Challenges ahead of 16th Finance Commission

Why in news?

The Central Government is to setup 16th Finance Commission in 2023, to recommend revenue sharing beween the Centre and States.

What is Finance Commission?

- ***Article 280*** of the Constitution of India provides for a quasi-judicial body, the Finance Commission.
- It is constituted by the ***President*** of India every fifth year or at such earlier time as he considers necessary.
- The recommendations made by the Finance Commission are only *advisory* in nature and hence, ***not binding*** on the government.
- **15th Finance Commission -** It was constituted in 2017 by President under the chairmanship of ***N.K.Singh.***
- **Tenure-** 5 years (2021-22 to 2025-26)
- **Vertical Devolution-** It is the devolution of taxes to the states by Union.
    - *41%* of the divisible pool is recommended (1% adjustment is made due to bifurcation of Jammu and Kashmir into Union Territories.
- **Horizontal Devolution-** It is devolution of taxes between states.
    - Demographic performance- 2.5%
    - Income-45%
    - Population and area- 15% each
    - Forest and ecology-10%
    - Tax and fiscal efforts-2.5%

- **Performance based incentives and grants to states**

Themes	Focus
Social sector	Health and education
Rural economy	Agriculture and maintenance of rural roads
Governance and adminstration	Judiciary, statistics, Aspirational districts and blocks
Power sector	Performance based incentive

- **Other grants provided**
    - Revenue deficit grants
    - State specific grants
    - Grant to local bodies
    - Disaster risk management

Key Recommendations in 15th Finance Commission

15th Finance Commission-
• Centre's debt to GDP ratio is 58.7% and Fiscal Deficit to GDP ratio 9.2%
• There is a need to reduce States debt-GDP target to 20%.
• It recommended to re-examine the 2018 amendment to Fiscal Responsibility and Budget Management Act (FRBM).

What are the challenges ahead of 16th finance commission?

- **Increase in cess and surcharge-** The effective share of States in the Centre's gross tax revenues (GTR) averaged close to 31% in 2020-21 to 2023-24 which was significantly lower than the corresponding share of nearly 35% during 2015-16 to 2019-20.
- This is due to inordinate increase in cess and surcharge from 12.8% in 2015 to 18.5% in 2020.
- **GST collection**- An issue of concern in recent years has been the poor performance of the Goods and Services Tax (GST) and the consequent decline in total divisible pool.
- GST collection in last 2 years have maintained good buoyancy, there is still a need to restructure GST to good and simple tax.
- **Income weightage**- Income distance criterion (45%) gives larger number of share to relatively lower income states, many rich states have argued to lower the weightage in the criterion.

What lies ahead?

- **Set up Loan Council-** It is an independent body recommended in 12th finance commission to oversee the loan magnitude and profiles of the Central and State governments.
- **Subsidies-** The 16th Finance Commission should examine the subject of non-merit subsidies in detail.
- **Maintain State Fiscal Deficit-** The Finance Commission should be strict with states in maintaining Fiscal Deficit (FD) within limits.
- It can include fiscal performance of the states as a criterion in horizontal distribution.
- If the states exceed FD limit then act on the extent of the borrowing allowed for the states.
- **Scrutinise Cess and Surcharge-** Freeze the share of Cess and Surcharge to some base number.
- **Income criteria-** It may be useful to freeze the weight to income distance criterion at the current level (45%) or even reduce it to 40%.
- **Need of equalisation principle-** In the overall scheme of resource transfers there is a need to prioritise equalisation of education and health services provisions.

References

1. The Hindu| Chart path for 16th finance commission
2. PRS| Report of 15th finance commission



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