sustainable levels. The Commissions have commented on the need to consider the cost of debt, the use and the productivity of borrowed funds and the arrangements for amortization of debt while resorting to borrowings. Specific mention was also made for not using the debt to meet revenue expenditure. The Commissions pointed out that the disturbing features in the debt profile of the States were the use of loans in unproductive or non-performing enterprises and the non-provision of depreciation or amortization of funds in respect of government owned assets. This led to repayments being made out of fresh borrowings. Also, the determination of sustainable levels of debt depends critically upon factors such as the rate of growth of GSDP, the effective interest rate on borrowings by the concerned governments (Centre/ States), the rate of growth of revenue receipts and the proportion of primary expenditure (expenditure other than interest payments) relative to GSDP.

Impact of Debt Swap Scheme

Taking advantage of the falling interest rate regime and recommendations of the FC, the Central Government introduced the debt-swap scheme in September 2002. This policy gave relief to the States from the 'high-cost debts' owed by the States to the Central Government. High-cost debt is defined as the debt which carried an interest rate of 13% or above. State plan loans and small savings loans given till 31st March 1999 qualified for debt-swap.

Table 7.5: Interest Wise Outstanding Loans & Advances of Sikkim from Govt. of India

(As On 31st March 2008)- (Pre-Actuals)

(Rs. in crore)

Rate of Interest	Block Loan	Small Saving	NSSF	Other	Total
4.75	0.00	0.00	0.00	0.84	0.84
6.75	0.00	0.00	0.00	2.94	2.94
7.25	0.00	0.00	0.00	0.01	0.01
7.75	0.00	0.14	0.00	0.04	0.18
8.50	0.00	0.00	0.00	0.06	0.06
8.75	0.00	0.00	0.00	0.00	0.00
9.00	38.25	0.00	0.00	16.82	55.07
9.50	0.00	0.00	77.07	0.13	77.20
9.75	0.26	0.01	0.00	0.01	0.28
10.00	0.00	0.00	0.00	0.01	0.01

10.25	1.30	0.02	0.00	0.01	1.33
10.50	33.92	0.00	31.19	7.35	72.46
10.75	2.28	0.00	0.00	0.01	2.29
11.50	25.43	0.00	0.00	7.75	33.18
11.75	3.49	0.00	0.00	0.19	3.68
12.00	35.37	0.19	0.00	3.42	38.98
12.50	30.71	0.00	0.00	0.68	31.39
13.00	0.00	0.00	0.00	1.69	1.69
Total	**171.01**	**0.36**	**108.26**	**41.96**	**318.33**

Two borrowing sources were identified for swapping the 'high-cost' Central Government loans - additional open market borrowings and State governments' investment in small savings securities. It was expected that additional market borrowings could be raised at an interest payment of around 7 percent. The small savings debt carried interest in excess of 14.5 percent. This swap was expected to give the State governments a clear interest savings of over 6 to 8 percent in respect of small savings loan swapped with additional market borrowings. The States' investments in NSSF securities carried an interest obligation of 9.5 percent. This stream was expected to result in an interest savings of 3.5 percent to 5.5 percent. The small savings are supplemented with additional market borrowings by the State Governments depending upon the liquidity position.

In the case of Sikkim, the loan composition according to the interest category (Table:7.5) indicates that around 64.88% of the total loans have interest rate in the range of 9% to 11% while 33.87% of the loans carry an interest rate in the 11% to 13% range; only 1% of the loans have a less than 9% interest rate. Block loans and NSSF comprise 53.2% and 33.7% of total loans, respectively.

For the States, the debt-swap scheme results in a change in the composition and maturity profile of the debt, but not in the overall magnitude of the debt. The benefits from this scheme are that, over a period of time, the savings due to lower interest payments would reduce the pressure on the States' revenue account and thereby, bring a reduction in the overall borrowing requirements. Further, the role of the Central Government as an intermediary, in respect of loans to State governments, gets reduced.

As a result of the debt swap scheme, cumulative debt relief for Sikkim (after consolidation of Central loans contracted before 31st March 2004 and outstanding on 31st March 2005 as per the award of the Twelfth Finance Commission) was Rs 44.65 crore; of this, Rs 10.69 crore was towards repayment and Rs 33.69 crore on account of interest due. Till March 2005, total debt swapped by the State was Rs 67.13 crore (Table 7.6). Subsequently, the debt/interest relief was not availed of by Sikkim under the Debt Consolidation and Relief Facility recommended by the Twelfth Finance Commission.

Table 7.6: Components of Total Debt Swapped by the State till March, 2005

(Rs. in Crore)

Debt swapped 2002-03 from Small Savings	0.74
Debt swapped 2003-04 from Small Savings	6.60
Debt swapped out of AOMB	44.95
Amount of High Cost debt relief	0.21
Debt swapped 2004-05 from Small Savings	5.67
Debt swapped out of AOMB	8.96
Amount of Total debt swapped till March 2005	**67.13**

Note: AOMB = Additional Open Market Borrowings

Source: Indian Public Finance Statistics, 2006-07

Under Debt Swap Scheme, the year wise details of the loans taken from the market by the State Government during different years are given in Table 7.7.

Table 7.7: Loans Taken from the Market by the State Government

Year	Payment made through Debt Swap	Amount (Rs in crores)
2000-01	Govt. of India	10.00
2001-02	Govt. of India	10.00
2002-03	Govt. of India	10.74
2003-04	Govt. of India	58.20
2004-05	Govt. of India	26.37
	NABARD	19.48
	Total	**134.79**

In fact, the total fiscal transfer by the Twelfth Finance Commission to the State of Sikkim from the Central taxes and the non-plan revenue deficit grants was Rs. 1,582 crores as against the transfer of Rs. 1,533 crores made by the Eleventh Finance Commission. The increase in Sikkim's share in Central taxes and non-plan revenue grants was only 3.20 percent whereas this increase in some other States was phenomenal: 141.39 percent in Punjab, 111.82 percent in Manipur, 106.29 percent in Gujarat, and 105.03 percent in Goa. In this list, Sikkim ranks second last from the bottom. Also, the estimated pre-devolution non-plan revenue deficit was far away from reality (Table 7.8).

Table 7.8: Projected Pre-Devolution Non-plan Revenue Deficit over 12th Finance Commission Assessment (2005-2010) - Sikkim

Year	Projection by the State (Rs. In Crore)	Assessed by 12th FC (Rs. In Crore)
2005-06	562.32	274.39
2006-07	627.13	284.71
2007-08	720.63	325.56
2008-09	826.21	335.53
2009-10	966.66	360.02
Total	**3,702.95***	**1,580.21**

* Annexure 6.1 of the Twelfth Finance Commission Report indicates the projections furnished by the State Government on Non-plan Revenue Deficit as Rs. 2924 crores against the figure Rs. 3702.95 crores actually projected by the State Government.

Due to this overestimation in the forecast of the State's own revenue and curtailment on the level of expenditure and also incorrect projection of figures submitted by the State Government, the total non-plan revenue deficit grant recommended by the Twelfth Finance Commission was Rs. 188.67 crores as against Rs. 840.58 crores recommended by the Eleventh Finance Commission, indicating a fall of 77.55 percent.

It is important to note that the State government has made various representations to the Government of India at different levels and a Committee headed by the Secretary DONER has been constituted to look into the hardships faced by the State due to the unsatisfactory recommendation of the Twelfth Finance Commission.

However, due to the incorrect assessment of the Twelfth Finance Commission regarding the fiscal situation prevailing in the State, the fiscal deficit of the State has increased disproportionately to accommodate the level of expenditure in both the Plan and Non-plan sectors. Further, Sikkim could not avail of the debt consolidation and relief facility.

Debt Consolidation and Relief Facility (DCRF)

Owing to the constraints and limitations mentioned above, the State Government was not able to implement the FRBM Act and could not achieve the target of 30 percent Debt-GSDP ratio. It has also not been possible to draw up a Fiscal Correction Path (FCP) during 2005-06 to 2009-10. Also, it could neither take benefit under DCRF provisions nor under the Debt write-off scheme.

Capacity Building for Debt Repayment

A number of measures have been taken by the Government of Sikkim to improve the capacity building for repayment of debt. First, efforts were made to improve the tax to GSDP ratio, as enumerated in Chapter 3 of the Memorandum. As a result of these measures, *viz.* the introduction of VAT, revision of rates of land revenue and registration fees, and introduction of a profession tax etc., the State was able to maintain the tax-GSDP ratio at the level of 14-17 percent for the period2003-07. However, there was an exception during 2002-03 when tax to GSDP ratio was 19.5, which was due to receipts from online lottery.

On Debt Relief and Debt-Restructuring

The scheme of debt relief recommended by the Twelfth Finance Commission envisages the following:

(a) *Rescheduling of all Central loans***:** All loans contracted till the end of March 2004 and outstanding as on March 31, 2005, were to be rescheduled into fresh loans for 20 years with a 7.5 percent interest rate effective from the year a State enacts the Fiscal Responsibility Legislation. For Sikkim, the debt relief awarded by the Twelfth Finance Commission through consolidation amounts to Rs. 44.65 crore over the award period of 5 years, comprising of relief of Rs. 10.69 crore for repayment of the principal and Rs. 33.96 crore to cover the interest liabilities. The Government has accepted this recommendation subject to the condition laid down by the Twelfth Finance Commission. It also expects that the State government would comply with the obligations regarding fiscal deficit and revenue deficit imposed by the Fiscal Responsibility legislation. The Centre will request the next Finance Commission to make the appropriate adjustments in case the State availing of the debt relief is not able to comply with the Fiscal Responsibility Legislation.

