

15th finance commission report

November 11, 2020

The Finance Commission's role in providing conditional and unconditional transfers to the states has far-reaching consequences for the provision of public services and the union-state fiscal relations. State governments have to be given fiscal freedom to ensure better governance of state and to enhance their economic and social wellbeing.

In news: 15th finance commission submits final report.

Placing it in syllabus: Finance commission

Static dimensions

1. Finance commission
2. Fiscal federalism in India

Current dimensions

1. About the report
2. Defense fund

Content:

About the report:

- The main report is titled "**Finance Commission in Covid Times**" which depicts a set of scales on its cover to denote balance between the Union and the States.
- Along with it, **two more volumes as part of its submissions** have been presented.
- The first one focuses on the State of the Union government's finances, with an in-depth scrutiny of key departments, the medium-term challenges facing the Centre and a roadmap for the future.
- The second volume is entirely dedicated to States, with

the finances of each analysed in great depth.

- The panel has come up with **State-specific considerations** to address the key challenges that individual States face.
- All **terms of reference (ToR)** such as considering a new non-lapsable fund for financing national security and defence spending and offering performance incentives for States that deliver on reforms are considered.
- Apart from the vertical and horizontal tax devolution, local government grants, disaster management grant, the Commission also examined whether a separate **mechanism for funding of defence and internal security** ought to be set up.
- The Commission had submitted an **interim report** for 2020-21 in 2019.
- The interim report had **reduced States' share in the divisible pool of taxes from 42% to 41%** for that current year, after the dissolution of Jammu and Kashmir as a State.
- The devolution of funds between the Centre and the States for the **period 2021-22 to 2025-26** has been recommended.

Defence fund:

- In 2019, the central government had added a **new ToR for the FC, asking it to examine the scope of setting up a non-lapsable defence and internal security fund.**
- Several states had raised concerns over the proposal to create a non-lapsable defence fund out of the divisible pool of central taxes.
- The states had sent in additional memoranda to the commission over pointing out that allocation of funds for defence was entirely the responsibility of the union government, should come from the Consolidated Fund of India and not result in any reduction in the divisible pool of central taxes.

- The status of the fund is yet to be known as the report has not been made public.

Finance commission:

- Under **Article 280** of the Indian Constitution, for every 5 years, the President has to constitute a Finance Commission of India.
- It consists of a Chairman and four members and all the appointments are made by the President.
- It shall be the duty of the Commission to **make recommendations to the President** in relation to the:

the distribution between the Union and the States of the net proceeds of taxes which are to be, or maybe, divided between them;

the allocation between the States of the respective shares of such proceeds;

the principles which should govern the grants in aid of the revenues of the States out of the Consolidated Fund of India;

any other matter referred to the Commission by the President in the interests of sound finance.

- The President has to lay the recommendation made by the Finance Commission and its explanatory memorandum before each House of Parliament.

Fiscal federalism in India:

- Fiscal federalism refers to the **financial relations between the country's federal government system and other units of government.**
- It is the study of how expenditure and revenue are allocated across different vertical layers of the government administration.
- **Article 246 and Seventh Schedule** of the Indian

Constitution distributes powers and allots subjects to the Union and the states with a threefold classification type – union, state and concurrent lists.

- Since 2015-2016, three **landmark changes in fiscal relations between the union and state governments** include:

The abolition of the Planning Commission in January 2015 and the subsequent creation of the **NITI Aayog**;

Provision of **higher tax devolution** to the states based on the recommendations of the 14th FC;

The Constitutional amendment to introduce the **Goods and Services Tax (GST)** and the establishment of the GST Council for the central and state governments to deliberate and jointly take decisions.

Issues Under the Current Fiscal Federalism Structure:

- There has been a resurgence of **horizontal and vertical imbalances** in the structure.
- With the replacement of the Planning Commission by the NITI Aayog, state governments now solely rely on the finance commission, which in turn, leads to a serious problem of **increasing regional and sub-regional inequities**.
- A “**fragmented**” transfer system is a prime feature of the Indian fiscal federal arrangements between the union and the states.

General purpose transfers (i.e. states can spend these resources on their respective priorities which can be drawn up by them; or

Conditional transfers (i.e. the centre only transfers resources upon the condition that the states must use it for particular programs and schemes drawn up by the centre)

- **Approximately 40% of the total transfers are still linked to conditional transfers, which are largely linked to the Centrally Sponsored Schemes (CSS).**
- **The 7th provision of the ToR also mandates the 15th FC to assess and monitor the performance of GST implementation and various other governance indicators.**
- **This added functionality of the Finance Commission as a monitoring agency of the states' performance goes against its constitutional role.**
- **As the central government is given a much greater domain of taxation, with a collection of 60% of the total taxes, despite their expenditure responsibility only amounting to 40% of the total public expenditure vertical imbalances occur.**
- **Under GST, the centre still retains their power to levy additional excise duty on tobacco products, but states having no such right are deprived of their main source of income.**

A serious review of the conditional transfers, their relative importance in total transfers, the design of conditional transfers and their impact on spending as well as the outcomes in delivery of services by the states, role of GST in promoting cooperative federalism needs to be done.

Mould your thought:

1. What is Fiscal federalism in India? What role does the Finance commission play in promoting it?

Approach to the answer:

- Define fiscal federalism
- Write the importance of FC
- Write the current issues of fiscal federalism and how FC is related to it
- Conclude (on a positive note)