B.A Program

Vth Semester

EDPI

Finance Commission

The Finance Commission is a Constitutional body formulated under Article 280 of the Indian Constitution. It is constituted every five years by the President of India to review the state of finances of the Union and the States and suggest measures for maintaining a stable and sustainable fiscal environment. It also makes recommendations regarding the devolution of taxes between the Center and the States from the divisible pool which includes all central taxes excluding surcharges and cess which the Centre is constitutionally mandated to share with the States. The FFC has submitted its recommendations for the period 2015-16 to 2020-21.

Vertical Distribution

With a view to minimising discretion, improving the design of transfers, avoiding duplication and promoting co-operative federalism, the FC-XIV suggested a review of existing arrangements for transfers outside the recommendations of the FC. Accordingly, it suggested that a new institutional arrangement may be evolved which can, inter alia, make recommendations regarding sector-specific and area-specific grants. The FC-XIV has radically enhanced the share of the states in the central divisible pool from the current 32 percent (as recommended by FC-XIII) to 42 per cent which is the biggest ever increase in vertical tax devolution. The last two Finance Commissions viz. Twelfth (period 2005-10) and Thirteenth (period 2010-15) had recommended a state share of 30.5 per cent (increase of 1 per cent point basis) and 32 per cent (increase of 1.5 per cent point basis), respectively in the central divisible pool. The sector-specific FC grants to be dispensed with - reflecting compositional shift in transfers from grants to tax devolution with a view to meet the twin objectives of increasing the flow of unconditional transfers to the States and yet leave appropriate fiscal space for the Union to carry out specific purpose transfers to the States (RBI, 29 Jan 2016). The balance in fiscal space thus remains broadly the same. in quantitative terms, but tilts in favour of states in qualitative terms through a compositional shift in favour of devolution and hence fiscal autonomy (Reddy, 2015).

Horizontal Distribution

Inter-state devolution attempts to mitigate the impact of the differences in fiscal capacity and cost disability among States. The 14th FC has not used the distinction between non-special and special category states. The FC-XIV proposed a new horizontal formula for the distribution of the states' share in divisible pool among the states. There are changes both in the variables included/excluded as well as the weights assigned to them. Relative to the Thirteenth Finance Commission, the FCXIV incorporated two new variables i.e. 2011 population and forest cover; and excluded the fiscal discipline variable. Fiscal discipline as a criterion for tax devolution was used by FC-XI and FC-XII to provide an incentive to states managing their finances prudently. The criterion was continued by the FC-XIII as well by giving more weightage of 17.5 per cent. The index of fiscal discipline is arrived at by comparing improvements in the ratio of own revenue receipts of a state to its total revenue expenditure relative to the corresponding average across all states. The Commission had a view that the devolution formula should continue to be defined in such a way that it attempts to mitigate the impact of the differences in fiscal capacity and cost disability among States. Therefore they have used the following criteria with specified weightage

Recommendation of fourteen finance commission

Some of the major recommendations are as follows:

- The FFC has radically enhanced the share of the states in the central divisible pool from the current 32 percent to 42 per cent which is the biggest ever increase in vertical tax devolution. The last two Finance Commissions viz. Twelfth (period 2005-10) and Thirteenth (period 2010-15) had recommended a state share of 30.5 per cent (increase of 1 percent) and 32 per cent (increase of 1.5 percent), respectively in the central divisible pool.

- The FFC has also proposed a new horizontal formula for the distribution of the states' share in divisible pool among the states. Relative to the Thirteenth Finance Commission, the FFC has incorporated two new variables: 2011 population and forest cover; and excluded the fiscal discipline variable. The FFC has not made any recommendation concerning sector specific-grants unlike the Thirteenth Finance Commission.

- Grants: Should be distributed to states for local bodies on the basis of the 2011 population data; the grants be divided into two broad categories on the basis of rural and urban population — constituting gram panchayats, and constituting municipal bodies respectively.

- Types of grants: A basic grant and a performance grant — the ratio of basic to performance grant be 90:10, with respect to panchayats; and 80:20 in the case of municipalities.

- Rail Tariff Authority: Replacement of the advisory body with the statutory through required amendments to the Railways Act 1989

- Delinking of schemes: Eight centrally sponsored schemes (CSS) will be delinked from support from the Centre; various CSS will now see a change in sharing pattern, with states sharing a higher fiscal responsibility.

Horizontal Devolution Formula in the 13th and 14th Finance Commissions		
Variable	Weights accorded	
	13th	14th
Population (1971)	25	17.5
Population (2011)	0	10
Fiscal capacity/Income distance	47.5	50
Area	10	15
Forest Cover	0	7.5
Fiscal discipline	17.5	0
Total	100	100

The spirit behind the FFC recommendations is to increase the automatic transfers to the states to give them more fiscal autonomy .There is concern that fiscal space or fiscal consolidation path of the Centre would be adversely affected. However, to ensure that the Centre's fiscal space is secured, the suggestion is that there will be commensurate reductions in the Central Assistance to States (CAS) known as "plan transfers."