(b) *Central Assistance:* The Twelfth Finance Commission has recommended that the Centre should release only the grant component of Central assistance for the State Plan and leave the States to raise loans from other sources. For States unable to raise loans from the market, the Centre may act as a financial intermediary but without any subsidisation of the cost. This approach has been accepted in principle and will be implemented in phases in consultation with the RBI. From 2005-06, the States would be allowed, at their own discretion, not to draw funds from the loan component of the Central Assistance.

(c) *Loan component of the Central assistance:* As per the approved annual plan of Sikkim for 2005-06, the loan component of the Central assistance was Rs 43 crore. The State government had to take a stand on the acceptance/ non-acceptance of this loan, especially in view of the stringent requirement regarding the revenue surplus.

(d) *External Assistance:* The Twelfth Finance Commission had recommended that the Centre should pass on external assistance on a back-to-back basis to States and manage it through a separate Fund in the Public Accounts. The Government has accepted this recommendation subject to the condition that the service cost and exchange rate risk would be passed on to the States under this arrangement. Though external assistance has not been an important source of funding for Sikkim in the past, this could form an important source of funding in the future. It is, therefore, important that the State government should endeavour to receive external assistance by way of grants or at least as soft loans.

With the acceptance of the recommendation of the Twelfth Finance Commission by the Government of India to do away with the loan component of Central assistance to States, plan loans from the Centre will become a minor component of the loan portfolio of the States. Also, in the future, reforms will put Sikkim in a much better position to raise adequate funds in the market at fairly reasonable terms.

As regards the level of borrowings, the considerations to be kept in view are the alternatives available for investment in critical sectors like power, road, network, airport etc. The public-private participation in the power sector, which the State Government has initiated in respect of Tista Stage II and III, has the potential for replication in respect of other capital-intensive projects like the proposed airport and an alternate highway. The important aspect of the Tista projects is that the State Government's equity participation is to be financed by the private partners who will be repaid from the revenue stream from the project after its completion. If the State Government can attract similar private partnership for major capital-intensive projects, there is scope for limiting the capital outlay under the plan to less than 10 percent of the GSDP.

An Earnest Appeal for Debt Relief

With the above stated position of the State in terms of composition and magnitude of public debt, as also its ability in terms of mobilizing market loans in the absence of softer Central loans, the Government of Sikkim earnestly requests the Thirteenth Finance Commission that:

- a relief in terms of rate subsidy be given to poor States like Sikkim. The *inter se* debt relief be granted based not only on population but other factors which demand more funds for development like geographical conditions where per unit cost of provision is pretty high compared to other States which are better placed in this regard; and
- a very special appeal is made to the Commission that the total loans taken by the State government during the award period of Twelfth Finance Commission (2005-10) for financing the State Plan needs to be written off due to the 'unfavourable' award.

CHAPTER 8

LOCAL BODIES IN SIKKIM

India has kept pace with global trend of decentralization of power with the introduction of 73^{rd} and 74^{th} Constitutional Amendments. This has accelerated the process of decentralization with greater devolution of funds and functionaries and delegation of powers to local governments, which are seen as the third tier of the government.

The State legislature is responsible and authorized to devolve the specific responsibilities, powers and authorities to the local bodies to enable them to function as institutions of self-government. The State may also empower the local bodies to levy, collect and appropriate certain taxes, duties, tolls and fees etc. and also assign to them the revenues of certain State level taxes subject to such conditions as are imposed by the State government. Further, grants-in-aid may also be provided to these institutions.

Under article 243 (I) each State has to constitute a State Finance Commission (SFC) every five years. The SFC is assigned the task of reviewing the financial position of local bodies and making recommendations on the sharing and assignment of various taxes, duties, tolls, fees etc and grants-in-aid to be given to the local bodies from the consolidated fund of the State.

This is based on the belief that the local bodies directly influence the welfare of the people under its jurisdiction by providing adequate civic, social and economic infrastructure services and facilities in both urban and rural areas. Ideally, the functional responsibilities should be closely linked with the financial powers delegated to the local government. In practice, there is a huge mismatch between functional responsibilities and the financial powers leading to a severe fiscal stress at the local level.

FUNCTIONS AND RESOURCES OF LOCAL BODIES

The 73^{rd} and 74^{th} Constitutional Amendments Act have accorded a constitutional status to the local self governments in all the States. This is done to empower them, both financially and administratively. Several new provisions have been added to the Constitution including a provision for the State Finance Commission. As these amendments will put an additional burden on the finances of the State Governments, measures were proposed to augment consolidated fund of the State. Accordingly, principles to govern the grants-in-aid to the States were established to transfer funds for the purpose from the Consolidated Fund of India to have sound finances for the local bodies.

Given the strategic position of the local bodies in delivering services in the hierarchy of the Government set up, the Tenth Finance Commission had suggested measures to augment the States resources. Accordingly, local bodies have been given more functions, powers and resources. However, over a period of time, the functions and responsibilities of local bodies have increased considerably without commensurate enhancement of their resource base in the States. Consequently, the local bodies in most States remain financially starved. Such built-in imbalances in functions and finances assigned to various levels of government eventually reflect in the high dependency of local bodies on State Governments and the latter, in turn, on the Central Government for funds

Local-Self Governance in Sikkim

Sikkim had started empowering its local bodies even before it joined the Indian Union. The first attempt to establish Panchayats in the State was made as early as 1948[13]. To begin with, an attempt was made to create Panchayats, consisting of the landlords or their representatives and four other members from the block, selected by the people in a meeting convened for the purpose. With a view to consolidating these Panchayats, the King of Sikkim promulgated Laws relating to Panchayats under the Sikkim Panchayat Act, 1965. The objective was to facilitate rural development and to enable participation by all communities at the village level. The term of such Panchayats was three years and each of these Panchayats was assigned 16 duties and functions.

To fulfill these duties, the Panchayats had resources comprising house tax, a proportion (10 percent) of the land revenue of the block, matching grants by the *Darbar* for original work (for which public contribution was collected), sanitation cess and water cess. The Sikkim Panchayat Act, 1965, also provided reservations for minorities. Also, a new Act was enacted in 1982 for decentralizing the work at district level. This Act envisaged the constitution of Zilla Panchayats at the district level.

Sikkim ushered in the new age of decentralization by implementing the Constitution 73rd Amendment Act, 1992. In doing so, it enacted the Sikkim Panchayats Act, 1993, to enable the Gram Panchayats and the Zilla Panchayats to have the authority to levy taxes, rates and fees. These provisions will be implemented in the State in the near future. It also intends to implement the 74th Constitutional Amendment Act shortly.

As of now, the State has a two-tier system of Panchayati Raj Institutions (PRIs), namely, Zilla Panchayats at district level and Gram Panchayats at unit level. There are 163 Gram Panchayats and 4 Zilla Panchayats in the State**.**

Duties of PRIs

The Second State Finance Commission has provided detailed functional domain of the PRI, namely, Gram Panchayats and Zilla Panchayats in the State. It may be noted that all the 29 subjects as per Eleventh Schedule have been transferred to the PRIs. Also, in every district (*viz.*, north, south, east and west districts) of the State there are Gram Panchayats according to population-size and the number of households The Panchayats are fairly equally distributed in the different districts of the State (detail information is available in Memoranda on Local Bodies)[14].

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[13] Vide Notification No.3054-254/PS dated the 24th January 1948

[14] See for details Volume IV on Local Bodies of the Memorandum submitted to the Thirteenth Finance Commission.

Sikkim State Finance Commissions and Action Taken Report (ATR) on the Recommendations

Following the Constitutional obligation to constitute the State Finance Commission, Sikkim set up its first Commission on 22nd July 1998. The Commission submitted its Report on 16th August 1999. Most of the recommendations of the First State Finance Commission have been implemented. The Second State Finance Commission was notified on 5th July 2003. This Commission deliberated over a year and submitted its Report on 30th September 2004. Most of the recommendations of the Second Commission have also been accepted and implemented. The Third State Finance Commission of Sikkim will be set up shortly, in the year 2008-09.

As there is no municipality in the State, the recommendations of both the State Finance Commissions relate to PRIs only. Urban areas (as declared by the Census), are the responsibilities of concerned Government Department. Further, the implementation of the 74th Amendment to the Constitution in the State will set up a platform for the formation and effective functioning of municipal governance in the State. When implemented, the State will have 12 urban local bodies.

The recommendations of the First and Second State Finance Commission, Sikkim, empowers local bodies in many ways. These recommendations and action taken by the State are given in a separate volume.[15]

A Committee was constituted to examine the recommendations of the Second State Finance Commission comprising following officers from the Rural Management and Development Department:-

1. Special Secretary,
2. Additional Secretary, and
3. Director, Panchayat

The Committee has recommended marginal changes in certain recommendations of financial nature and referred to the Finance, Revenue & Expenditure Department. The Committee has unequivocally recommended that the advisory body to the District Planning Committee should be wound up and that the pension and medical benefits to Panchayat members cannot be granted given the present financial conditions.

