



# INDIAN FEDERAL FINANCE

BY

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# Meaning

India's political structure is federal; so **its financial system is also federal in character.** The essence of the federal form of government is that each government (Central, Union Territories and State governments) and local-self government is independent of each other with constitutionally demarcated functions.

# Federal Government

## 2 LEVEL of Government

[Central Government + States Governments]

**POLITICAL POWERS SHARED**  
by 2 level of Government

The **Constitution** is **RIGID & CODIFIED**

**2 DIFFERENT types of LAW**  
[Central + States Laws]

# Unitary Government

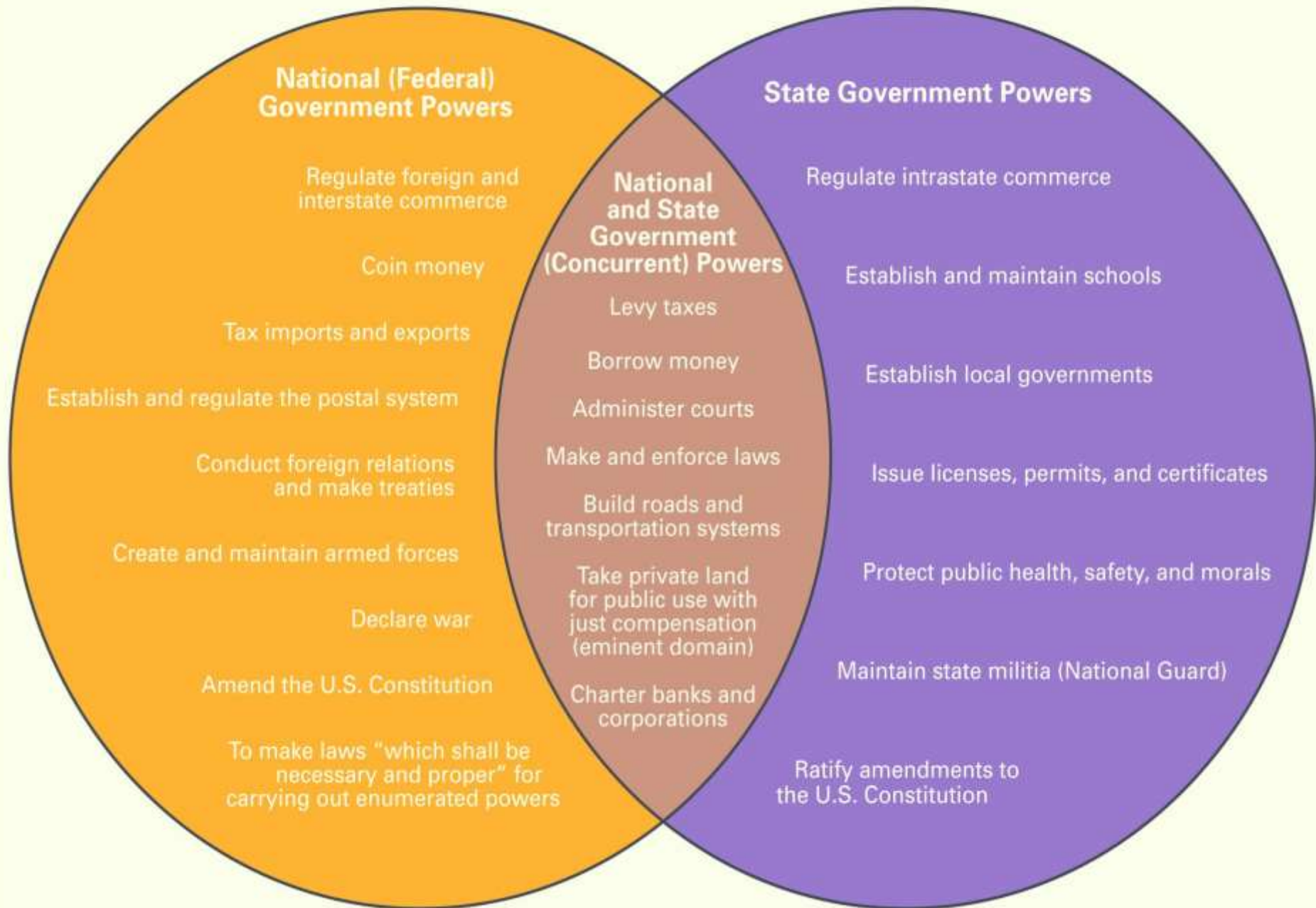
**ONLY 1 LEVEL of Government**  
[Central Government / National Government]

