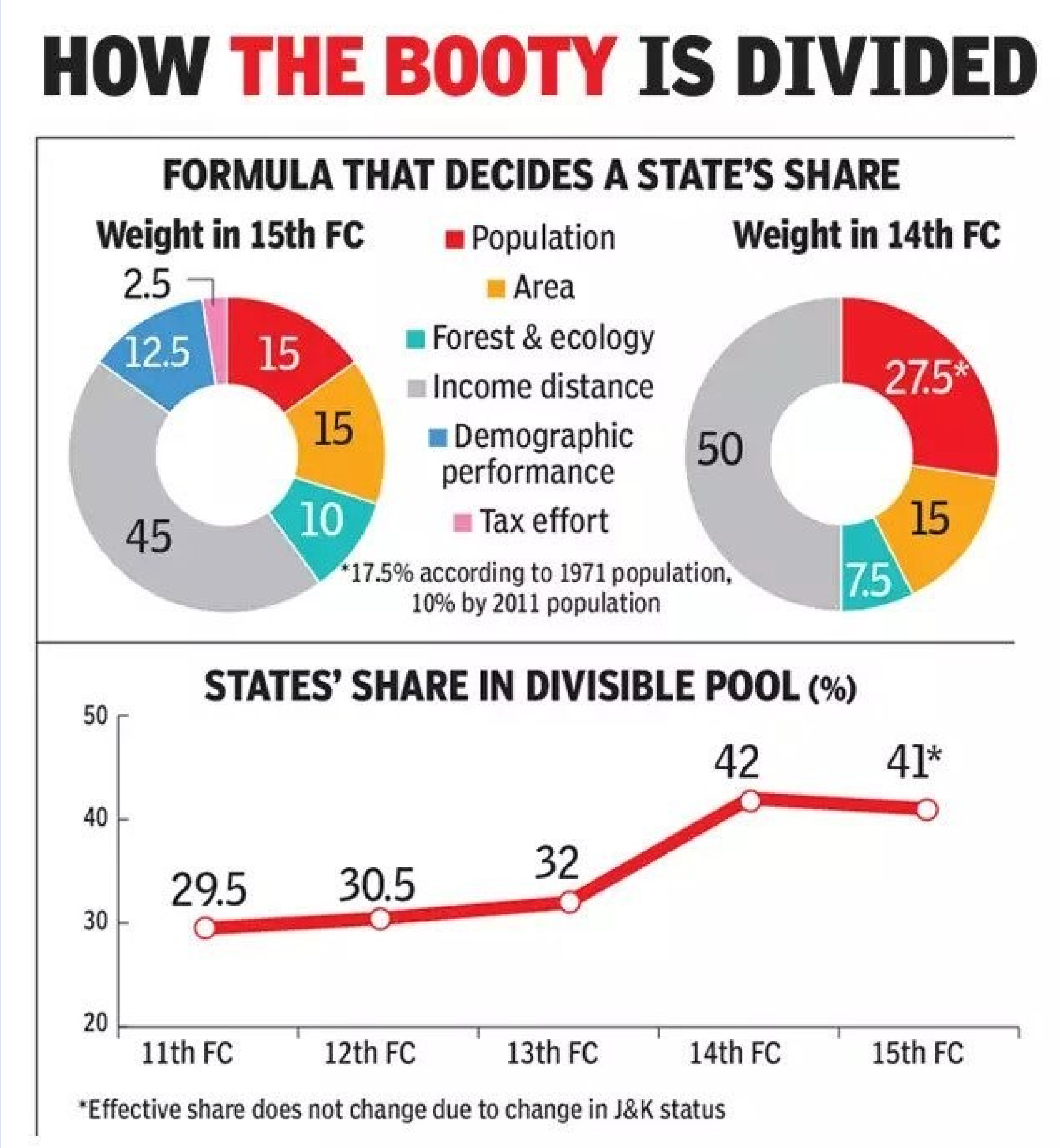
Revenue Sharing Between States

Why in news?

The revenue sharing by the Finance Commission between Centre and all the four Southern States have fallen over the last two decades.

Finance Commission

• **Constitutional body** -The Finance Commission is a constitutional body formed by the President of India to give suggestions on centre-state financial relations.
• **Autonomous body**- The Finance Commission (FC), an autonomous body which is governed by the government of India.
• **Article 280**-It was established by the ***President of India*** in 1951 under Article 280 of the Indian Constitution.
• **Role-** To define the financial relations between the central government of India and the individual state governments.
• **15th finance commission-** It was chaired by Mr. N. K. Singh which submitted the recommendations for 2021-26 period.
• **Key recommendations for 2021-26-** The share of states in the central taxes for the 2021-26 period is recommended to be 41%, same as that for 2020-21.
• This is less than the 42% share recommended by the 14th Finance Commission for 2015-20 period.
• The adjustment of 1% is to provide for the newly formed UTs of Jammu and Kashmir, and Ladakh from the resources of the centre.
• **Criteria for devolution**- Population (15%), Area (15%), Ecology and Forest (10%), Income Distance (45%), Demographic performance (12.5%) and Tax effort (2.5%).



Why southern States gets less revenue share from Centre?

- **Income distance-** This is the main criterion used to allocate the share of union taxes to each State, based on the gap between their per capita income and the highest per capita income among the States.
- The higher the income distance, the higher the share, this is fair as it reflects the principle of federalism and the need to redistribute wealth among the States.
- **Inequitable formula**- Population and area these two criteria have increased in weight over the years, and have resulted in a shift of revenue share towards larger and more populous States, such as Uttar Pradesh and West Bengal.
- **Area-** The weight given to area has doubled from 7.5% under 11th Finance Commission to 15% under the 15th Finance Commission, this tilts the scale in favour of States with large area, and is unfavourable to States such as Kerala which have a smaller area.
- **Population**- It was just 10% under the 11th Finance Commission (2000-05), increased sharply to 25% by the 12th Finance Commission (2005-10).
- The 15th Finance Commission has given a lower 15% weight to the population and 12.5% weight to demographic performance.
- **Demographic performance**- The formula for calculating the weight for demographic performance inverses the TFR and multiplies it by the population in 1971. This results in higher weight once again going to more populous states such as Uttar Pradesh and West Bengal.

Demographic performance is calculated by looking at the TFR (total fertility rate, which captures number of children born to each woman) of States and is intended to reward States which have controlled growth in population.

- **Penalize States-**This formula is unfair as it penalizes States that have smaller area or have controlled their population growth, such as Kerala.
- **Reduced weightage**- The criteria "demographic performance" and "fiscal discipline" have been reduced in weight by the 15th finance commission, they are meant to reward States that have lower fertility rates or better fiscal management.
- **South's loss**- The changing weight in the devolution formula have hurt the southern states more, as they have seen their share of union taxes decline significantly over the last two decades.
- The share lost by southern states by considering 2011 population was made up by the demographic performance criteria.

To know about challenges-ahead-of-16th-finance-commission click here

Reference

Business Line- Are States justified in opposing revenue sharing model