The Sikkim Panchayat (State Finance Commission) Rules, 1995 does not contain details of the terms of reference, period of review and period for which the recommendations shall be applicable. This is a relevant observation and it is, therefore, necessary to amend the rules to clearly indicate the terms of reference, period of review and period of application. It is further necessary to have the approved recommendations of the State Finance Commission available to the Central Finance Commission. In order to achieve this, the State Finance Commission must be constituted at least 2 years before the Central Finance Commission comes into operation. The Third State Finance Commission must, therefore, be constituted in 2008-09. The

[15] *Ibid.*

recommendations in respect of Urban Local Bodies (ULBs) have so far not been made owing to the fact that ULBs have not been constituted.

The Finance Department, subsequently, sought information on the amount of additional financial requirement needed for the establishment costs of the PRIs in case the recommendations of the Commission (after being examined by the Committee) are fully accepted and implemented. This amount has tentatively been worked out at Rs 90.00 lakhs per annum. The major portion of this additional amount is on account of enhancement of the honorarium of the elected Panchayat members. This additional expenditure is to be met from the revenue collected by the PRIs, as recommended by both the First and Second State Finance Commissions. Deficits, if any, may have to be considered by the State Government.

Recommendations of the Eleventh and Twelfth Finance Commissions

All the recommendations of the Eleventh Finance Commission have been implemented. A separate Panchayat Budget has been created and all the funds transferred directly to PRIs. Information regarding maintenance of accounts, training imparted to Rural Development Assistants and Panchayats was also given. Computers were provided to the Panchayat, *i.e.* at Head of Districts and Head Office level. Auditing of accounts of Panchayat is done by the CAG, Chartered Accountants and the Social Audit & Vigilance Committee setup in Panchayat units. The process of implementation of recommendations of the Twelfth Finance Commission has been undertaken and is under process. A permanent SFC Cell, however, has not been created.

Suggested Approach for the Thirteenth Finance Commission (TFC)

The State of Sikkim is of the view that the term 'measures' in the ToR of the Thirteenth Finance Commission refers to both qualitative and quantitative measures. Incorporation of Art.280(3)(bb) and (c) in Art.280 is a clear recognition of the 'need' to supplement the resources of the Panchayats/municipalities on the one hand, and 'inability' of the State governments to meet the entire additional financial burden imposed by the State Finance Commissions, on the other hand.

In view of the above, the Government of Sikkim urges that the Commission may follow the sequential steps in recommending 'measures' for the Panchayats & municipalities At the outset, it must determine the aggregate size of the grant for the local bodies and also resolve on the criterion of its Inter-State allocation. As a next step, **the Commission may determine the need of the local bodies on the basis of acceptable criteria. The quantum of vertical transfer/ distribution to the local bodies be attempted on the basis of the decentralization target based on local expenditure as a percentage of total Government expenditure instead of an arbitrary per capita allocation based on the population figure of thirty seven years back. Such expenditure of local Government should be met from central tax sharing by earmarking separate percentage duly expanding the pool of central taxes at least by ten percent above the scheme of devolution proposed for the State. The share of each tier of local bodies should also be decided accordingly. Allocation of TFC Grant to specified purposes could be the next step for the TFC. For this purpose** the Government of Sikkim suggests that the criteria for this purposes could be as follows: 5% on the basis of creation of database on devolution of functions, powers, staff support and resources, including the Finance Commission’s grants; 5% on the basis of maintenance of accounts of the village-level Panchayats; 10% on the basis of incentive grants to States for effecting larger resource devolution to Panchayats which again have to be used by the States to provide incentive grants to Panchayats; 40% on the basis of special assistance to Panchayats in backward / difficult areas; 20% on the basis of assistance for creation of physical infrastructure for the Panchayats; and 20% on the basis of Maintenance of basic civic services by the Panchayats; **For each of the above aspects, the Finance Commission may earmark its grant in percentage terms and make the inter-State allocation on an appropriate basis as per the suggested criteria. The Commission may consider a part of its grant for district-wise allocation in each State so as to ensure greater transparency of its grant.**

Finally, the TFC should not lay down conditionality governing the eligibility of the States and Panchayats to the TFC grant. The Tenth Finance Commission suggested that the local bodies/State governments were required to provide matching resources. However, it is felt that in most cases where the Panchayats were required to make the matching contribution, the grant has remained either unutilized or underutilized. **It is suggested that the Thirteenth Finance Commission may also adopt the recommendation of the Eleventh and Twelfth Finance Commission where no condition was laid for matching contribution by the State. Also,** the grant recommended by the Finance Commission to the Panchayats & municipalities should be 'untied'.

CHAPTER 9

UPGRADATION OF ADMINISTRATION & SPECIAL PROBLEMS OF SIKKIM

1. Introduction

With a view to removing the inter-regional imbalances and disparities in provision of services by the States, it is important that the requisite funds are made available to the States to enable them to provide a reasonable standard of social, economic and administrative services to the people in the State. In this context, the Finance Commission is empowered constitutionally to recommend transfer of resources in the form of upgradation grants out of the Consolidated Fund of India.

Up-gradation grants may be given to narrow down the disparities in the administrative and social services between the developed and the backward States. Similarly, special problem grants can be given to individual States to enable them to overcome certain special problems on account of their peculiar circumstances or any other matter of national importance.

Although, it was not specifically mentioned in the terms of reference of some of the earlier Finance Commissions, some of them have recommended grant-in-aid under Article 275 for both of these purposes, in one form or the other.

The First Finance Commission recommended grants for primary education. The Third Finance Commission suggested grants be made for the development of communication while the Sixth, Seventh and Eighth Finance Commissions recommended grants for backward States. Eighth Finance Commission also recommended grants to States facing special problems. In its first report, the Ninth Finance Commission recommended grants for the completion of the works recommended by the Eighth Finance Commission. The Tenth, Eleventh as well as Twelfth Finance Commissions also recommended grants for the same.

The Terms of Reference of the Thirteenth Finance Commission also does not directly call for making recommendation for such a grant but Para 4(ii) provides that the recommendation should be based on the principles which govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India. These sums are to be paid to the States which are in need of assistance by way of grants-in aid, under Article 275 of the Constitution, for purposes other than those specified in the provisions of Clause (I) of that Article.

Keeping this in view, the Government of Sikkim is submitting proposals to the Commission requesting necessary grants for the up-gradation of services of public goods like general administration, law and order, and other critical areas facing fiscal deficiencies where improvements are necessary to maintain a certain level of standard of living. These proposals mainly relate to **general administrative services** (*viz.* police administration, department of personnel and administrative reforms, human resource development, public works, and capacity building for fiscal services); **social and cultural services** (*viz.* education, health, public health engineering services including water supply, and cultural affairs and heritage activities); and

economic services (*viz.* forest, wild life and environment; tourism, roads and bridges, agriculture, horticulture, animal husbandry, veterinary, and rural management).

2. Up-gradation of General Administrative Services

Provision of good administration is a public good. It benefits all the citizens of the State. In Sikkim, while the efforts of the State have been to provide administrative services parallel to the services provided by the other States, the issues of capacity building and infrastructural deficiencies have created problems for the State. Some of the services that urgently need financial support from the Thirteenth Finance Commission through up-gradation grants are given below:

2.1. Police Administration

One of the important services that need up-gradation relates to police administration. Prior to joining the Indian Union in 1975, the Sikkim Police had limited manpower and residential/ non-residential buildings for the police administration. Since then there has been an improvement in these services but financial support is needed for further up-gradation which includes strengthening the police force, providing more housing facilities for the police, setting up of a national police mission, intelligence and security.

2.2. Human Resource Development Department

Transition from the erstwhile kingdom to a special State under the Union of India has brought about tremendous progress in the field of education in Sikkim. However, there are still many challenges and obstacles to be overcome. Therefore, the State Government has given top priority to education sector for the spread and development of educational infrastructure in the rural areas. Although the delivery of quality education depends on many factors, training of teachers is the most important one. The Sikkim Government upgraded the Teacher's Training Institute of Gangtok into the District Institute of Education and Training in 1998. This institute needs to be further strengthened. Also, establishment of similar institutes in other districts is needed. Given increasing number of students passing out from the schools and the limited intake capacity of the colleges, the infrastructural development in the sector of education needs (a) the Establishment of District Institute of Education and Training (Diet), (b) Infrastructure Development for Replacement of Old Schools, (c) Up-gradation and Improvement of Playfields, and (d) an Increase in the Number of Colleges

2.3. Public Works Department

To enable the administrative departments to project a humane approach combined with efficiency requires the setting up of proper and well-planned administrative buildings. This work is generally undertaken by the Public Works Department in the State. It is envisaged that this department should undertake the construction of the Secretariat building at Raj Bhawan (deleted) and also the construction of the Secretariat Annex Building at Tashiling Complex, both to be located at Gangtok. Renovation work has also to be done in the Health Secretariat.

2.4. Up-gradation and Special Problem Grant under Urban Development

As Sikkim is a developing State, it needs more attention from the Center in terms of creating new physical infrastructure and its maintenance for urban development. The specific areas of prime importance in urban development are (a) building and maintaining the drainage system, (b) construction of toilets, (c) hatsheds, (d) maintenance of capital assets, (e) garbage disposal, (f) computerization, (g) Public Awareness Campaign, (h) implementation of the 74th Constitutional Amendment Act (Urban Local Bodies), (i) multi-storey parking plazas at Mangan, Gyalshing and Namchi, (j) urban development of Sokeythang with the setting up of a Library, Habitat Centre, Community Center, State Children's Park, State Unity Centre etc.

