

# 15th Finance Commission's Interim Report

### Why in News?

The interim report of the 15th Finance Commission (FC) has been tabled in Parliament this budget session.

#### What is the Finance Commission?

- Article 280 of the Constitution of India provides for a quasi-judicial body, the Finance Commission.
- It is constituted by the President of India every fifth year or at such earlier time as he considers necessary.
- The recommendations made by the Finance Commission are only advisory in nature and hence, not binding on the government.
- The 15th Finance commission makes recommendations for the period of 2020-2025 (5 years).

#### How the devolution to the States is to be carried out?

- The report has largely preserved the devolution mathematics of its predecessor, belying concerns of a sizeable cut in States' share.
- (Devolution A process in which a central government of a country grants powers to sub-national governments).
- The report has recommended a **one percentage point reduction** in the vertical split of the divisible pool of tax revenues accruing to States to 41%.
- This follows the reorganisation of the erstwhile State of Jammu and Kashmir into the Union Territories of Jammu and Kashmir and Ladakh.
- The former State's notional share based on the parameters for horizontal devolution would have been about 0.85%.
- But, the FC has cited the security and other special needs of the two territories to enhance their aggregate share to 1%, which would be met by the Centre.

#### How the devolution to the local bodies is to be carried out?

• Urban local bodies, especially municipalities in cities with populations of more than one million, are set to get a larger share of the devolution.

- $\bullet$  There has been an increase in the percentage of outcome-tied funds from 10% to 50%
- This could prove vexing to the last mile providers of basic services in India's federal and highly fragmented structure of governance.

#### What is done to balance the financial needs?

- As part of an effort to balance the principles of fiscal needs, the following have been changed,
- 1. Equity and performance,
- 2. The need to ensure stability and predictability in transfers,
- 3. The criteria for the horizontal sharing of taxes among States.

### What is the new added parameter?

- The **demographic performance** is the new crucial parameter that has been added to the mix.
- The mandate to adopt the population data from the 2011 Census is the reason why the FC has incorporated this additional criterion.
- This will ensure that the States which have done well on demographic management are not unfairly disadvantaged.
- The norm has been assigned a 12.5% weight, as it indirectly evaluates performance on the human capital outcomes of education and health.
- This should address the concerns voiced by several States over the switch to the 2011 Census from the 1971 data.

## What does the report say about the tax system?

- Among the States, with the exception of Tamil Nadu, all the other four southern States see a reduction in the recommended share of taxes for the year 2020-21.
- Notably, the suggested devolution to Odisha and Uttar Pradesh has also shrunk in percentage terms.
- Crucially, the FC has flagged the issues dogging the GST as indirect taxes constitute almost half the total tax revenues of the Union.
- The **new tax has yet to stabilise** which leaves a majority of the States dependent on compensation from the Centre.

## What was the criticism the report made?

• The FC has also been justifiably critical of the Union and State governments' tendency to finance spending through off-budget

borrowings and via parastatals.

• It has done well to ask that such extra-budgetary liabilities be clearly earmarked and eliminated in a time-bound manner.

**Source: The Hindu** 

