

## Government accepts 14<sup>th</sup> Finance Commission Recommendation for Tax Devolution

### Major recommendations of Fourteenth Finance Commission (FFC) accepted by the government

- *States' Share in the net proceeds of Union tax revenues increased to 42% from 32% earlier.* This is the largest ever jump in percentage of devolution. In the past, changes have ranged between 1-2% increase.
- *Eight Centrally Sponsored Schemes (CSS) delinked from support from the Centre.* Finance Commission has identified over 30 CSS schemes to be delinked from Centre's support but all have not yet been delinked considering the national priorities and legal obligations.
- *Sharing pattern under various CSS to undergo a change,* with States sharing higher fiscal responsibility for scheme implementation.
- *Distribution of grants to States for local bodies based on 2011 population data (90% weight) and area (10% weight)*

### Other key recommendations of FFC that government will examine

- Revenue compensation to States under GST should be for five years; 100% in first three years, 75% in fourth year and 50% in fifth year.
- Create an autonomous and independent '**GST Compensation Fund**' through legislative actions to facilitate the compensation process.
- Suggesting a fiscal consolidation roadmap, FFC puts a ceiling on fiscal deficit at 3% of GDP from 2016-17 onwards.
- Some flexible provisions for State's borrowings over and above the annual limit of fiscal deficit at 3% of GSDP.
- Establish an independent **Fiscal Council** to undertake ex-ante assessment of fiscal policy implications of budget proposals and their consistency with fiscal policy and rules.
- Suitably amend Electricity Act 2003 to facilitate levy of penalties for delays in payment of subsidies by the State Governments.
- Have independent regulators for road sector for tariff setting, quality regulation, among other functions.
- Several recommendations made for evaluating government's ownership, disinvestment in Central Public Sector Enterprises.

#### Key features/ changes

- In calculating grants to States, entire revenue expenditure taken into account without making distinction between 'Plan' and 'Non-Plan'
- Calculations for distribution of divisible proceeds are based on the formula incorporating parameters of population (1971), changes in population since then, income distance, forest cover and area (refer Annexure for table)
- Post devolution Revenue deficit grant to be given; 11 states identified (Refer annexure for table)

*"...following the acceptance of the 14th FC recommendations, we are moving away from rigid centralised planning, forcing a 'One size fits all' approach on states..."*

*- Excerpts from PM's letter to the Chief Ministers*

#### Positive Implications

- With greater fiscal space, states can meaningfully contribute to the overall growth and development in their regions, thereby adding to the aggregate growth of the nation
- States will now have the flexibility to implement delinked CSS schemes as per local needs. This should ideally ensure efficient utilisation of government resources

#### Downside Risks

- In the near term, huge tax devolution could put some strain on Centre's finances, especially until major CSS schemes get delinked and GST is implemented
- With greater discretionary funds with States, there is a risk of wastage of funds by some states towards populist and non-productive ends.

## State-wise share in divisible pool of Union taxes

States	Share (%)
Andhra Pradesh	4.305
Arunachal Pradesh	1.370
Assam	3.311
Bihar	9.665
Chhattisgarh	3.080
Goa	0.378
Gujarat	3.084
Haryana	1.084
Himachal Pradesh	0.713
Jammu and Kashmir	1.854
Jharkhand	3.139
Karnataka	4.713
Kerala	2.500
Madhya Pradesh	7.548
Maharashtra	5.521
Manipur	0.617
Meghalaya	0.642
Mizoram	0.460
Nagaland	0.498
Odisha	4.642
Punjab	1.577
Rajasthan	5.495
Sikkim	0.367
Tamil Nadu	4.023
Telangana	2.437
Tripura	0.642
Uttar Pradesh	17.959
Uttarakhand	1.052
West Bengal	7.324
<b>All States</b>	<b>100</b>

## Grant-in-aid for Revenue Deficit States (2015-2020)

States	2015-20 (Rs crores)
Andhra Pradesh	22,113
Assam	33,79
Himachal Pradesh	40,625
Jammu and Kashmir	59,666
Kerala	9,519
Manipur	10,227
Meghalaya	1,770
Mizoram	12,183
Nagaland	18,475
Tripura	5,103
West Bengal	11,760
<b>Total States</b>	<b>1,94,821</b>

## Criteria and Weights for calculating tax devolution

Criteria	Weight (%)
Population	17.5
Demographic Change	10
Income Distance	50
Area	15
Forest Cover	7.5

### Notes

- Population is as per 1971 census
- Demographic changes are changes in population since 1971
- Income distance is computed by calculating difference between 3 year average GSDP for each state with respect to state with highest per capita GSDP
- Forest cover to take into account the opportunity cost in terms of area not available for other economic activities
- Area has a floor limit of 2% for smaller states in deciding horizontal devolution