2.5. Capacity Building For Administrative and Fiscal Reforms

The establishment of a full-fledged Institute of Capacity Building with the purpose of imparting training, transfer of knowledge, and for building and developing capacities of the unemployed youth will meet the needs of the State for trained manpower. The Directorate of Capacity Building in consultation with the Director, Administrative & Accounts Training Institute (AATI) has undertaken the initiative to explore the possibility of having the Capacity Building Institute at Burtuk, alongside the proposed AATI. This will meet the current and future infrastructural needs of the State. Therefore, this initiative needs to be supported.

Capacity building for fiscal reforms is an area that requires considerable efforts. The State Government has prioritized some areas of reforms on the basis of the expert opinion sought by the State Government[16]. The other activities that need special emphasis include: (a) Staff training for better expenditure management, (b) E-Governance, and (c) the computerisation of entire Commercial Tax Division of the Department especially for successful implementation of VAT. One of the most important aspects of tax administration is the Management Information System (MIS). Computerisation of tax returns will help in the collection of data related to reforms in Other Taxes, *i.e.* land revenue**,** property tax etc. Computerisation will also simplify the operation of registrations, annual fee collection and the updating of vehicle population data.

To improve statistical infrastructure it is important to have (a) staff training in the basic tools of statistics and computers; (b) capacity building for poverty estimation, and (c) up-gradation of library facilities.

3. Up-gradation of Social and Cultural Services

Social and cultural services are an important component of the non-tax sources of revenue in many of the States. In Sikkim, however, this requires special attention given the large capital expenditure needed for the provision of these services, as mentioned below:

[16] This is based on the assessment made by the National Institute of Public Finance and Policy (NIPFP), New Delhi. The study has recommended several capacity building programmes to improve the fiscal scenario in the State. See for details NIPFP (2005), *Capacity Building for Fiscal Reforms in Sikkim*, New Delhi.

3.1 Conservation of Heritage and Culture of Sikkim

Sikkim was a kingdom ruled by the Chogyals till 1817. The British entered Sikkim only after 1817. Hence, the British influence on the social and architectural heritage of the State is minimal.

Heritage buildings have been manned by civil service officers who are basically not archeologists. They have not been able to tackle the problem of decay of heritage monuments. The Government, from time to time, has tried to involve the Archaeological Survey of India and NGOs (like INTACH) in the restoration of Sikkim's heritage sites. The State has been able to conserve a number of monuments under the grant given by Twelfth Finance Commission. In spite of all the hurdles, the Sikkim Government is actively involved in the preservation of various monasteries, traditional houses, historical buildings and *devithans.* **Archaeology basically entails the Preservation/Restoration of monuments of historical relevance, which have survived for 100 years** without undergoing major architectural changes. Given the importance of heritage buildings/monuments, the State of Sikkim is placing before the Thirteenth Finance Commission proposals relating to **(**a) Restoration/Preservation of Monasteries and Mandirs, (b) Documentation of the Intangible Heritage of the State, (c) Up-Gradation of Museums and Archives, (d) Preservation/Restoration of Traditional Houses, (e) Preservation/Restoration of Historical Buildings, (f) Preservation/Restoration of Chorten, Mendangs and Mani Lakhang, (g) Preservation of Devithans and Pilgrimage Centers, (h) Preservation of Sacred Caves, Water Bodies and Hermitage, (i) Revival of Traditional Arts and Crafts, and (j) Restoration/Preservation of various Ruins in the State.

3.2. Health Care, Human Service and Family Welfare Department.

To create a proper health infrastructure, The Sikkim Manipal Medical College Hospital has to provide tertiary care facilities in the State. The role of the Sikkim Government in providing health care facilities (particularly curative care) in the State is crucial. The up-gradation of the Sir Thutob Namgyal Memorial (STNM) Hospital into a state-of-the-art hospital, in line with the concept of establishing a mini AIIMS in the State, has been a vision of the State Government. Also, it is proposed to have a comprehensive health insurance scheme for families below the poverty line (BPL).The scheme will be managed by an insurance company registered with the Insurance Regulatory and Development Authority (IRDA). The Department of Health Care, Human Services and Family Welfare, Government of Sikkim, shall act as the nodal agency. The Government of Sikkim, through the Department of Health Care, Human Services and Family Welfare, has decided to provide health care cover to BPL Families of the State through an effective Health Insurance Scheme. The objective of the scheme will be to improve the access of BPL families to quality medical care through an identified network of health care providers.

3.3. Water Security and Public Health Engineering Department

The Water Security and Public Health Engineering Department is required to take care of drinking water supply in all the Urban Towns of the State. Among the various water supply schemes, the following three schemes located in the two districts headquarters require immediate attention.

Up-Gradation of Namchi Water Supply scheme: Namchi is a south district town and the administrative centre for the District. At present, Namchi Water Supply is entirely dependent on Bermely water source which is 47 km away from Namchi. The existing Water Supply was commissioned in 1989. Due to excessive rusting of pipes and leakages, water is not being delivered with full force.

The Over-hauling of the Lower Changay Source for Gyalshing Water Supply: One source of the Gyalshing water supply is lower Changay. It was commissioned in the year 1975. The line being very old, there is frequent disruption in the water supply. The entire pipe line needs to be replaced with a new one.

The Overhauling of the Rabdentse Water Supply Scheme, Gyalshing: Rabdentse water supply scheme for Gyalshing was commissioned in 1967. Its source is at upper Changay. There are innumerable leakages in the pipe line due to 'deformed' and rusted pipes. At present, there is shortage of drinking water due to the growing demand of water at Pelling and Gyalshing. The over-hauling of the Rabdentse Water Supply Scheme will help to increase water supply.

The above schemes are vital for the augmentation of drinking water supply in two districts of South and West.

4. Up-gradation of Economic Services

4.1 Tourism Sector

The thumb-shaped Sikkim State is a land endowed with magnificent mountains, rich culture and pristine environment. It offers the magical feel of a Himalayan fairytale land with its amazing hidden valleys, snow-fed lakes and a mountain setting covered with flowers, forests and mystical monasteries. It is pristine, tranquil and peaceful. Being one of the 26 bio-diversity "hot spots" of the world, Sikkim is a veritable treasure house of some of the world's most beautiful streams, lakes and waterfalls. The State has rich flora and fauna despite having only 0.22% land of the country. Mt. Khangchendzonga (8598 metres) is the third highest peak in the world and dominates the landscape of Sikkim. Altitude in the State ranges from 253 metres above sea level in South Sikkim to 8598 metres above sea level in the North. As a result, climate of Sikkim varies from place to place. The topography of Sikkim does limit the scale of human intervention to better the standard of living in the State.

Having realized that '**Tourism**' is a major engine of economic growth, employment generator and poverty alleviator; the Government of Sikkim has given special recognition to tourism as the thrust sector for marketing of its beautiful products of nature. **Certain priority sectors which need grants from the Thirteenth Finance Commission to popularize nature- tourism are presented below:**

Passenger Ropeway from Dodak to Barsey Rhododendron Sanctuary:

The Rhododendron Sanctuary has become one of the most important eco-tourism destinations in Sikkim. Though the Department has constructed trekking routes with the minimum required way-side amenities to connect Barsey and Hilley to Hee-Gaon, it is important to develop the site as a highly attractive tourist spot by connecting Dodak (Burikhop) to Barsey with a modern cable-car facility. Given the difference of 1300 mts in the vertical elevation between Dodak (Burikhop) and Barsey, this will entail approximately 2500 mts of ropeway. It is proposed to have a Bi-cable Ropeway System for transportation of passengers. This would be a very useful infrastructural development to promote tourism in the State.

Nature Interpretation Centre, Eco-Lodge, Meditation Centre and Crafts Village

Ravangla has been one of the favorite eco-tourism destinations in Sikkim and the inflow of both domestic and foreign tourists has been constantly on the rise. For further development of this place, the State Government has decided to develop ‘Cho Dzo’ Lake with various centers for the benefit of the tourists. These include (a) Nature Interpretation Centre, (b) Crafts Village and Eco-lodge and (c) Meditation Centre etc. at Ravangla. With the development of the above centres and further schemes in the project on a total built up area of 21,000 sq. ft., Ravangla is going to become a landmark tourist destination in the State.

Promotion and Development of Village and Eco-tourism

As a showcase of nature-tourism, Sikkim is the most favored destination given its exotic biosphere reserves, rich environmental and cultural diversity. As the State is blessed with immense natural endowments like magnificent high mountain ranges, snowy peaks, picturesque landscape, biological wealth, and amazing natural foliage, it possesses great potential to be known as the world’s ultimate eco-tourism destination. Rapid industrialization, the fast pace of development and stress of urban lifestyles has led to a “counter urbanization” syndrome. This manifests in a new found interest for ‘untouched’ rural areas. The villages of Sikkim offer the perfect ambience which ensures that the ‘urban weary’ tourists are physically invigorated, mentally rejuvenated, culturally enriched and also spiritually ‘elevated’. Sikkim plans to use the direct and multiplier effects of tourism for employment generation and socio-economic development of the villages. This will help in preserving the cultural heritage, encouraging the promotion of tribal and local crafts, facilitating the growth of social justice and improving the overall environment of the village. A few of villages in the State such as Kewzing, Assam Lingzey, Lachen etc. are already accruing benefits under the concept of village tourism by promoting ‘home stay facility’. The project aims at providing basic tourism facilities which would include improvement of the surroundings of the village such as development of parks, landscaping, fencing, improvement of connectivity and walkways, tourist accommodation (such as village guest house and home-stay facilities) , illuminations in the village, parking yards, reception and information centers etc.

