15th Finance Commission – A Roadmap

What is the issue?

15th Finance commission (FC) which is about to make recommendations for the 5 years (2020-2025). These are some suggestions for them.

What were their problems?

- Dilution of the original mandate of equalising opportunities for every citizen by ensuring uniform public services.
- Reluctant to rock the boat and lose credibility by doing anything very different.
- Average Indian continued to suffer from poor public services.

What had the past FCs' done?

- The **12th** FC had the **most success** with a combination of carrots and sticks — **debt restructuring conditional on acceptance of State-level** Fiscal Responsibility and Budget Management (**FRBM**) legislation.
- The **13th** FC introduced **incentive payments** but since capacity constraints prevented some States from utilising them.
- The**14th** FCs shifted to payments towards **capacity building**. Data is required on what worked.

What are the major issues?

- **Independence vs. uniformity** for States.
- The **public services** are poor because the facilities tend to cut to match the funds available, rather than raising funds to provide a uniform level of services.
- There are **no limitations** on imposing conditions on **grants in aid** of revenue and in CSS.
- States delay giving the final urban status to rapidly growing census towns because of tax and municipal service provision issues.
- Tax share is regarded as a right, so the **States resist conditionality** in devolution.

What can be solution?

- Richer States or those with competitive own schemes may want to opt out of CSS.
- They could be given the choice, **conditional on outcomes** being above a threshold which encourages healthy competition in schemes.
- **Appropriate compensation in devolution** could be on the basis of quality adjusted least cost schemes.
- A **rich database** is needed, also for other TORs such as 3 and 7 on assessing revenues and needs.
- NITI Aayog has long been ranking States on various criteria which can be used as a database.
- A research suggests that **incentives work** but intergovernmental transfers, given tax capacity, have a negative association with tax effort of States which should be concentrated on.

What changes can be made to the current system?

- Setting up of **Permanent Fiscal Council** to make them responsible for conditional data-based fund devolution to States.
- Revival of **Inter-State Council** to get participation and feedback from States for a vibrant fiscal federation, so that the sanctioning delays may also reduce.
- The taking over of erstwhile **Planning Commission** functions by central ministries, has created resentment among States.

What changes can be made in the 15th FC?

- Improving the level and **uniformity of public services** can be a lens to look at the terms of reference (TOR) of the 15th FC.
- It could **give funds conditional** on implementing devolution to the third tier, with payments made for improvements in rather than for levels of services provided.
- The **CSS can be rationalised** and clubbed further.
- Money paid could be partly replaced by well-targeted central direct benefit transfer **(DBT) to individuals**.
- **Economies of scale** from pooling and coordination efficiencies may reduce costs in health and education.
- Although now there is GST, user charges are a major area where States still have to make efforts.
- **Ring fencing** productive expenditure could also raise revenue effort.
- An **award in line** with **broad principles** of justice would **generate less resistance**.

How to reduce the States' debt (TOR 2)?

- Safeguarding of expenditure that creates future income.
- **Encouraging higher growth** brings down debt ratios as growth rates normally exceed interest rates on catch-up growth paths.
- Rise in revenue deficit **decreases growth** and therefore slows reduction in debt ratios.
- There are plans to **increase the market discipline on States** further by releasing more high frequency data on State finances to enhance rating.
- **Expenditures are cut** (often developmental and capital expenditures).
- Incentives must also protect the quality of expenditure.

Source: Business Line

