Fiscal Architecture OfIndia: A Review On 15thFinance Commission With A Comparison To 14thFinance Commission

DevasishHazarika

PhD Research Scholar,Mahatma Gandhi Central UniversityMotihari, Bihar

Email ID: hdevasish@gmail.com

Abstract: The fiscal policies of India are the backbone of growth and development. JM Keynes advocated about the importance of fiscal policy during great depression. The Indian Economy runs on the basis of the recommendations made by the finance commission. The recommendations made by the finance commission are taken into consideration by the government and implemented in accordance with its suitability. The 14th finance commission made huge different recommendations in relation to the previous year finance commissions. The economists are of the view that the vertical and horizonal tax devolutions are now equitable to some extent. After the recommendations of 14th finance commission the states experience more fiscal autonomy. This paper has made an honest attempt to review 15th finance commission and also to make a comparative analysis based on 14th and 15th finance commission. For this purpose secondary data are being taken. The paper is descriptive and analytical in nature.
Keywords: Finance Commission, Vertical Tax Devolution, Horizontal Tax Devolution, Fiscal Autonomy

1. INTRODUCTION:

The functions of macroeconomic stabilisation and distribution are considered to be in the domain of the federal government and that of allocation in the realm of the tier of government closet to the beneficiaries. In other words, allocation in the absence of externalities should be left to the tiers of government which can do it at least as efficiently as the federal government. This is known as the subsidiarity principle. Under this division of powers, taxes with more buoyant would in the jurisdiction of the federal and the larger expenditure obligations, would fall in the fiscal territory of the provinces. The natural consequence of this is the vertical fiscal imbalance between the federation and the provinces. In Indian context also, the constitution recognizes this kind of imbalances inherent in Indian federation and it provides for the appointment of the finance commission by the President of India in every five years to resolve this imbalance by making recommendation on tax devolution and grants in aid of revenue. Thus, the Finance Commission is a constitutional body, an independent arbiter of resources between the union and states. The core mandate of the commission is to divide union taxes in a way that enables the union and states to perform their respective expenditure responsibilities defined in the 7th schedule of the constitution of India.

The 15th Finance Commission under the presidentship of N. K. Sing was appointed on November, 2017, required to submit two reports. The first report (interim report) was tabled in the Parliament on 1st February, 2020. This report is for the financial year 2020-21. The final report of the 15th finance Commission, that will make recommendations for devolution of tax revenue for the next five years, is expected to be submitted in October, 2020. In her 2020-21 budget speech, Union finance minister, NirmalaSeetharaman stated that the central government has accepted the recommendations of the first report in 'substantial measure'.

2. REVIEW OF LITERATURE:

Ranjit Kumar Mohanty (2017) studied about the recommendations of 14th finance commission and comparative fiscal federalism in India . According to the paper the new regime believes in more fiscal autonomy of the states. The paper is based on secondary data and mostly descriptive and analytical in nature. The paper finds that the recommendations are made to reduce regional disparity creating a sustainable fiscal environment reducing fiscal deficit to 3% of GDP. In an research article entitled as " Fiscal Architecture of India : A comparative Analysis on Finance Commission Report" the author Dr.KishinchandPoornimaWasdani made a comparative analysis of 13th and 14th finance commission. The article is based on secondary data and is both descriptive and analytical in nature. He further analysed the recommendations of 13th and 14th finance commission. He found the recommendations of 14th finance commission to be optimistic but of a cautious nature. KartikPrasan Jane in his article " Recommendations of 14th Finance Commission, Fiscal Empowerment of states and impact on Odisha" made an attempt to analyse the key recommendations of 14th finance commission and to bring out some good things about the commission making Indian states fiscally more stable. He mentioned about giving more fiscal autonomy to the states. The paper is based on secondary data and observations. No econometric models are used to forecast and find out the significance scientifically. This paper finds the recommendations of 14th finance commission to be more freedom giving to the states and local bodies. The recommendations if implemented will empower the states.

