15th Finance Commission Recommendations - States' Share

What is the issue?

- The 15th Finance Commission (FC) recently submitted its report with recommendations for 2021-26 period.
- The Finance panel has pushed conditional grants, but left other concerning issues untouched.

What is the FC recommendation in this regard?

- The 15th Finance Commission report has been quite conservative.
- It has not suggested major changes in the vertical and horizontal devolution of finances from the Centre to States.
- However, it moots a high ratio of incentive-linked grants (rightly linked to agriculture reform and health spend) to untied aid.
  - At about 25%, this amounts to a transfer of over Rs.10.3-lakh crore over 5 years till 2025-26.
- The untied transfers to States over this period, at 41% of the divisible pool of tax revenues (excluding cess and surcharge), are estimated to account for Rs.42.2-lakh crore.
- Significantly, the divisible pool for 2021-26 shrinks from Rs.135.2-lakh crore to Rs.103-lakh crore when cess, surcharge and cost of collection are left out.
- Disappointingly, the panel sidesteps the contentious issue of cess and surcharge.
  - It has only suggested that they should be transparently accounted for in the Budget.

What is the States' financial position?

- The key task before any finance panel is to strike the right balance between promoting nationwide reforms and honouring the fiscal autonomy of the States.
- The States account for 60% of total government expenditure of over Rs.60-lakh crore annually.
- For this, it relies on central transfers through taxes and grants to the extent of 35% or more (about Rs.11-lakh crore annually).
- This share has been climbing in view of the States' inability to mop up own revenues.

- On the other hand, the committed expenditures account for half the States' budgets.
- So, States end up borrowing to meet over 20% of their needs.

What are the other provisions and challenges?

- The 15th Finance Panel report has been released in unprecedented, pandemic times.
- The Central transfers to States have been under strain during these times.
- **Deficit** - In order to relieve the burden on States, the Finance panel has done well to continue with revenue deficit grants.
- The roadmap to bring revenue and fiscal deficit under control can be reset, as suggested by the panel and the Budget.
- **Revenue expenditures** are necessary to keep social sector schemes going.
- However, the panel lays down a stringent fiscal roadmap for States in this regard.
  - States should curb frivolous expenditure, such as loan waivers.
  - They can step up revenues from stamp duty and registration of property.
- The Economic Survey 2020-21 points to a "decline in actual capital spending relative to BE observed in the States for the last 3 years".
- This should be checked to ensure a return on higher levels of spending in these times.
- **Devolution** - Interestingly, the panel report moots two new criteria for horizontal devolution, even as income and population weights have been changed.
  - These are 'demographic performance' or fertility reduction and 'tax effort'.
- If this is an effort to reward governance in southern States, it has not worked so far; transfers to them did not improve in 2020-21.
- A persistent north-south divide will not serve the cause of cooperative federalism.

Source: Business Line