15th FC and its interim report

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Manifest pedagogy: After the Constitution of 15th FC it has been in news for various reasons like terms of reference, Census year and now Interim report. The topic has to be studied from the point of two disciplines

1. Polity and Governance
2. Economy

In news: 15th FC has submitted its interim report.

Placing it in syllabus: Finance Commission

Dimensions:

- Terms of reference
- Interim report

Content: The 15th Finance Commission (FFC) was notified on November 27, 2017 and was mandated to suggest a formula for devolution of funds to states for five years (2020-2025). However, an interim report has been submitted for 2020-21. The **final report with recommendations for the (2021-26) period will be submitted by October 30, 2020.**

Reasons for extending the tenure of the FC:

1. The abolition of Statehood to Jammu and Kashmir required the Commission to make an estimation excluding the Union Territory.
2. As the nominal GDP growth has been slowed down due to low inflation and deceleration in growth, making projections of tax revenues and expenditures based on

this for the medium term could have posed serious risks.
3. Poor revenue performance of tax collection and GST.

Terms of reference (ToR):

The **major aspects of the ToR** given to the 15th FC are:-

- The mandate for using the **2011 population**
- The **possible elimination of "Revenue Deficit Grants"**
- **Impact of the GST** on the finances of the Centre and States
- Conditionality needed on **State borrowing**
- Providing **performance incentives to states** on certain indicators
- **Going back to 32% formula** from the current 42% devolution to states

In July, 2019, centre had mandated FC to **suggest ways for allocation of non-lapsable funds** for defence and internal security. But a change in ToR was opposed in the Rajya Sabha, as the move would reduce the fiscal space for the states.

Interim report:

Factors used:

Devolution of taxes to states: The share of states in the centre's taxes is recommended to be **decreased from 42% during the 2015-20 period to 41% for 2020-21.** The 1% decrease is to provide for the newly formed UTs of Jammu and Kashmir and Ladakh from the resources of the central government.

Income distance: Income distance is the **distance of the state's income from the state with the highest income.** States with lower per capita income would be given a higher share to maintain equity among states.

Forest and ecology: This criterion has been arrived at by calculating the **share of dense forest of each state in the**

aggregate dense forest of all the states.

It has used **two additional factors** – demographic performance and tax effort.

Demographic performance: As per ToR, the Commission has **used 2011 population data** for its recommendations. It is computed by using the reciprocal of the total fertility ratio of each state, scaled by 1971 population data. **States with a lower fertility ratio will be scored higher on this criterion.**

Tax effort: This criterion has been used to reward states with higher tax collection efficiency.

Factors with weightage:

Forest cover and ecology – 10%

Population of a state (2011) – 15%

Tax effect – 2.5%

Income distance – 45%

Demographic performance – 12.5%

Grants-in-aid

- In 2020-21, the following grants will be provided to states:

(i) revenue deficit grants

(ii) grants to local bodies

(iii) disaster management grants

Consequent to the recommendations of the FFC, the **tax share of most southern states, including Andhra Pradesh, Kerala, and Karnataka, has come down**. The share of Bihar, Madhya Pradesh, Punjab, Maharashtra, and Gujarat has gone up.

In terms of **relative shares in tax devolution,** among the major States the **biggest loser is Karnataka followed by Uttar Pradesh, Kerala,** Telangana and Andhra Pradesh. The major reason is that **their per capita income growth has been faster than most other States.**

Kerala and Andhra Pradesh have post-devolution gaps and hence qualify for revenue gap grants.

Disaster management grants:

- The Commission recommended setting up **National and State Disaster Management Funds (NDMF and SDMF)** for the promotion of local-level mitigation activities.
- The **cost-sharing pattern** between centre and states is (i) 75:25 for all states, and (ii) 90:10 for north-eastern and Himalayan states.
- For disaster management, a total of ₹28,183 crore has been determined of which the Central contribution will be ₹22,184 crore.
- Inter-State allocation is made based on past expenditures, area and population and disaster risk index.

Local body grants:

- The total grants to local bodies for 2020-21 has been fixed at **Rs 90,000 crore,** of which Rs 60,750 crore is recommended **for rural local bodies (67.5%)** and Rs 29,250 crore for **urban local bodies (32.5%).**
- This allocation is 4.31% of the divisible pool.
- This is an increase over the grants for local bodies in 2019-20, which amounted to 3.54% of the divisible pool.
- The grants will be **divided between states based on population and area in the ratio 90:10.**
- The grants will be made available to all three tiers of Panchayat- village, block, and district.
- **50% of the grant is tied to improving sanitation and**

supply of drinking water while the remaining is untied.

- In the case of municipal bodies, ₹9,229 crore is allocated to cities with a million-plus population and the remaining ₹20,021 is allocated to other towns.

Guidelines for performance-based grants:

State-specific grants will be provided in the final report. The Commission has proposed a framework for sector-specific and performance-based grants which is as follows:

(i) implementation of agricultural reforms

(ii) development of aspirational districts and blocks

(iii) power sector reforms

(iv) enhancing trade including exports

(v) incentives for education

(vi) promotion of domestic and international tourism

((The grant amount will be provided in the final report)).

To improve tax revenue:

The Commission has recommended the following:

(i) broadening the tax base

(ii) streamlining tax rates

(iii) increasing capacity and expertise of tax administration in all tiers of the government