Press Information Bureau
Government of India
Ministry of Finance
24-February-2015 20:02 IST

14th Finance Commission (FFC) Report Tabled in Parliament; FFC Recommends by Majority Decision that the States' Share in the Net Proceeds of the Union Tax Revenues be Raised to 42% Which is a Huge Jump from the 32% Recommended by the 13th Finance Commission

Article 280 of the Constitution of India requires the Constitution of a Finance Commission every five years, or earlier. For the period from 1st April, 2015 to 31st March, 2020, the 14th Finance Commission (FFC) was constituted by the orders of President on 2nd January, 2013 and submitted its report on 15th December, 2014.

The Finance Commission is required to recommend the distribution of the net proceeds of taxes of the Union between the Union and the States (commonly referred to as vertical devolution); and the allocation between the States of the respective shares of such proceeds (commonly known as horizontal devolution).

With regard to vertical distribution, FFC has recommended by majority decision that the the States' share in the net proceeds of the Union tax revenues be 42%. The recommendation of tax devolution at 42% is a huge jump from the 32% recommended by the 13th Finance Commission. The transfers to the States will see a quantum jump. This is the largest ever change in the percentage of devolution. In the past, when Finance Commissions have recommended an increase, it has been in the range of 1-2% increase. As compared to the total devolutions in 2014-15 the total devolution of the States in 2015-16 will increase by over 45%.

The consequence of this much greater devolution to the States is that the fiscal space for the Centre will reduce in the same proportion. As recorded in Chapter-8 of FFC's Report, amongst other demands of the States, the States had demanded both an increase in share of tax devolution, and a reduced role of CSS. In Paras 8.6 & 8.7 of its Report, the FFC has noted that

> "8.6:*Another dominant view has been that a majority of the resources should flow in the form of tax devolution---* "
> "8.7: *An overwhelming majority of States have suggested reducing the number of CSS as well as outlays on them---.*"

FFC has taken the view that tax devolution should be primary route of transfer of resources to States. It may be noted that in reckoning the requirements of the States, the FFC has ignored the Plan and Non-Plan distinction; it sees the enhanced devolution of the divisible pool of taxes as a "compositional shift in transfers from grants to tax devolution" (Para 8.13 of FFC Report). Thus, basically the FFC Report expects the CSS, in fact Central assistance to State Plans as a whole, to reduce and be replaced by greater devolution of taxes.

Keeping in mind the spirit of cooperative federalism that has underpinned the creation of National Institution for Transforming India (NITI), the Government has accepted the recommendation of the FFC to keep the States' share of Union Tax proceeds (net) at 42%.

In recommending horizontal distribution, the FFC has used broad parameters of population (1971) and changes of population since, income distance, forest cover and area. The details of this criteria and the weight assigned to them are given in **Annexure-1**. The State-wise share of the divisible pool of Central taxes, in percentage terms, is given in **Annexure-2**. As service tax is not levied in J&K, the share of the States, in percentage terms has been calculated separately by FFC. These are given in **Annexure-3**.

The Finance Commission is also required to recommend on 'the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State'.

FFC has recommended distribution of grants to States for local bodies using 2011 population data with weight of 90% and area with weight of 10%. The grants to States will be divided into two, a grant to duly constituted Gram Panchayats and a grant to duly constituted Municipal bodies, on the basis of rural and urban population.

FFC has recommended grants in two parts; a basic grant, and a performance grant, for duly constituted Gram Panchayats and municipalities. The ratio of basic to performance grant is 90:10 with respect to Panchayats and 80:20 with respect to Municipalities.

FFC has recommended out a total grant of Rs 2,87,436 crore for five year period from 1.4.2015 to 31.3.2020. Of this the grant recommended to Panchayatas is Rs 2,00,292.20 crores and that to municipalities is Rs 87,143.80 crores. The transfers in the year 2015-16 will be Rs 29,988 crores. Inter-se share of each state in respect of local bodies grant is at **Annexures-4 and 5**.

The Government has accepted the recommendations of the Finance Commission with regard to grants to local bodies. The Finance Commission is also required to 'review the present arrangements as regards financing of Disaster Management with reference to the National Calamity Contingency Fund and the Calamity Relief Fund and the funds envisaged in the Disaster Management Act, 2005 (Act 53 of 2005), and make appropriate recommendations thereon'.

