

## Challenges ahead of 16th Finance Commission

### Why in news?

The Central Government is to setup 16<sup>th</sup> Finance Commission in 2023, to recommend revenue sharing between the Centre and States.

### What is 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.
- **15<sup>th</sup> Finance Commission** - It was constituted in 2017 by President under the chairmanship of **N.K.Singh**.
- **Tenure**- 5 years (2021-22 to 2025-26)
- **Vertical Devolution**- It is the devolution of taxes to the states by Union.
  - **41%** of the divisible pool is recommended (1% adjustment is made due to bifurcation of Jammu and Kashmir into Union Territories.
- **Horizontal Devolution**- It is devolution of taxes between states.
  - Demographic performance- 2.5%
  - Income-45%
  - Population and area- 15% each
  - Forest and ecology-10%
  - Tax and fiscal efforts-2.5%
- **Performance based incentives and grants to states**

Themes	Focus
Social sector	Health and education
Rural economy	Agriculture and maintenance of rural roads
Governance and administration	Judiciary, statistics, Aspirational districts and blocks
Power sector	Performance based incentive

- **Other grants provided**
  - Revenue deficit grants
  - State specific grants
  - Grant to local bodies
  - Disaster risk management

### **15<sup>th</sup> Finance Commission-**

- Centre's debt to GDP ratio is 58.7% and Fiscal Deficit to GDP ratio 9.2%
- There is a need to reduce States debt-GDP target to 20%.
- It recommended to re-examine the 2018 amendment to Fiscal Responsibility and Budget Management Act (FRBM).

### **What are the challenges ahead of 16<sup>th</sup> finance commission?**

- **Increase in cess and surcharge-** The effective share of States in the Centre's gross tax revenues (GTR) averaged close to 31% in 2020-21 to 2023-24 which was significantly lower than the corresponding share of nearly 35% during 2015-16 to 2019-20.
- This is due to inordinate increase in cess and surcharge from 12.8% in 2015 to 18.5% in 2020.
- **GST collection-** An issue of concern in recent years has been the poor performance of the Goods and Services Tax (GST) and the consequent decline in total divisible pool.
- GST collection in last 2 years have maintained good buoyancy, there is still a need to restructure GST to good and simple tax.
- **Income weightage-** Income distance criterion (45%) gives larger number of share to relatively lower income states, many rich states have argued to lower the weightage in the criterion.

### **What lies ahead?**

- **Set up Loan Council-** It is an independent body recommended in 12<sup>th</sup> finance commission to oversee the loan magnitude and profiles of the Central and State governments.
- **Subsidies-** The 16th Finance Commission should examine the subject of non-merit subsidies in detail.
- **Maintain State Fiscal Deficit-** The Finance Commission should be strict with states in maintaining Fiscal Deficit (FD) within limits.
- It can include fiscal performance of the states as a criterion in horizontal distribution.
- If the states exceed FD limit then act on the extent of the borrowing allowed for the states.
- **Scrutinise Cess and Surcharge-** Freeze the share of Cess and Surcharge to some base number.
- **Income criteria-** It may be useful to freeze the weight to income distance criterion at the current level (45%) or even reduce it to 40%.
- **Need of equalisation principle-** In the overall scheme of resource transfers there is a need to prioritise equalisation of education and health services provisions.

### **References**

1. [The Hindu| Chart path for 16<sup>th</sup> finance commission](#)
2. [PRS| Report of 15<sup>th</sup> finance commission](#)



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