Roles of Finance Commission and 15th FC

What is the issue?

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- 15th FC's terms of reference (ToR) is gaining significance with states' demand for more equity and fairness in resource allocation.
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- In this context, it is essential to look into the roles and responsibilities of Finance Commission and the ToR of 15th FC.
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Why is FC's role so significant?

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- **Unity** - Article 1 of the Constitution of India recognises India as a Union of States.
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- Real fairness and equity in the matter of devolution of powers and resources to the States is essential to preserve this stated unity.
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- The foremost objective of the FC is thus an equitable distribution of financial resources between the two units of the Union.
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- **Resources** - The fundamental tasks relating to income growth, human development, livelihoods, environment, etc are entrusted to the States.
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- At present, the States do not have adequate resources as well as the right to raise such resources to fulfil these tasks.
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- FC's role gains significance in equipping states with adequate resources to take up these major tasks of nation-building.
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- **Federalism** - The Centre’s capacity to mobilise resources is far greater than that of the States.
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- But states are required to undertake development expenditures that far

exceed their revenue generating capabilities.
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- The Constitution entrusts FC with the responsibility of addressing this anomaly and asymmetry in India's federal system.
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- **Recent developments** - The finances of States have received a double blow due to demonetisation, and Goods and Services Tax.
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- Post-GST, states have hardly any major tax left with them to make a difference to State resources.
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What are the concerns with 15th FC's ToR?

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- **Demographic differences** - From 2001 and 2011 many states have successfully reduced their rate of population growth.
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- This does not mean less expenditure for these states.
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- These have incurred huge fiscal costs to achieve a lower population growth and healthy demographic indicators.
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- They have made substantial investments on education, health and directly on family welfare programmes.
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- Moreover it creates new commitments by the States to those in labour force and especially to senior citizens.
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- Thus using the population data of 2011 as the base for tax devolution should not reduce the allocation to these States.
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- **Caring elderly** - Many States have achieved a replacement rate of growth of population or have gone below that rate in a short span of time.
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- An immediate effect of this is a sharp rise in the proportion of elderly population.
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- The enhanced costs for states for caring them must be considered by the FC in allocation and in deciding the population criterion.
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- **Revenue deficit** - It is specified that the 15th FC may also examine whether

revenue deficit grants be provided at all.
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- Revenue deficits are offshoots of the path of development followed by States.
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- It cannot be brought down in the short term.
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- To discontinue post-tax devolution of revenue deficit grants would go against the principle of cooperative federalism.
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- **Approach** - The FC should not take a “residual approach” of distributing what is left over after providing for Centre's requirements.
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- However, the 15th FC's ToR explicitly privilege the “committed expenditures” of the Centre.
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- **Policy domain** - The 15th FC is asked to consider proposing performance-based incentives.
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- This grant is proposed beyond those relating to fiscal responsibility, population and devolution to local bodies.
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- States see this as an attempt to micro-manage their fiscal domain.
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- This is because states have set their own agenda for development.
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- The sectors may include health, education, forest management, public distribution of food, agricultural production, etc.
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- This development resulted not necessarily because of Central incentives.
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- It was rather the effect of the best practices followed by the states depending on their regional needs and demands.
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- Thus, FC proposing “measurable performance-based-incentives” would affect the liberty and flexibility of the states' policy realm.
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- It is not the duty of the FC to venture into the realm of day-to-day governance of the states.
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- **Fiscal space** - The 14th FC recommended an increase in devolution to states from 32% to 42%.
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- It is argued that the fiscal space available to the Centre had shrunk due to this.
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- However, when implementing this, the Union government cut allocations to several Centrally Sponsored Schemes in 2015-16.
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- The cutback was almost equal to the amount received by the States as a whole on account of the rise in share of taxes and duties.
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- Thus, there is evidently no squeeze of the fiscal space available to the Union government.
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- In fact, the total resources devolved from Union to all States put together has been declining as a share of GDP for some years now.
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- There is thus no ground for reducing the share of States in the vertical devolution.
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- **Diversity** - To recognise India's diversity is also to recognise the States' diverse paths of development.
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- The FC must facilitate diversity and a democratic path of development.
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- Respecting principles of equity and fairness in allocating resources between the Centre and States is essential for this.
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Source: The Hindu

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