3. OBJECTIVES:

This paper attempts to fulfil the following objectives:

1To review 15th finance commission

2To make a comparative analysis between 14th finance commission and 15th finance commission.

4. METHODOLOGY:

In this study, an honest attempt has been made to analyse descriptively the fiscal architecture of India with a review on 15th finance commission and the comparative analysis on both 14th and 15th finance commission on the basis of the secondary data. Secondary data was collected from official publications like Economic Survey and the websites of GOI, some relevant books, journals, reports, periodicals, newspapers etc. Statistical tools like data tables are used. The present study is both descriptive and analytical in nature.

5. TERMS OF REFERENCE:

Terms of Reference and the matters that shall be taken into consideration by the Fifteenth Finance Commission in making the recommendations are as under:

(i) The distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under Chapter I, Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds;

(ii) The principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India and the sums to be paid to the States by way of grants-in-aid of their revenues under Article 275 of the Constitution for purposes other than those specified in the provisos to clause (1) of that article; and

(iii) 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.

2. The Commission shall review the current status of the finance, deficit, debt levels, cash balances and fiscal discipline efforts of the Union and the States, and recommend a fiscal consolidation roadmap for sound fiscal management, taking into account the responsibility of the Central Government and State Governments to adhere to appropriate levels of general and consolidated government debt and deficit levels, while fostering higher inclusive growth in the country, guided by the principles of equity, efficiency and transparency. The Commission may also examine whether revenue deficit grants be provided at all.

3. While making its recommendations, the Commission shall have regard, among other considerations, to:

(i) The resources of the CentralGovernment and the State Governments for the five years commencing on 1st April 2020 on the basis of the levels of tax and the non-tax revenues likely to be reached by 2024-25. In the context of both tax and non-tax revenues, the Commission will also take into consideration their potential and fiscal capacity;

(ii) The demand on the resources of the Central Government particularly on account of defence, internal security, infrastructure, railways, climate change, commitments towards administration of UTs without legislature, and other committed expenditure

(iii) The demand on the resources of the State Governments, particularly on account of financing socioeconomic development and critical infrastructure, assets maintenance expenditure, balanced regional development and impact of the debt and liabilities of their public utilities;

(iv) The impact on the fiscal situation of the Union Government of substantially enhanced tax devolution to States following recommendations of the 14th Finance Commission, coupled with the continuing imperative of the national development programme including New India -2022;

(v) The impact of the GST, including payment of compensation for possible loss of revenues for 5 years, and abolition of a number of cesses, earmarking thereof for compensation and other structural reforms programme, on the finances of Centre and States; and

(vi) The conditions that GoI may impose on the States while providing consent under Article 293(3) of the Constitution.

4. The Commission may consider proposing measurable performance-based incentives for States, at the appropriate level of government, in following areas:

(i) Efforts made by the States in expansion and deepening of tax net under GST;

(ii) Efforts and Progress ma0de in moving towards replacement rate of population growth;

(iii) Achievements in implementation of flagship schemes of Government of India, disaster resilient infrastructure, sustainable development goals, and quality of expenditure;

(iv) Progress made in increasing capital expenditure, eliminating losses of power sector, and improving the quality of such expenditure in generating future income streams;

(v) Progress made in increasing tax/non-tax revenues, promoting savings by adoption of Direct Benefit Transfers and Public Finance Management System, promoting digital economy and removing layers between the government and the beneficiaries;

(vi) Progress made in promoting ease of doing business by effecting related policy and regulatory changes and promoting labour intensive growth;

5. The Commission shall use the population data of 2011 while making its recommendations.

6. The Commission may review the present arrangements on financing Disaster Management initiatives, with reference to the funds constituted under the Disaster Management Act, 2005 (53 of 2005), and make appropriate recommendations thereon.

7. The Commission shall indicate the basis on which it has arrived at its findings and make available the State wise estimates of receipts and expenditure.

8. The Commission shall make its report available by 30th October, 2019, covering a period of five years commencing 1st April, 2020.