**Political Power held by Central Government ONLY**

The **Constitution** is **FLEXIBLE & UNCODIFIED**

**ONLY 1 set of law (uniform)**  
for whole country

# GOVERNMENT POWERS UNDER U.S. FEDERALISM



Implication of Panchayati Raj/ Municipalities as the  
Third Tier of Governance on  
India's Federal structure





# Principles of Federal Finance

1. Principle of Independence.
2. Principle of Equity.
3. Principle of Uniformity.
4. Principle of Adequacy.
5. Principle of Elasticity.
6. Principle of Integration and coordination.
7. Principle of Efficiency.
8. Principle of Administrative Economy.
9. Principle of Accountability.

# Constitution of India

## Union List

Includes subjects like,

- ◊ Defense
- ◊ Atomic Energy
- ◊ Foreign Affairs
- ◊ War and Peace
- ◊ Banking
- ◊ Railways
- ◊ Post and Telegraph
- ◊ Airways
- ◊ Ports
- ◊ Foreign Trade
- ◊ Currency & Coinage

Union Legislature alone can make laws on these matters.

## State List

Includes subjects like

- ◊ Agriculture
- ◊ Police
- ◊ Prison
- ◊ Local Government
- ◊ Public Health
- ◊ Land
- ◊ Liquor
- ◊ Trade and Commerce
- ◊ Livestock and Animal Husbandry
- ◊ State Public Services

Normally only the State Legislature can make laws on these matters

## Concurrent List

Includes subjects like,

- ◊ Education
- ◊ Transfer of Property other than Agricultural land
- ◊ Forests
- ◊ Trade Unions
- ◊ Adulteration
- ◊ Adoption and Succession

Both Union and State Legislature alone can make laws on these matters.

## Residuary Powers

Include all other matters not mentioned in any of the Lists.

- ◊ Cyber Laws

Union Legislature alone has the power to legislate on such matters

# Centre State Relation

India follows a federal shape in which the powers are shared among each centre and the states. It's also stated that India follows a quasi-federal shape in which the central government enjoys greater powers over the states. The financial resources that have been positioned at the disposal of the state are so meager that they've to look up to the Union Government for subsidies and contributions. Articles 268 to 281 of the Indian Constitution contain provisions providing guidelines for the center regarding the allocation of financial resources among the states.

Generally, in a typical federation along with the distribution of legislative and administrative powers, the financial resources of the country are also so distributed to ensure the financial independence of the units. However, the Indian Constitution does not make a clear cut distribution of the financial resources and leaves much to be decided by the Central Government from time to time. The financial resources which have been placed at the disposal of the state are so meagre that they have to look up to the Union Government for subsidies and contributions.

- GoI Act 1935
- Distribution of Taxes as well as non Tax revenues, Power of borrowing and Grat-in-aid by the Union to the states.
- Who Will Collect the taxes



# Taxes Exclusively Assigned to the Union

Income from certain subjects like customs and export duties, income tax, excise duty on tobacco, jute, cotton, etc., corporation tax, taxes on the capital value of assets of individuals and companies; Estate duty and succession duty in respect of the property and other than agricultural land; and income from the earning departments like the railways and postal departments have been exclusively assigned to the Union Government by the Constitution.

# Taxes Exclusively Assigned to States

Income from land revenue, stamp duty except on documents included in the Union List; succession duty and Estate duty in respect of agricultural land; income tax on agricultural lands; taxes on goods and passengers carried by road or inland water; taxes on vehicles used on roads, animals, boats, taxes on the consumption or sale of electricity, tolls, taxes on lands and buildings; taxes on professions, traders, calling and employment; duties on alcoholic liquors for human consumption, opium, Indian hemp, and other narcotic drugs, taxes on the entry of goods into local areas, taxes on luxuries, entertainments, amusements, betting and gambling, etc. has been assigned to the States.