FFC has recommended that up to 10 percent of the funds available under the SDRF can be used by a State for occurrences which State considers to be 'disasters' within its local context and which are not in the notified list of disasters of the Ministry of Home Affairs.

The FFC has noted in Para 10.26 as follows:

"*The financing of NDRF has so far been almost wholly through the levy of cess on select items, but if the cess are discontinued or when they are subsumed under the Goods and Services Tax (GST) in future, we recommend that the Union Government consider ensuring an assured source of funding for NDRF*".

In view of the above, with regard to disaster relief, the Government has decided that the percentage share of the States will continue to be as before, and that the flows will also be of the same order, as in the existing system; and that, once GST is in place, the recommendation of FFC on disaster relief would be implemented in the manner recommended by the Finance Commission.

The Finance Commission is also required to make recommendation regarding the principles governing grants-in-aid of the States' revenues, by the Centre. As noted by the FFC in Para 11.28, while calculating grants to the States they "have departed significantly from previous Finance Commissions, by taking into consideration a States' entire revenue expenditure needs without making a distinction between Plan and Non-Plan". Taking thus into account the expenditure requirements of the States, the tax devolution to them, and the revenue mobilization capacity of the States, the FFC have recommended "Post-Devolution Revenue Deficit Grants" of a total of Rs. 1,94,821 crores, for the five year period. The States of Andhra Pradesh, Assam, J&K, Himachal Pradesh, Kerala, Manipur, Meghalaya, Mizoram, Nagaland, Tripura and West Bengal (a total of 11 States) have been identified for receiving these revenue deficit grants. The details are given in **Annexure-6**. The Government has accepted the recommendation in principle.

To summarize, the Grants-in-Aid to the States total to Rs. 5.37 lac crores is given in the Table given below:

Grants-in-Aid to States

(Rs. crore)

1	Local Government(all States)	287436
2	Disaster Management(all States)	55097
3	Post-devolution Revenue Deficit (11 States)	194821
	Total	**537354**

As stated above, the compositional shift recommended by the FFC would substantially impact Central Assistance. In this regard, para 7.43 of the FFC Report states as follows :

"*Plan revenue expenditure of States is financed by States' own resources, borrowing and Plan grants from the Union. The Plan grants include normal Central assistance, which is untied,additional Central assistance for specific-purpose schemes and transfers,special Plan assistance,special Central assistance,Central Plan schemes and CSS.For the purpose of our assessment of Plan revenue expenditure of States, we have included expenditure incurred on State Plans and States' contribution to CSS. This excludes Union expenditure on CSS, central Plan schemes and North Eastern Council Plan schemes and externally aided projects financed through grants from the Union. We have estimated the 2014-15 base year Plan revenue expenditure (as defined above) for each State, applying an annual growth rate of 13.5 per cent over 2012-13 and 2013-14. For the purpose of our projection period, we have assumed an annual growth rate of 13.5 per cent over base year estimates for all the States, implying that the Plan revenue expenditure will increase at the same rate as the GDP growth rate.*"

Based on the above, over 30 Centrally Sponsored Schemes have been identified which ought to have been transferred to the States because expenditure on them has already been taken into account as State expenditure, in arriving at the greater devolution of 42% to the States. However, keeping in mind that many of these schemes are national priorities, and some are legal obligations (such as MGNREGA) and in order to underline the Central Government's continued support to national priorities, especially with regard to schemes meant for the poor, most of these are proposed to be continued. The Government has decided that only 8 Centrally Sponsored Schemes be delinked from support from the Centre.

Certain programmes of the Government will have to continue unaltered as they are either legal/Constitutional obligations, or are privileges available to the elected representatives for welfare of their constituents. Further, and more importantly it is proposed that the Union

Government may continue to support certain programmes which are for the benefit of the socially disadvantaged in an unaltered manner from its own resources.

In respect of various Centrally sponsored schemes, the sharing pattern will have to undergo a change with States sharing a higher fiscal responsibility for scheme implementation. Details of changes in sharing pattern will have to be worked out by the administrative Ministry/Department on the basis of available resources from Union Finances.

Other recommendations of the FFC

In addition to the recommendations regarding Vertical, and Horizontal devolution and grants, the FFC has made certain other recommendations. These relate to cooperative federalism, Goods & Services Tax, Fiscal Consolidation Roadmap, Pricing of Public Utilities and Public Sector Enterprises. The recommendations of the Finance Commission will be examined by the Government in due course in consultation with the concerned stakeholders.