Evaluation of 15th Finance Commission:

1) Revenue Deficit Grants:

The ToR states that the Commission also examines if revenue deficits grants are to be provided at all. There is an argument that discontinuance of the provision of revenue deficit grants is an unwarranted invitation, because this discontinuance according to some critiques

should be made compulsory rather than mere direction or instruction. Recurring revenue expenditure is not seen as growth inducing therefore revenue expenditure should never exceed revenue receipts. This discontinuance is in line with the expectations of FRBM Act, 2003, which recommends that states should maintain a revenue deficit of zero. Also this ensures that all borrowings of the states are exclusively channelized growth-promoting capital expenditure. But revenue deficit grants is a provision that states with persistent deficits would expect and they are in need of this grants. This discontinuance will lead to failure of Finance Commission to notice the expectation of the states. Moreover the earlier Finance Commission underestimated the revenue deficits grants for some states (for examples Kerala, West Bengal).
However the 15th Finance Commission in 2020-21, recommends revenue deficits grants of estimated 73,340 crores for 14 states.

2) Consent to states for Borrowing:
The ToR directs the 15th Finance Commission to consider the conditions that the Union Government may impose on the states while providing consents under Article 293(3) of the constitution of India. This reference of examining the use of conditionality while giving permission to state government to borrow appears to be driven by the fear that “the union would be derived of its ability to enforce fiscal rules on the states”.

But union has unable to enforce fiscal rules on the states even when it is empowered to do so under Article 293(3). The Nine states projected revenue deficits in their budgets for 2017-18 and wereall required to take the centre’s consent for borrowing under Article 293(3) and they have probably done so. The centre has been either unwillingly or unable to disciple these states fiscally. On one hand, Centre has not been able to enforce fiscal rules on states under Article 293(3) when centre can do it under Article 293(3) and on the other hand putting additional conditionalities for borrowing does not make any sense. Moreover, the central government could encourage 12 states who are likely to pay off their outstanding loan to the entire to avail external development assistance on back-to-back basis. Already ‘back-to-back’ arrangement entails exposure to states to uncertain movement in international rates of interest and currency exchange rates. This would be better way to ensure control on states’ lending in the medium term rather than putting additional conditions for borrowings.

3) Incentives as Controls:
Performance based incentive will have an influence on policy decisions that the states will take. This provision is problematic because:

- It discourage the independent decision making by the states which is an important component of cooperative federalism; and

- It does not hold union government accountable for its own fiscal prudence and dilutes the joint responsibility that the centre and states have.

If common resources are shared based on incentives, then the principle of creating fiscal equality can never be realized. Moreover, the XV-FC will be no longer a right institution to judge the performance of states and provide incentives.

4) Change in Population Data:

The 15^{th} FC has decided to use the population data from only Census of India 2011 for its recommendations which results in an unequal distribution of tax proceeds because population in a given statedetermines a major portion of the resources that received from Centre. This is unlike all FC (since the Seventh Finance Commission) that have used the 1971 population data for devolution of taxes, duties and grants in aid. Southern states strongly opposed that because they adopted population control policy and they are almost successful in control growing population. So they feel that they are being disincentivised, as states with larger population are expected to be allocated more fiscal resources.

In order to solve this said problem an interesting and completely new parameter demographic performance has been introduced in the 15^{th} FC. This is based on the state's total fertility rate-the average number of children borne by each women resident.

Not only does this help reward states for achieving family planning goals, it also recognizes them for doing well in health, education and gender, which are all highly correlated with low total fertility rate.

Another criterion called 'tax effort' has been reintroduced by the Commission defined that states which are able to called a heavy amount taxes in relation to their gross domestic product will be rewarded.

This said recommendation is criticized on basis of following grounds-

a) Not doing enough:
However, though all those steps have been taken by the Commission, it is seen that the share of South in the tax proceeds decline again with Karnataka as the biggest loser from 4.71% to 3.65% followed by Kerala, Andhra Pradesh and Telangana.

In the North, the Hindi belt saw an increase in its allocations, with every state other than Haryana and Uttar Pradesh receiving a larger portion of the pie. In total, while the South saw its allocation drop by 1.96% the Hindi belt saw its share of the pie rise by 1.84%.