## **Taxes Levied by Union but Collected and Appropriated by the State**

The taxes on the following items are levied by the Union Government but the actual revenue from them is collected and appropriated by the States; (i) stamp duties on bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, etc.; (ii) Excise duties on medicinal toilet preparation containing alcohol or opium or Indian hemp or other narcotic drugs.

## **Taxes Levied and Collected by the Union but assigned to States**

The taxes in this category are levied and collected by the Union Government although they are subsequently handed over to the states wherefrom they have been collected. Such taxes included duties in respect of succession to property other than agricultural land; state duty in respect of property other than agricultural land terminal taxes on goods or passengers carried by railways, sea or air, taxes on railway freights and fares; taxes other than stamp duties on transactions in stock exchanges and futures markets; taxes on the sale or purchase of newspapers and advertisements published therein; taxes on purchase or sale of goods other than newspapers where such sale or purchases take place in the course of interstate trade or commerce.

## **Taxes Levied and Collected by the Union but Shared**

Taxes on income other than agricultural income and excise duties other than those on medicinal and toilet preparations are levied and collected by the Union Government but shared with the states on an equitable basis. The basis of distribution is determined by the Parliament through a law.

# Financial Relation Between Centre And States - Constitutional Provisions

## Article 268

- Article 268 deals with stamp duty levied by the Union but collected and distributed by the States.
- These taxes are not included in the Consolidation Fund of India and are allocated by the same state in which they are levied, so they do not contribute to the Indian Consolidation Fund.
- With the **88th amendment to the Constitution**, a new provision **268 A** was included in this article, which included the tax on services in its ambit, but it was again excluded by the 101st Amendment to the Constitution and the introduction of GST.

## Article 269

- It is a tax levied on all interstate purchases, sales and transportation of goods, except those mentioned in section 269 A and in newspapers.
- Taxes are collected and collected by the central government but are distributed by the state governments. The tax levied under this clause is not included in the consolidated fund of India.

## Article 269 A

- The 101st Constitutional Amendment introduced a new provision 269A, which introduced a number of significant changes.
- **Article 269A (1) mainly deals with the following aspects:** Taxation and collection of tax on goods and services (GST).

## Article 270

- Taxes are collected and levied by the Center, but are allocated between the Center and the states (Article 270).

## Article 271

- Parliament has the right to increase taxes or duties at any time by introducing additional charges, except in the case of the goods and services tax referred to in section 246A.
- All income generated from surcharges will be part of India's consolidated fund. Taxes will be withheld by Parliament and will not be shared between states.

## **Distribution Of Non-tax Revenues**

- The Centre – receipts from Posts & telegraphs, Banking Railways, Broadcasting, Coinage & currency, Escheat & lapse.
- The States – receipts from Irrigation, Forests, Fisheries, State PSE, Escheat & lapse

## **How States Get Grant-in-aids From The Centre?**

- In addition to the distribution of taxes between the Center and the states, there are several provisions in the Constitution that regulate the scope for Grants-in-aid.
- In accordance with Article 275 and 282, Parliament may provide grants-in-aid from the Consolidation Fund of India to such states as they needed assistance, especially to improve the welfare of the tribal areas, including a special grant to Assam.

## **Statutory Grants**

- Statutory grant is provided in Article 275 of the Indian Constitution.
- Parliament provides these grants to specific states that need assistance.

## **Discretionary Grants**

- In accordance with Article 282, the Center may, at its discretion, provide assistance to certain states for public purposes.
- These Grants are optional, not compulsory in nature.

## **Other Grants**

- Grants for a temporary period
- Grants provided in lieu of export duties on jute & jute products to the states of Assam, Bihar, W. Bengal & Orissa.

# Finance Commission - Article 280

- The Finance Committee, established in 1951 in accordance with article 280 of the Constitution.
- It mainly determines how income is distributed between the Center and the States.
- In addition, the Commission also determines the principles for grants-in-aids to states.
- Article 280 regulates the Finance Commission, a quasi-judicial body established by the President.