Hydro-Tourism with River Course Development

Hydro-tourism along the river course of Tista and Rangit River forms apart and parcel of nature and adventure-tourism in Sikkim. The Tista River originates from a Glacial Lake of extreme northern Sikkim and is an important tributary of the mighty Ganga. The sparkling Rangit River flows from the west to the south of the State and merges with Tista at Triveni. Both these rivers will definitely help in bringing about a vibrant river tourism support for the State. This would help the State to be positioned as a much sought after global brand in the burgeoning tourism trade by harnessing the vast untapped raw water potential of the State.

Snow Tourism Infrastructure at Lachen Village

Lachen, a village of Northern Sikkim (120 km from Gangtok) is located at an altitude of about 9000 ft, en-route the Guru-Dongmar Lake. The sparkling stream Lachen-Chu (Tista) originates from Cholhamu Lake and meanders down the Lachen valley till it finally confluences with Lachung-Chu at Chungthang, about 27 km. downstream. A beautiful monastery, perched on the imposing hill above the valley, offers a bird’s eye view of the entire habitation below. The place is extremely spectacular especially during the cold winter when the entire village is covered under a white blanket of snow. In view of its prime tourism potential and the snowy terrain, Lachen valley can be developed into a winter resort for snow tourism. This will provide a unique and distinctive experience to the tourists by giving them adequate accommodation in a typical ‘Igloo Home’ with facilities at par with international standards.

Wetland Tourism

The Guru-Dongmar Lake, nestled like a jewel amidst snow-crested peaks is one of the most important tourist spots in Sikkim. It is one of the highest tourist spots of the State with an altitude of 17,800 ft and is regarded as a sacred place as its water is considered to be‘*Amrit*’, possessing amazing healing powers and curative properties. The Guru-Dongmar Lake has enormous potential to be an independent tourist destination for the purpose of pilgrimage, nature and adventure tourism. The other places of tourist attraction en-route to Guru-Dongmar are Lachen, Thangu and Cho-Lhamu Lake. The tourists visiting Guru-Dongmar Lake are required to make a halt for a day or two at Lachen (9000 ft.) or Thangu (14,000 ft.) for the purpose of acclimatization or else may suffer from acute mountain sickness. Tourism Department has constructed a Tourist Lodge at Chopta Valley, 1.00km beyond Thangu, which is being extensively used by the tourists on their trek towards Guru-Dongmar or the Green Lake.

Neh as a tourist destination

Neh, a village of South Sikkim, is located at the foothill of Bhaley Dhunga. It is 55 km from the capital town of Gangtok and in close proximity to Yangyang village. It is a place of immense natural beauty and is situated at an altitude of 4500 ft, above sea level

The purpose of promoting Neh as a major tourist destination is to provide a link to the other tourist destinations so that a fair connectivity exists between different tourist destinations in Sikkim. The hilltop of Bhaley Dungha (10200 feet) is the main tourist attraction of Neh. Bhaley Dunga remains under the cover of snow during the winter season. In view of its tremendous tourism potential, the State Government has already taken affirmative steps to connect this hilltop with an attractive passenger ropeway to Dhappar, near Yangyang.

This project will include works like building Eco-tourist huts, Open-Air Theatre, Eco-Park, Walkways, Gazebo, Traditional House type Cafeteria, development of village life styles, proper drainage, and Signage and Community hall for cultural shows. The software component of this project comprises of the capacity building program for facility providers, awareness campaign in handling tourists and tourist related business.

Skywalk at Hill-top

The Bhaley Dhunga hill (10200 feet) which majestically towers over Yangyang village (4500 feet) is a favourite tourist spot of south Sikkim. Located at a distance of 55 km. from Gangtok, it is a paradise for nature lovers with fascinating scenic grandeur and is also a place of worship for the pilgrims. With the installation of the proposed Sky walk, the Bhaley Dhunga will be the focus of tourist attraction in the State. The cantilever sky walk, which will balance on the hill-top through its counterweight, will take advantage of the vertical rocky face of the mountain. It will be a breathtaking experience to walk 100 feet over the transparent glass overlooking the skies below. The proposal is expected to transform the entire region into an unmatched, independent tourist destination in southern Sikkim. The project would be beneficial as it would provide economic upliftment because of increased employment opportunities.

Darap Trekking Sites

Darap is a quiet village of west Sikkim, along the Pelling-Rimbi road. Most of the tourists opt for trekking to Goechala, Dzongri Base Camp and the Singhalila trail - the designated popular trekking trails of the State. Other places of tourist interest in this district are Kecheodpalri Lake, Dubdi Monastry (oldest monastery in Sikkim), Tashiding monastery and Melli-Aching monastery. Darap being centrally located, tourists have to invariably pass through this village to reach other destinations located in west Sikkim. In view of the rising demand for tourist accommodation in this village, one of the main objectives of this project is to construct tourist guest houses along with the creation of adequate home stay facilities. It is also proposed to construct an amphitheatre where traditional cultural shows can be hosted for the entertainment of the visitors.

4.2. Forest, Environment and Wildlife Management Department

The forest of Sikkim can be classified into five major types on the basis of altitude & composition:

Height above sea level	Type of vegetation
Up to 900m	Tropical Semi-Deciduous and Tropical wet forest. Most of the lower southern valleys fall into this category
900-1,800 m	Tropical Moist Forest or Broad-leaved Forests
1,800-2,800 m	Temperate Broad-leaved Forests
2,800-3800 m	Temperate Coniferous and Broad leaved Forests
3,800 – 4,500 m	Sub-Alpine Vegetation
4,500 – 5500 m	the High Altitude Desert

The State Government has throughout followed a conservation-oriented forest policy which emphasizes the preservation of the biodiversity of the forest areas and imposes a ban on commercial exploitation of forest resources of the State. This has been done by demarcating 'Protected Areas' comprising 32% of the geographical area of the State, imposing a ban on green felling above 1000 m altitude, ban on grazing in reserved forest areas, ban on collection of non-timber forest produce for commercialization, free distribution of LPG cylinders to people living in the vicinity of forests, participatory forest management and the launching of the State Green Mission. These are some of the notable steps taken by the State Government to preserve ecological balance and environment security by bringing about moderation in the regional climate.

A report on Forest Resources of East and South Districts of Sikkim was published by the Forest Survey of India in 1988, and for the West and South Districts in 2001. The forest cover and, therefore, the wood content of Sikkim's forests have increased from 1988 to 2001. As a consequence of the conservation policy of the State, the expenditure incurred for forest protection is very high. The average area of patrolling by a forest guard is one guard per 4 sq km. By this norm, the State Forest Department in Sikkim should have about 800 Forest Guards. The expenditure on deployment of guards would be about Rs. 6.00 crores per annum apart from the cost of maintaining infrastructure for uniform, housing, mobility and communication.

As one of the ToR of the Thirteenth Finance Commission is to take note of the environmental aspects while sanctioning grants, Sikkim gets a high claimant status for its proposed forest preservation measures.

Establishment of Institute for the Protection of Environment

The proposed Institute for the Protection of Environment will be located at the Pangthang Nursery Area (East Sikkim). This institute will undertake research studies to analyse the pattern of snow accumulation and its melting as this is important for the appropriate utilization of this Himalayan water resource. Observing the glacial advancement and recession is also important as it can assist in identifying and thus, help in mitigating mountain disasters so as to safeguard the livelihoods of vulnerable mountain people and their downstream neighbors**.** The Institutes will provide important facilities to conduct baseline survey of the current physical status of the Himalayas, glaciers, water bodies, lakes, and the flora and fauna. The Centre will affiliate with the other Universities in the country for research work on various factors leading to deterioration of the Himalayas and its surrounding landscape. The collaborative work on research and capacity building for the younger generation shall be promoted through various International Organizations.

4.3. Rural Management and Development Department.

With the intention of the Government to promote *Rural and Religious Tourism* it is proposed to have the following infrastructural developments in the State:

Circular Road around Chardham

Construction of Pilgrimage-cum-Culture Centre at Solophok (Namchi) in South Sikkim as a unique Pilgrim Centre, with a 108 feet tall statue of Lord Shiva on the hilltop at Solophok. Besides having a tall Shiva statue, this Pilgrim Centre will also have replicas of the twelve Jyotirlingas for Lord Shiva's devotees. It is believed that Lord Shiva incarnated as Kirateshwar in Indrakeel (present Sikkim). Therefore, in this hunter incarnation, he is locally worshipped by the people of Sikkim as Lord Kirateshwar. A18 feet high statue of Lord Kirateshwar has also been included as part of the complex. This is going to be a major centre for pilgrims and tourists visiting Sikkim. It will promote religious and general tourism, and will provide immense income generation avenues and opportunities through the economic spin-off. The construction work of this project has been going on continuously since May 2005. It is proposed to further extend this road and make it a circular road with one way traffic. This road will extend down from Solophok to Namchi–Assangthang road and its length will be about 4 kms. It is also proposed to construct a footpath alongside this road for the pilgrims who want to travel on foot for the *darshan*. This footpath will be provided with Kota stone or equivalent flooring and will have railings throughout its length. Alongside this footpath, the State Government will set various amenities necessary for the pilgrims such as drinking water, sanitation, resting sheds and statues of various gods and goddesses.

