15th Finance Commission: The Balancing Act

What is the issue?

\n\n

\n
- The union government recently constituted the 15th Finance Commission (FC) to take review the financial distribution between states and the centre.
\n
- As the terms of reference given to the FC have already created a controversy, it will have to take a prudent call on the degree of equalisation that's feasible.
\n

\n\n

What are the Terms of Reference (ToR) given to the 15th FC?

\n\n

\n
- Finance Commission is constituted by the president every 5 years (or earlier) to take stock of distribution of proceeds from the central tax pool to states.
\n
- The commission studies the fiscal situation of governments and makes its recommendations, which are only advisory in nature.
\n
- ToR is a list of issues highlighted by the union government for the FC to consider on a priority basis in its brainstorming exercise.
\n
- The key aspects of the ToR given to the 15th finance commission are
\n

\n\n

\n
- The mandate for using the 2011 population
\n
- The possible elimination of "Revenue Deficit Grants"
\n
- Impact of the GST on the finances of the Centre and States
\n
- Conditionality needed on State borrowing

\n
- Providing performance incentives to states on certain indicators
\n
- Going back to 32% formula from the current 42% devolution to states
\n

\n\n

Why is the proposal to update to 2011 census data worrying some states?

\n\n

\n
- Distribution of tax proceeds to states is decided based on multiple factors and population of the state is one major factor.
\n
- In order to promote family planning programs, it was decided in the 1970s to freeze the 1971 census as the bench mark for future the reference of FCs.
\n
- Notably, this was done to eliminate the benefit of an expanding population to reflect upon the financial proceeds a state receives from the centre.
\n
- Over the years population control mechanisms haven't been uniform throughout the country with some states doing much better than the rest.
\n
- As southern states performed particularly well in population control, they now content that a shift to the 1971 census would affect their finances.
\n
- Contrarily, some argue that we need to move to current figures instead of making our policies based on 50 year old archaic date (1971 census).
\n
- Notably, major federations like Australia and Canada almost always use the latest information available for devolving funds to its provinces.
\n
- "Fiscal Capacity Distance" (FCD) is the "difference of a state's per capita income from that of the state with the highest per capita income".
\n
- FCD is another criterion for distributing proceeds, and here too, for calculating the per capita income, the 1971 census is used.
\n

\n\n

What are the other parameters in devolution of funds?

\n\n

\n

- Losses or gains for states depend on the relative weights attached to different criteria, and changes in other information including per capital GSDP.
\n
- As some states have raided concerns, there is now a case to have a relook and lower the weights attached to the population and fiscal-distance criteria.
\n
- Notably, weight attached to the population has varied from 25% to 10% and that attached to the distance from 62.5% to 50% from the 10th to the 14th FCs.
\n
- **Grants -** Revenue Deficit Grants are given to states that weren't able to meet their fiscal deficit targets and have strained balance sheets.
\n
- This has been under criticism for adversely affecting budgetary prudence as it provides leeway for incentivising states to spend recklessly.
\n
- The government has hence rightly asked for considering its abolition, but this won't have any impact on the other grants for serving better purposes.
\n
- Notably, Article 275(1) urges the Finance Commission to determine the principles that govern the grants-in-aid to be provided by centre to the states.
\n

\n\n

\n

- **Equalisation -** Most federations follow an equalisation approach to determine fiscal transfers, for ensuring better support for poorer regions.
\n
- Such an approach is key to ensure that all states are financially capable of providing services at comparable standards.
\n
- Hence, if richer states are losing out a little, it's because they can sustain the same national standard with lesser share from the central pool.
\n

\n\n

What is the case of the poorer mineral rich states?

\n\n

\n

- Mineral rich States like "Jharkhand, Odisha, Chhattisgarh, Madhya Pradesh and Assam" are an interesting grouping.

\n
- These States carry a significant pollution load on behalf of the nation.
\n
- These states had the potential to become industrialised early on by virtue of their proximity to resources.
\n
- But they lost out due to the central government's policy of freight equalisation whereby the transport of coal was subsidised.
\n
- Notably, freight equalisation was what led to many thermal power plants being set up in the southern States, which powered their industrial growth.
\n
- Hence, these regions do possess a legitimate right to access more funds from the central pool in order to overcome its backwardness.
\n

\n\n

What are some technical concerns with ToRs given to the 15th FC?

\n\n

\n
- The Finance Commission should remain policy neutral as it has to come out with recommendations that accommodate conflicting claims.
\n
- Hence, it is not the appropriate platform for promoting Central policy priorities – but some ToRs given to the 15th FC contravene this principle.
\n
- ToR's points involving - Centre's flagship schemes, 'populist policies' of States, and conditionality on State borrowing could've been avoided.
\n
- In any case, too long a list of ToRs, like the one given to the 15th FC, should've been avoided, as FCs deserves considerable independence in their approach.
\n

\n\n

What are the other aspects that need pondering?

\n\n

\n
- The contribution of proceeds from a particular state to the central tax kitty needs to be accounted for in devolving funds.
\n
- Demographic aspects like aging populations in states like Kerala and Tamil

Nadu need to taken into account as this could mean more health costs.
\n
- Environmentally affected mineral belt and geographically constrained states (ex: hilly and forested states) also need special consideration in allocations.
\n

\n\n

\n\n

Source: The Hindu

\n