## **FC Recommends To The President:**

- Allocation, Respective shares and Distribution of taxes among Centre and State.
- Principles that will guide Grants in Aid by the Center to the states.
- Measures necessary to increase the Consolidation Fund
- Any other issues proposed by the President



# **GST Regime - 101st Amendment to the Constitution**

- Goods and Services Tax (GST) is an indirect tax introduced in India on July 1, 2017, and applied throughout India, replacing the tiered taxes levied by the central government and the state.
- It was passed as the Constitution (One Hundred and First Amendment) Act, 2016, following the passage of the 122nd Constitutional Amendment Bill.
- According to the GST, goods and services are taxed at the following rates: 0%, 5%, 12%, 18% and 28%.
- GST is classified as CGST, SGST, or IGST depending on whether the transaction is for intrastate or interstate delivery.

# Gadgil-Mukherjee Formula

Up to 3rd Five Year Plan (FYP) [1961-66] and during Plan Holiday (1966-69), allocation of Central Plan Assistance was schematic and no formula was in use.

## The Gadgil Formula comprising

1. Population [60%]
  2. Per Capita Income (PCI) [10%]
  3. Tax Effort [10%]
  4. On-going Irrigation & Power Projects [10%] and
  5. Special Problems [10%] was used during 4th FYP (1969-74) and 5th FYP (1974-78).
- ❖ However, since item (4) was perceived as being weighted in favour of rich states, the formula was modified by raising the weightage of PCI to 20%. The National Development Council (NDC) approved the modified Gadgil formula in August 1980.
  - ❖ It formed the basis of allocation during 6th FYP (1980-85), 7th FYP (1985-90) and Annual Plan (AP) 1990-91.
  - ❖ Following suggestions from State Governments, the modified Gadgil Formula was revised to Population (55%), PCI [25% {20% by deviation method and 5% by distance method}], Fiscal Management (5%) and Special Development Problems (15%). However, it was used only during AP 1991-92.

Due to reservations of State Governments on revision, a Committee under Shri Pranab Mukherjee, then Deputy Chairman, Planning Commission was constituted to evolve a suitable formula. The suggestions made by the Committee were considered by NDC in December 1991, where following a consensus, the Gadgil-Mukherjee Formula was adopted. It was made the basis for allocation during 8th FYP (1992-97) and it has since been in use. After setting apart funds required for (a) Externally Aided Projects and (b) Special Area Programme, 30% of the balance of Central Assistance for State Plans is provided to the Special Category States. The remaining amount is distributed among the non-Special Category States, as per Gadgil-Mukherjee Formula.

#### **Gadgil-Mukherjee Formula**

I	Criteria	Weight	Remarks
II	Population (1971)	<b>60%</b>	
	Per capita Income	<b>25%</b>	
	<i>a) Deviation method</i>	20%	Covering states with per capita SDP below national average
	<i>b) Distance method</i>	5%	For all states
III	Performance in Tax Effort, Fiscal Management and Progress in respect of National objectives	<b>7.5%</b>	Tax policy [2.5%], Fiscal Management [2.0%], National objectives [3%] comprising population control (1.0%), elimination of illiteracy (1.0%), timely completion of Externally Aided Projects (0.5%) and land reforms (0.5%)
IV	Special Problems	<b>7.5%</b>	

# 13<sup>th</sup> Finance Commission

- Members of the Commission were:[\[2\]](#)
- Dr. Vijay L. Kelkar, Chairman
- Shri [B.K. Chaturvedi](#), Part-time
- Dr. [Indira Rajaraman](#)
- Prof. [Atul Sarma](#)
- Dr. [Sanjiv Misra](#)
- Shri [Sumit Bose](#), Secretary

# Major Recommendations

- The major recommendations of the Commission were:
- The share of states in the net proceeds of the shareable [Central](#) taxes should be 32%. This is 1.5 percentage-points higher than the recommendation of the [12th Commission](#).
- [Revenue deficit](#) to be progressively reduced and eliminated, followed by revenue surplus by 2013–2014.
- [Fiscal deficit](#) to be reduced to 3% of the [gross domestic product](#) (GDP) by 2014–2015.
- A target of 68% of GDP for the combined debt of centre and states.
- The [Medium Term Fiscal Plan](#) (MTFP) should be reformed and made the statement of commitment rather than a statement of intent.
- [Fiscal Responsibility and Budget Management Act, 2003](#) need to be amended to mention the nature of shocks which shall require targets relaxation.
- Both centre and states should conclude 'Grand Bargain' to implement the model Goods and Services Act (GST). (Task force recommended single positive GST rate of 12% comprising 5% CGST and 7% SGST ) To incentivise the states, the commission recommended a sanction of the grant of Rs500 billion.
- Initiatives to reduce the number of Central Sponsored Schemes (CSS) and to restore the predominance of formula-based plan grants.
- States need to address the problem of losses in the power sector in time bound manner.