So while the FC has introduced new parameters, the wide gap between the fertility rates of the South and the North means that even with these new factors, southern states have shown as significant decline in horizontal devolution.

b) Faulty Formula:
This is attributed to the fact that the FC formulae often consider population even the parameters have nothing to do with the population data. For instance, to calculate demographic performance the reciprocal of the fertility rates of states are taken and it makes sense. And then this inverse of states' fertility rates are multiplied with 1971 population. It is really questionable how the population of state in 1971 is a factor while calculating demographic performance.

Similarly, the tax effort criteria also include population: this time, the 2011 figure. Tax effort, in theory, is supposed to measure, in the commission's own words, "efficiency of tax

collection". It is unclear how the size of a state can be a factor in determining how good it is at collecting taxes.
As a result, this formula produces inexplicable results. For example, Uttar Pradesh scores higher than Tamil Nadu on "tax effort". And Bihar beats Kerala on "demographic performance"
The Terms of Reference of the 15th Finance Commission have generated lot of debate and discontent because some Indian states feel that their powers are being taken away. While states that have done better on development indicators are concerned that they are being disadvantaged, the larger is about the reversal of India's **cooperativefederalism.**

6. COMPARISON:

Some significant changes have been noticed in the key recommendations in the first report of 15th FC for the period 2020-21.

1. The share of states in centre's taxes is recommended to be decreased from 42% during 2015-20 period to 41%for 2020-21. The 1% decrease is to provide for newly formed union territories J&K and Ladakh.

2. There is a change in the criteria adopted by the 15th FC to determine the share of each state in the central taxes. Earlier there were 5 criteria each of which had a different weightage. The 15th FC adopted 6 criteria in 3 broad categories- need based equity based and performance based.

Criteria	14th FC	15th FC
1. Income distance	**50.0**	**45.0**
2. Population (1971)	**17.5**	**-**
3. Population(2011)	**10.0**	**15.0**
4. Area	**15.0**	**15.0**
5. Forest & ecology	**-**	**10**
6. Demographic Performance	**-**	**12.5**
7.Tax Effort	**-**	**2.5**

Source: Report of 15th FC

As we mentioned earlier only population figures from 2011 census are being considered by 15th FC unlike during the previous commission where the data from 1971 and 2011 census were both considered with varying weightage.

The criterion of ‘Forest Cover' is replaced by three new criteria-Forest and Ecology, Demographic Performance, Tax effort. Weightage of Income Distance is reduced from 50% in the 14th FC to 45%.

The performance of states in population control rewarded the inclusion of Demographic Performance as a criterion with 12.5% weightage. States with lower fertility rates are given a higher score.

2.5% weightage is provided for Tax effort in recognition of states efforts in effective tax collection.

Central Tax Share among different States: A Comparison withPrevious Commission:

State	**14th Finance Commission**		**15th Finance Commission**		**Devolution for FY 2020-2021**
	Shareout of 42%	**Share in divisible pool**	**Shareout of 41%**	**Share in divisible**	**(In Rs Crore)**
Andhra Pradesh	**1.81**	**4.31**	**1.69**	**4.11**	**35156**
Arunachal Pradesh	**0.58**	**1.38**	**0.72**	**1.76**	**15051**
Assam	**1.39**	**3.31**	**1.28**	**3.13**	**26776**
Bihar	**4.06**	**9.67**	**4.13**	**10.06**	**86039**
Chhattisgarh	**1.29**	**3.07**	**1.4**	**3.42**	**29230**
Goa	**0.16**	**0.38**	**0.16**	**0.39**	**3301**