Suspension Foot Bridges in the North District

The rural foot bridges (suspension type) were constructed decades ago for rural connectivity of different villages at remote places in backward areas. For the convenience of the common man, school-going children and sick people going to hospitals, the Government of Sikkim started constructing rural suspension foot bridges at various places in the State so that people could have easy accessibility to various facilities. Due to paucity of funds and the high demand for such bridges, timber and bamboo were extensively utilized for the construction for these bridges till 1999. These were the easily available local materials in the North District of Sikkim. It is now proposed to replace these timber suspension foot bridges with steel bridges. There are a total of 71existing bridges which have to be repaired, with a total length of 3894.35 mtr**.**

4.4 Animal Husbandry, Livestock & Veterinary Services.

4.4.1. Construction of Hygienic Slaughter House at Namchi and Geyzing

To meet the growing demand for meat, large numbers of animals are brought from outside the State. It is estimated that 70% of the total meat produced in the State comes from unregistered slaughter houses thus exposing the meat to pathogenic bacteria and risking the health of the consumers. In order to produce wholesome meat under hygienic conditions, it is essential to have a hygienic slaughter house. The Government proposes to establish two modern slaughter houses (abattoirs). These will be set up at Geyzing & Namchi in the West & South Districts of Sikkim and will have an installed capacity of 20 & 30 heads of large animals per day, respectively. This will also yield by-products like skin hide, hooves, horns, blood, and bones that can be effectively utilized in the manufacture of various other products.

The above proposals for up-gradation of administration and the special problems of Sikkim are presented here to give a bird's eye view of the issues involved in this hilly State of India. While the details of all these issues have been submitted in a separate volume[17], a summary of all the costs for the above services to be provided by the State are given in Table 9.1.

4.5 Horticulture and Cash Crops Development

Agriculture/ Horticulture is the main occupation of the people of the State. In 1991, there were 1.11 lakh cultivators (66.16 percent). Important commercial crops grown are large cardamom, Sikkim mandarin orange and apple.

Proposal on Rejuvenation of Large Cardamom

The cultivation of large cardamom, the main cash crop of Sikkim, is facing many problems due to the existence of old plantations, drought, reduced crop vigor, unrestricted movement of planting materials within the State, the lack of intra-State quarantine for pests and diseases and the continuous cropping pattern. Therefore, to revive the cardamom crop industry in Sikkim, it is proposed to take up a programme of 'Rejuvenation of Large Cardamom'. To rejuvenate cultivation of large cardamom, the department will need to establish 25 small nurseries to produce disease-free planting materials in the private sector and also take up re-plantation in a phased manner. This re-plantation scheme will start by the beginning of the second year of the scheme when the first batch of multiple suckers will be ready for distribution.

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[17] See for details, Government of Sikkim, *Up-Gradation of Administration and Special Problems of Sikkim, Vol. V,* Memorandum submitted to the Thirteenth Finance Commission.

Proposal for Orange Rejuvenation Programme

Mandarin Orange is the most important commercial fruit of the State. It is cultivated on an area of 5600 hectares, with an average yield of less than 2 tons per hectare. The productivity and the citrus content has been continuously declining. Hence, to overcome these problems, the State government (with the help of the Central Government) initiated the orange rejuvenation programme in different orange growing belts of the State. Here all the scientific practices are being followed and as a result, the old orchards are now giving a better yield of oranges. Now the State government proposes to rejuvenate the (deleted) orange orchards of the State, covering 650 Hectares. Under the proposed project, this rejuvenation programme will be implemented continuously (for at least 3 years) in the same orchards and assistance to the farmers will be provided as a complete package with replanting/gap filling, appropriate nutrition, plant health measures and scientific know-how.

Project for Development of Apple Industry at Lachung and Lachen Valley

Since apple cultivation is predominantly labor intensive and mainly confined to small and marginal farmers, it offers immense scope for employment generation in the rural areas apart from improving the income level and nutritional standard of the masses. In this context, the Horticulture and Cash Crops Development Department (deleted) is planning to implement a project for the development of the apple industry at Lachung Valley and Lachen valley. The project will help in the growing of the apple variety that serves as an important raw material for production of apple juice, jam and jelly. The proposed project will include improvement of infrastructure, introduction of scab resistant varieties with high yielding potential, high-tech package of practices of cultivation, post-harvest management, and market network and technology for the multiplication of quality planting materials.

Establishment of an Integrated Floriculture Development Centre

Organic farming and floriculture are the two important pillars of the rural economy of Sikkim. Flowers commercially promoted in the State are Cymbidium orchid, rose, lilium, anthurium and alstroemeria. At present, the total area under different flowers is 135 Ha producing gladiolus, lilium and other traditional flowers. To bring about rapid and sustainable development of floriculture in the State, the Horticulture and Cash Crops Development Department has adopted a multi-pronged approach. First, for the production of quality planting materials, the department has established a tissue culture laboratory and cold storage facility. Four more tissue culture laboratories have been set up in the private sector with the support of the Government of India. Cymbidium is the most important flower of the State. Therefore, the Cymbidium Development Centre has been set up at Rumtek with a small tissue culture lab, a training hall, poly-green houses and a pre-hardening unit. A state- of-the-art tissue culture laboratory; training hall with ultra modern training facilities for capacity building; pre-cooling and cold storage facilities, and an integrated consolidation centre for collection, grading, processing and packaging of flowers will be the main features of this centre. For the development of floriculture, a four-acre land for the setting up of this model farm has already been identified at Maniram, South Sikkim. This will function as an Integrated Floriculture Development Centre

Table 9.1: Estimates of Grant Expenditure for Up-gradation of Administration Special Problems and Specific Needs of Sikkim

(Rs. in crores)

Sl.No.	Name of Department/Sector	Amount
1	***Introduction.***	
2	***Upgradation of General Administrative Services***	
2.1	***Police Administration***	*Not estimated*
2.2	***Human Resource Development Department***	***550.00***
2.2.1	*Establishment of District Institute of Education and Training (Diet)*	*50.00*
2.2.2	*Infrastructure Development for Replacement of Old Schools*	*100.00*
2.2.3	*Up gradation and Improvement of Playfield*	*100.00*
2.2.4	*Increase in the Number of Colleges*	*300.00*
2.3	***Public Works Department***	***135.00***
2.3.1	*Construction of Secretariat building at Raj Bhawan at Gangtok, East Sikkim*	*15.00*
2.3.2	*Construction of Secretariat Annexe Building at Tashiling Complex, Gangtok, East Sikkim*	*120.00*
2.4	***Up-gradation and Special Problem Grant under Urban Development***	***128.90***
2.4.1	*Drainage*	*2.50*
2.4.2	*Construction of Toilets*	*1.25*
2.4.3	*Hatsheds*	*8.65*
2.4.4	*Maintenance*	*7.50*
2.4.5	*Up-gradation of Towns*	*5.00*
2.4.6	*Garbage Disposal*	*2.50*
2.4.7	*Computerisation*	*1.00*
2.4.8	*Public Awareness Campaign*	*0.50*
2.4.9	*Multi-storey Parking Plazas at Mangan, Gyalshing and Namchi*	*42.60*
2.4.10	*Development of Sokeythang to create- Library, Habitat Centre Community Center , State Children Park etc.*	*57.40*
2.5	***Capacity Building for Administration and Fiscal Reforms***	***17.00***
2.5.1	*Establishment of State Capacity Building Institute*	*10.00*

Sl.No.	Name of Department/Sector	Amount
2.5.2	*Staff Training for Better Expenditure Management*	*Not estimated*
2.5.3	*E-Governance*	*7.00*
3	***Up-gradation of Social and Cultural Services***	
3.1	***Conservation of Heritage and Culture of Sikkim***	***8.60***
3.1.1	*Restoration/Preservation of Monasteries and Mandirs*	*2.50*
3.1.2	*Documentation of the Intangible Heritage of the State*	*0.50*
3.1.3	*Up-Gradation of Museum*	*0.50*
3.1.4	*Up- Gradation of Archives*	*1.00*
3.1.5	*Preservation/Restoration of Tradition Houses*	*0.80*
3.1.6	*Preservation/Restoration of Historical Buildings*	*1.00*
3.1.7	*Preservation/Restoration of Chorten, Mendangs and Mani Lakhang*	*0.40*
3.1.8	*Preservation of Devithans And Pilgrimage Centers*	*0.60*
3.1.9	*Preservation of Sacred Caves, Water Bodies and Hermitages:*	*0.50*
3.1.10	*Revival of Traditional Arts and Crafts*	*0.30*
3.1.11	*Restoration/Preservation of Various Ruins in the State*	*0.50*
3.2	***Health Care, Human Service and Family Welfare Department***	***218.31***
3.2.1	*Upgradation of the Sir Thutob Namgyal Memorial Hospital into a 500-Bed Multi- specialty Hospital*	*203.31*
3.2.2	*Health Insurance Scheme for BPL Families of Sikkim.*	*15.00*
3.3	***Water Security and Public Health Engineering Department***	***20.82***
3.3.1.	*Up-Gradation of Namchi Water Supply scheme*	*17.42*
3.3.2	*Over-hauling of Lower Changay Source for Gyalshing Water Supply*	*1.18*
3.3.3.	*Overhauling of Rabdentse Water Supply Scheme, Gyalshing*	*2.22*
4	***Up-gradation of Economic Services***	
4.1	***Promotion of Tourism***	***560.90***
4.1.1	*Passenger ropeway from Dodak to Barsey Rhododendron sanctuary in West Sikkim*	*18.00*
4.1.2	*Nature interpretation centre, Eco-lodge, meditation centre and crafts village at Cho-Dzo, Ravangla*	*4.90*

