Finance Commission Formula for North Eastern States

Why in news?

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The 15th FC is planning a fair formula for the distribution of tax proceeds between the Union and the States.

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What the formula of 14th Finance Commission?

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- The 14th FC had adopted a formula-based tax devolution approach, apart from grants-in-aid for local bodies, disaster relief, and post-devolution revenue deficit grants.
- The share of devolution to the States was enhanced to 42% from 32%, which gave the States considerable flexibility.
- However, it dispensed with sectoral grants for elementary education, the forest sector and renewable energy sector, among others. No State-specific grants were recommended.
- The assumption was that a higher level of devolution would offset other requirements.
- The devolution formula, therefore, is central to the approach of resource transfers.
- The 14th FC accorded 27.5% weight to the population (of which 17.5% was of the 1971 population), 15% to area, 7.5% to forest cover and 50% to income distance.
- By this Larger States with larger populations have a greater requirement of resources.
- Income distance was adopted as a proxy for fiscal capacity, and forest

cover was given weightage for the first time, underscoring ecological benefits.
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What are the concerns with the 14th FC formula for N.E states?

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- The Northeast represents a distinct entity for developmental planning and has a special category status.
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- Low levels of human development indices, a low resource base, and poor connectivity and infrastructure pose a different challenge which must be taken into account in the devolution formula.
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- Central Ministries earmark 10% of their allocations for the Northeast, by the same logic, 10% of tax proceeds could be earmarked for vertical devolution to the region.
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- A number of centrally sponsored schemes have been rolled out where the obligation of State share is huge, adding to revenue expenditure.
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- Sometimes the real burden is far more than the mandated 10%, Many centrally sponsored schemes are discontinued midway, and the burden of employee salaries falls on the States.
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- The Northeast also bears a disproportionate burden of natural disasters every year on account of rainfall.
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- The 14th FC disaster relief grants bore no correlation with vulnerability but were ad hoc extrapolations of previous allocations.
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How 13th Finance commission approached N.E states?

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- The 13th FC acknowledged the different position of the Northeast while arriving at the formula for horizontal devolution. Its twin guiding principles were equity and efficiency.

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- It accorded 47.5% weight to fiscal capacity distance. Per capita GSDP was taken as a proxy for fiscal capacity.
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- But States were divided into two groups, general and special category States, given that the average tax to GSDP ratio was higher for the former.
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- Three-year per capita GSDP was computed separately in these two groups, weighted means of tax to GSDP ratio obtained, and per capita tax revenue was assessed for each State.
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- Fiscal distance was thereafter calculated on estimated per capita revenue with reference to the highest State, which was then multiplied by the 1971 populations to arrive at the share of each State.
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What factors needs to be considered?

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- The disaster vulnerability index is highest for the Northeast, this needs to be factored in while allocating grants.
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- The region also has the highest forest cover and represents the largest carbon sink nationally.
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- Allocating 10% for forest cover would encourage States to preserve the forests.
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- The Terms of Reference of the 15th FC also mention performance-based incentives based on improvements in GST collection, Direct Benefit Transfer rollout, etc, This would definitely infuse a spirit of competition.
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- Thus the performance of the North eastern States must be benchmarked with other North-eastern States and not with other states.
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Source: The Hindu

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