ISSN 2515-8260 Volume 07, Issue 08, 2020

Gujarat	**1.3**	**3.1**	**1.39**	**3.4**	**29059**
Haryana	**0.46**	**1.1**	**0.44**	**1.08**	**9253**
Himachal Pradesh	**0.3**	**0.71**	**0.33**	**0.8**	**6833**
Jammu & Kashmir	**0.78**	**1.86**			
Jharkhand	**1.32**	**3.14**	**1.36**	**3.31**	**28332**
Karnataka	**1.98**	**4.71**	**1.49**	**3.65**	**31180**
Kerala	**1.05**	**2.5**	**0.8**	**1.94**	**16616**
Madhya Pradesh	**3.17**	**7.55**	**3.23**	**7.89**	**67439**
Maharashtra	**2.32**	**5.52**	**2.52**	**6.14**	**52465**
Manipur	**0.26**	**0.62**	**0.29**	**0.72**	**6140**
Meghalaya	**0.27**	**0.64**	**0.31**	**0.77**	**6542**
Mizoram	**0.19**	**0.45**	**0.21**	**0.51**	**4327**
Nagaland	**0.21**	**0.5**	**0.23**	**0.57**	**4900**
Odisha	**1.95**	**4.64**	**1.9**	**4.63**	**39586**
Punjab	**0.66**	**1.57**	**0.73**	**1.79**	**15291**
Rajasthan	**2.31**	**5.5**	**2.45**	**5.98**	**51131**

ISSN 2515-8260 Volume 07, Issue 08, 2020

Sikkim	**0.15**	**0.36**	**0.16**	**0.39**	**3318**
Tamil Nadu	**1.69**	**4.02**	**1.72**	**4.19**	**35823**
Telangana	**1.02**	**2.43**	**0.87**	**2.13**	**18241**
Tripura	**0.27**	**0.64**	**0.29**	**0.71**	**6063**
Uttar Pradesh	**7.54**	**17.95**	**7.35**	**17.93**	**153342**
Uttarakhand	**0.44**	**1.05**	**0.45**	**1.1**	**9441**
West Bengal	**3.08**	**7.33**	**3.08**	**7.52**	**64301**
TOTAL	**42**	**100**	**41**	**100**	**855176**

Sources: Reports of 14^{th} and 15^{th} Finance Commission

The greatest loss as per the interim report of 15^{th} FC is in the case of Karnataka which is now slated to receive 3.65% of divisible pool as opposed to 4.71% i.e. a reduction by 1.06%. Kerala, Telangana, Andhra Pradesh and Assam also witnessed a fall in their share.

After consultation with the central and state governments, the 15^{th} FC decided to continue with existing framework and legacy of the earlier FC as far as Grants-in-Aid like Revenue Deficit Grant's , Local Bodies Grant's and Disaster Management Grants. Grant's to the local bodies for 2020-21 has been fixed at 90000 crores. This allocation is 4.31%of the divisible pool, which is 3.54% of the divisible pool in the year 2019-20.15^{th} FC recommended special Grant's to the Telangana Mizoram and Karnataka aggregating 6,764 crores.

Area and population are still the major drivers for the tax devolution formula.
The larger income distance of under developed states and higher weightage implies that these states continue to get a higher share in the funds available for the states from the divisible pool.

Reducing the weightage given for income gap and introducing development based criteria like demographic performance is a step in the right direction encouraging the good performance of the states.

ISSN 2515-8260 Volume 07, Issue 08, 2020

7. CONCLUSION:

From the above discussion it is clear that 15th FC is upgraded version of the previous year's commission. It has adopted 6 criteria in three broad categories; it mandated the use of Census of 2011 population data and considered the impact of GST on centre state finance. But the FC has generated a lot of debate. The ToR of the Finance Commission, which is the last in the chain of events, hastens the process of centralization and if it implemented, cooperative federalism would only exist in name. It creates threat in the matter of cooperative federalism. In this case fundamental changes are needed to make cooperative federalism a meaningful and functioning one.

REFERENCES:

[1]. MohantykumarRanjit(2017).Recommendations of 14th Finance Commission and comparative Fiscal Federalism in India.
[2]. Dr. WasdaniPoornimaKishinchand(2016).Fiscal Architecture of India: A comparative study of finance commission report.
[3]. Jena KartikPrasan(2017).Recommendations of 14th finance commission , fiscal empowerment of states and impact on Odisha