Sl.No.	Name of Department/Sector	Amount
4.1.3	*Eco-tourism: Village or Rural Tourism*	*100.00*
4.1.4	*Creation of hydro-tourism with river course development project the on along Tista and Rangit rivers*	*200.00*
4.1.5	*Complete tourism infrastructure at Lachen village (Snow Tourism)*	*20.00*
4.1.6.	*Development of Guru-Dongmar wetland tourism as an international tourist destination.*	*10.00*
4.1.7	*Development of Neh, South District, as a tourist destination.*	*5.00*
4.1.8	*Construction of Skywalk at Bhaley Dhunga Yangyang*	*200.00*
4.1.9	*Construction of Village tourism at Darap, West Sikkim*	*3.00*
4.2	***Forest, Environment and Wildlife Management Department***	***15.50***
4.2.1	*Conservation Oriented Forest Policy*	*5.50*
4.2.2	*Establishment Of Institute For Protection Of Environment (Water Bodies, Glacier, Melting Snow, Research And Skill Upgradation Training Centre*	*10.00*
4.3	***Rural Management and Development Department.***	***50.05***
4.3.1.	*Circular Road Around Chardham at Solophok, Namchi In South Sikkim.*	*15.00*
4.3.2.	*Repair/ Renovation of 71 Suspension Foot Bridges under North District*	*35.05*
4.4	***Animal Husbandry, Livestock & Veterinary Services***	***10.14***
4.4.1	*Construction of most hygienic slaughter house at Gyalshing*	*4.36*
4.4.2	*Construction of most hygienic slaughter house at Namchi*	*5.78*
4.5	***Agriculture/ Horticulture***	***12.07***
4.5.1	*Rejuvenation of Cardamom*	*2.33*
4.5.2	*Rejuvenation of Mandarin Orange*	*1.72*
4.5.3	*Rejuvenation of Lachen/ Lachung Apple*	*2.49*
4.5.4	*Establishment of Floriculture Research Study Centre including Tissue Culture, Marketing, Cold Storage, Pre-Hardening & Hardening*	*5.53*

CHAPTER 10

AND THE STATE OF SIKKIM URGES…….

The State of Sikkim welcomes the appointment of the Thirteenth Finance Commission (TFC) and eagerly looks forward to its deliberations with the hope that the Commission will be able to design a more rational revenue transfer system and bring about a national consensus for a fair and balanced fiscal federalism in the country.

The Approach for Macro Aspects

The State of Sikkim is of the view that *at the macro level*, in addition to making recommendations on the aspects included in its Terms of Reference (ToR), the Thirteenth Finance Commission should pay special attention to the overall Centre–State financial flows. The TFC should, therefore, put focus on the following aspects:

- The share of the States in Central revenues is restricted to just 30.5 percent. The Eleventh Finance Commission and the Twelfth Finance Commission have not brought any substantial improvement in the Tenth Finance Commission’s recommendation of 29 percent share in the overall divisible pool of Central tax revenue. The share of the States was only marginally increased. Given the various functions of the States, the States’ share in the divisible pool of taxes must be increased considerably.
- The gap filling approach for giving grants under Article 275(1) is confronted with the in-built flaw of not distinguishing between the fiscally imprudent and the fiscally disadvantaged States. This approach has a built-in incentive for the backward States to continue lagging behind the other better off States as they are cross subsidized by the latter.
- Based on the elaborate procedures laid down by the Planning Commission, the overly centralized planning process for the States is too rigid and counterproductive. The States are unable to reflect their regional priorities in the plan. Also, it puts a premium on fresh capital formation and leads to the corresponding neglect of maintenance of existing assets, even though the latter yields much greater returns for every rupee invested.
- The arena of Centrally Sponsored Schemes (CSS) in the planning process is too inflexible in design and does not reflect grass root priorities and constraints. Also, the related release and monitoring procedures set up by the Union Ministries is tedious and often results in delays. There is no provision for the release of advance funds in most ongoing schemes.

The State of Sikkim strongly urges the TFC to give due consideration to the above aspects as these are crucial for the very fabric of fiscal federalism in India.

Micro Issues at Cross Roads

***At the micro level*, in the context of the State of Sikkim, the recommendation that the Commission should adopt the population figures of 1971 in all cases where population is**

regarded as a factor for determination of devolution of taxes and duties and grants-in-aid needs to be modified and used in conjunction with some other determinant variables of tax devolution. The State Government, while appreciating the objective underlying such a stipulation, would like to reiterate its earlier stand made to the previous Finance Commissions that such a condition is opposed to the provision under Article 275 of the Constitution where it is clear that such grants must also be given to the States which are in need of assistance. Such a need of assistance cannot be based on the three decades old population figures but must be based on the current population figures for the period for which the grant is being made available.

Population of 1971 not Error Free for Sikkim

In the case of Sikkim, the population figures of 1971 Census cannot be considered error free. This is because the State had not become part of the Union at that time. Also, the Census operations in 1971 in Sikkim did not conform to the rigours and refinements laid out for the rest of the country in the decennial census operation. Prior to 1971, the growth of population in Sikkim was lower than that of India. However, after joining the Indian Union in 1975, Sikkim's population has grown at a higher rate than the average growth rate of the country as a whole due to the influx of people from other parts of the country. The expansion in the population of Sikkim during this short period was abnormally high. According to the 1981 Census, the growth of population in Sikkim over the decade was over 50%. However, after 1981, population grew at a significantly lower rate as the State Government undertook family planning measures vigorously and also adopted stringent measures to contain the influx. In this regard, the Commission should take note of the National Policy Resolution on population of 29th June 1977, where it was *inter-alia* stated that "**in all cases where population is a factor as in the allocation of Central assistance to State Plans, devolution of taxes and duties and grant-in-aid, population figures of 1971 will continue to be followed till the year 2001**".

In the past, previous Finance Commissions have adopted 1981 and 1991 Census population figures along with 1971 Census population figures for different purposes. For instance, the population figures of the latest census available were adopted for distribution of grants for additional duties of excise in lieu of sales tax on tobacco, sugar and textiles by the previous Finance Commissions. The Tenth Finance Commission used 1991 census population figures for the purposes of *ad hoc* grants for local bodies and additional excise duties. **The State of Sikkim, therefore, requests the Commission to earnestly consider the adoption of the latest 2001 Census population figures** instead of the three decades old population figure of 1971 Census as during these three decades (1971-2001) Sikkim's population has increased by 157.57 percent, *i.e.* more than doubled. By the time the recommendations of the Thirteenth Finance Commission become effective, the figures from Census 2011 may also be available.

To empirically highlight the adverse impact of taking 1971 population figures for Sikkim, we take the award of the Twelfth Finance Commission for the State of Sikkim. According to the 1971 census, the share of Sikkim's population was 0.0383 as against 0.0534 in 2001. If population of 2001 is taken as the base, the additional share allocated to Sikkim will be 0.0151[18].

[18] See for population table, Government of India (2008), *Economic Survey*, Ministry of Finance, New Delhi, last page.

Now if we apply this criteria to the award of the Twelfth Finance Commission, its total tax devolution was Rs 613112 crore[19] of which 25 percent (*i.e.* Rs 153278 crore) was on the basis of population. Sikkim's share from the Twelfth Finance Commission is Rs 1392.94 crore; hence, by using 2001 population in place of 1971 population, Sikkim may get 1.66% more than what it actually got from the Twelfth Finance Commission. This will tantamount to be getting an additional sum of Rs 23.14 crore (0.0151 percent of Rs 153278 crore) *i.e.*1416.08 crore.

A Way Out

Given the above peculiar circumstances, in case it is not possible to make allocations as per the 2001 Census, the State Government would like to urge the Commission to reconsider the concessional measures and provide *adhoc* additional assistance to the Sikkim State to compensate for the loss that it would incur from the adoption of 1971 Census figures for the purpose of devolution of the State's share of taxes and Grants-in-aid.

Devolution of Share of Central Taxes

The Government of Sikkim opines that the devolution of taxes has two facets: the taxes that should be shared and the quantum of share from the pool.

All Taxes to be the Part of the Divisible Pool

Various Finance Commissions, including the Tenth and Eleventh Finance Commissions, have observed that surcharges/cesses should not be levied by the Centre except to meet emergent requirements. This must be done only for limited periods and this source should not be resorted to as a normal revenue raising measure to fill the budgetary gaps. Still, the Centre has raised revenue through this measure for longer periods. **The Government of Sikkim is, therefore, of the view that surcharges/cesses should be treated as a normal source of revenue and be made a part of the sharable kitty.**

In the context of the magnitude of the share, the vertical transfer recommended by the Twelfth Finance Commission was 30.5 percent of shareable Union tax revenue. **The State Government suggests that the divisible pool should be increased to 40% of the divisible resources to be transferred to the States** and the bulk of the transfer should be through tax sharing. This is essential in view of the increasing responsibilities of the States to incur development expenditure and to meet other commitments. Above all, **the States need larger resources to implement second generation reforms in the social and infrastructural sectors.** Hence, there is logical justification for raising the share of States to 40% from 30.5%.

Special Allocation for Special Category States

In the *inter-se* distribution of shareable Union taxes amongst the States, a certain percentage must be earmarked for the Special Category States. This will help the disadvantaged States to be at par with a 'normal' State.

[19] See for Tax share data, Government of India (2004), *Report of the Finance Commission*, Ministry of Finance, Government of India, New Delhi, p.197.

Weights for *Inter-se Distribution*

Different weights have been used for different criteria by the earlier Finance Commissions. These relate to population, backwardness, per capital income, infrastructure index, fiscal self-reliance, tax effort, etc. As stated earlier, wherever population is to be used as a criteria, Sikkim should be treated as a special case for the simple reason that in 1971 it was a different entity. When Sikkim became the 22nd State of India in 1975, all the paraphernalia required in a State, *viz.* the Governor's Secretariat, High Court, State Legislative Assembly etc. had to be established involving recruitment of personnel etc. Hence, weightage assigned to the size of population needs to be redesigned. The State of Sikkim recommends the following weights and norms:

Criteria		***Norm***	***Weight***
1	Population		10%
2	Debt–GDSP Ratio		20%
3	Cost disability(i)	Area distance	5%
	(ii)	Cost of living standard	5%
	(iii)	Availability of facilities like road, rail & air link	10%
4	Availability of cultivable land in proportion to total Area of State		15%
5	Achievement in Administration Efficiency		15%
	(i)	Investment in human resource development and growth in literacy rate	
	(ii)	IMR & MMR in health sector	
	(iii)	Crime rate	
	(iv)	Maintenance of peace & tranquility efficiency	
6	Infrastructure distance		10%
7	Revenue Raising Capacity		10%

Sikkim – a Special Case for Grants

As a hill State confronted with a different set of problems, the State of Sikkim urges the Thirteenth Finance Commission to determine the State's fiscal requirements on more concessional terms.

The State is of the opinion that over the years, the efficiency based criteria hinged upon specific parameters, *viz.* tax effort, fiscal discipline, fiscal performance etc. This has been the guiding principle in determining devolution of Central taxes, allocation of grants to local bodies and in providing for debt relief. This formula is beneficial to developed States. However, Sikkim is a resource starved State which made a late entry into the national mainstream. It is a remote, land-locked and industrially backward State; for strategic reasons, Sikkim needs every consideration of the Commission to facilitate the growth of the State's economy through concessional dispensations. Stability, both economically as well as politically, in this strategically located State is conducive to national security**. It is, therefore, urged that the Commission take a sympathetic view while making its recommendations in respect of the State of Sikkim.** It is apparent that the State's own resources are almost negligible, constituting a mere 5-6 percent of the GSDP. Therefore, the State of Sikkim is almost entirely dependent on Central support.

Besides a good designed transfer mechanism, **there should be a realistic assessment of revenue gap for the award period of the Finance Commission. Determination of grant-in-aid is based on the assessment of the State's revenue and expenditure requirements computed** using the normative approach as adopted by the Ninth Finance Commission and followed thereafter, by the successive Finance Commissions. It is also dependent on the extent of the State's share in Central Taxes and Duties based on various principles adopted by the various Finance Commissions. The same methodology and principles have been used in determining the requirements of backward hill States and the developed States. However, the situations in both the categories of States are not only incomparable but also have wide variations. Given this backdrop, it is evident that generally revenues of hill States are overestimated and their expenditure requirements underestimated. The wide variations has put their fiscal health in such a bad shape that successive Finance Commissions as well as the Central Government, *viz.* Ministry of Finance and the Planning Commission, have been suggesting changes in the grants-in-aid. However, certain policy decisions have only helped to further aggravate the problem.

The Twelfth Finance Commission recommended grants-in-aid based on the assessment of the financial needs of the States for Post-devolution non-plan revenue deficit; Health sector; Education sector; Maintenance of roads & bridges; Maintenance of building; Maintenance of forests; Heritage conservation; State-specific needs; Local bodies, and Calamity relief. However, no fund has been earmarked under Health and Education sectors for the State of Sikkim.

Up-gradation and Special Problem Grants for Sikkim

It may be noted that the two recent Finance Commissions have adopted different approaches to sanction grants-in-aid. Twelfth Finance Commission did not provide any grant for up-gradation of education and health sectors. As a State specific problem, physical connectivity of Sikkim with the rest of the country is a critical issue and a matter of concern. Bagdogra is the only airport in the vicinity. There is a heli-service but this is quite uncertain due to the hostile weather conditions. In the event of any unrest at Bagdogra, the nearest airport, the State gets cut off from the rest of the country as the road connectivity is not good. Therefore, the State government has planned to construct an airport in the State. It sought an assistance of Rs.174 crore for this purpose based on the estimate and the Detailed Project Report (DPR) prepared by the Airport Authority of India (AAI). The Twelfth Finance Commission provided an amount of Rs.100 crore. Since then inflation has adversely affected the execution of this plan and the cost estimate has been revised by AAI to Rs. 359 crores; the work has not been accomplished. It is, therefore, requested that full grant for the completion of the work of the airport would enable the State to complete the job. In addition, landslides and the frequent *bandhs* in North Bengal block the movement of goods from the State to other parts of the country. This has discouraged many industrialists from making investments in the State. **To ease this problem, the necessity of having an alternative route to link the State with the rest of the Country is highly felt by the State Government.**

Grants to Local Bodies

The State of Sikkim is of the view that the term 'measures' in the ToR of the Thirteenth Finance Commission refers to both qualitative and quantitative measures. Incorporation of Art.280(3)(bb) and (c) is a clear recognition of the 'need' to supplement the resources of the Panchayats/Municipalities, on the one hand, and the 'inability' of the State governments to meet the entire additional financial burden imposed by successive State Finance Commissions, on the other.

The Government of Sikkim, therefore, urges that the Commission follows these sequential steps in recommending 'measures' for Panchayats & municipalities. At the outset, it must determine the aggregate size of the grant to the local bodies and also resolve the criterion for its inter-State allocation. **The Commission must then determine the need of the local bodies on the basis of acceptable criteria. The quantum of vertical transfer/ distribution to the local bodies should be attempted on the basis of the decentralization target based on local expenditure as a percentage of the total Government expenditure instead of an arbitrary per capita allocation based on the population figures of thirty seven years ago. Such expenditures of the local Government should be met from the Central tax revenue. Sharing of revenue amongst the States has to be done by earmarking a separate percentage from the expanding pool of Central taxes. This should be at least ten percent above the scheme of devolution proposed for the State. The share of each tier of local bodies should also be decided accordingly. Allocation of TFC Grant for specified purposes will be the next step for the TFC. For this purpose** the Government of Sikkim suggests that the criteria should be as follows:

i. 5% on the basis of creation of database on devolution of functions, powers, staff support and resources (including the Finance Commission's grants);
ii. 5% on the basis of maintenance of accounts by the Village-level Panchayats;
iii. 10% on the basis of incentive grants to States for effecting larger resource devolution to Panchayats which again have to be used by the States to provide incentive grants to Panchayats;
iv. 40% on the basis of special assistance to Panchayats in backward / difficult areas;
v. 20% on the basis of assistance for creation of physical infrastructure for the Panchayats;
vi. 20% on the basis of maintenance of basic civic services by the Panchayats.

For each of the above aspects, the Finance Commission may earmark its grant in percentage terms and make the inter-State allocation on an appropriate basis as per the suggested criteria. The Commission may consider a part of its grant for district-wise allocation in each State so as to ensure greater transparency of its grant.

Finally, the TFC should not lay down conditions for the eligibility of the States and Panchayats to the TFC grant. The Tenth Finance Commission suggested that the local bodies/State governments were required to provide matching resources. However, it is felt that in most cases where the Panchayats were required to make the matching contribution, the grant has remained either unutilized or underutilized. **It is suggested that the Thirteenth Finance Commission may also adopt the recommendation of the Eleventh and Twelfth Finance Commission where no condition was laid for matching contribution by the State. Also,** the grant recommended by the Finance Commission to the Panchayats & Municipalities should be 'untied'.

A Special Appeal to the TFC

While concerted efforts are being made by the State of Sikkim to contain and to further reduce the non-plan expenditure, the revenue projections will have to be made on a relatively lower base considering the erosion in the revenue generation front and the higher revenue expenditure on account of inflation, which is more pronounced in the hilly areas. Keeping these circumstances in view, the Commission is requested to reconsider and determine the State's fiscal requirements on more concessional terms.

Earnest Appeal for Debt Relief

Given this position of the State in terms of composition and magnitude of public debt, as well as State's inability for mobilizing market loans in the absence of softer Central loans, the Government of Sikkim earnestly requests the Thirteenth Finance Commission that a relief in terms of a subsidy be given to poor States like Sikkim. The *inter se* debt relief so granted should be based not only on population but other factors which demand more funds for development, *viz.* geographical conditions prevailing in States where the per unit cost of provision is pretty high as compared to the other Indian States . **A very special appeal is made to the Commission that the total loans taken by the Sikkim State Government for financing the State Plan, during the award period of Twelfth Finance Commission (2005-10), needs to be written off due to the 'unfavourable' nature of the award.**