**Table 1.1: Inter se Shares of States**

<b>States</b>	<b>Share of all Shareable Taxes Excluding Service Tax(per cent)</b>	<b>Share of Service Tax (per cent)</b>
Andhra Pradesh	6.937	7.047
Arunachal Pradesh	0.328	0.332
Assam	3.628	3.685
Bihar	10.917	11.089
Chhattisgarh	2.470	2.509
Goa	0.266	0.270
Gujarat	3.041	3.089
Haryana	1.048	1.064
Himachal Pradesh	0.781	0.793
Jammu & Kashmir	1.551	nil
Jharkhand	2.802	2.846
Karnataka	4.328	4.397
Kerala	2.341	2.378
Madhya Pradesh	7.120	7.232
Maharashtra	5.199	5.281
Manipur	0.451	0.458
Meghalaya	0.408	0.415
Mizoram	0.269	0.273
Nagaland	0.314	0.318
Orissa	4.779	4.855
Punjab	1.389	1.411
Rajasthan	5.853	5.945
Sikkim	0.239	0.243
Tamil Nadu	4.969	5.047
Tripura	0.511	0.519
Uttar Pradesh	19.677	19.987
Uttarakhand	1.120	1.138
West Bengal	7.264	7.379
<b>All States</b>	<b>100.000</b>	<b>100.000</b>

**Table 1.2: Grants-in-Aid to States**

		<i>(Rs. crore)</i>
I	Local Bodies	87519
II	Disaster Relief (including for capacity building)	26373
III	Post-devolution Non-plan Revenue Deficit	51800
IV	Performance Incentive	1500
V	Elementary Education	24068
VI	Environment	15000
	<i>(a) Protection of Forests</i>	5000
	<i>(b) Renewable Energy</i>	5000
	<i>(c) Water Sector Management</i>	5000
VII	Improving Outcomes	14446
	<i>(a) Reduction in Infant Mortality Rates</i>	5000
	<i>(b) Improvement in Supply of Justice</i>	5000
	<i>(c) Incentive for Issuing UIDs</i>	2989
	<i>(d) District Innovation Fund</i>	616
	<i>(e) Improvement of Statistical Systems at State and District Level</i>	616
	<i>(f) Employee and Pension Data base</i>	225
VIII	Maintenance of Roads and Bridges	19930
IX	State-specific	27945
X	Implementation of model GST	50000
	<b>Total</b>	<b>318581</b>

# 14<sup>th</sup> Finance Commission

The Fourteenth Finance Commission of India was a finance commission constituted on 2 January 2013. The commission's chairman was former Reserve Bank of India governor Y. V. Reddy and its members were

- Sushma Nath,
- M. Govinda Rao,
- Abhijit Sen,
- Sudipto Mundle, and
- AN Jha.

The recommendations of the commission entered force in April 2015; they take effect for a five-year period from that date.

# Recommendations of 14<sup>th</sup> FC

## **Sharing of Union tax revenues with states**

- Transfers from Union to states consist of tax devolution, non-Plan grants, Plan grants and grants for various Central Supported Schemes (CSS) including those which were transferred directly to the implementing agencies bypassing the budget.

## **Vertical devolution**

- The fourteenth finance commission is of the view that tax devolution should be the primary route of resources to the states. The commission recommends to increase the tax devolution of the divisible pool to states to 42% for years 2015 to 2020. This is 10% more compared to 32% target set by 13th financial commission.
- The commission recommended that the new tax devolution should be the primary route of transfer of resources to States since it is formula based and thus conducive to sound fiscal federalism. However, to the extent that formula-based transfers do not meet the needs of specific States, they need to be supplemented by grants-in-aid.
- The commission felt that new target serve the twin objectives of increasing the flow of unconditional transfers to the States and yet leave appropriate fiscal space for the Union to carry out other duties and specific purpose transfers to the States.

## Horizontal devolution

**The commission came up with new formula to divide the 42% share of the divisible pool between the states.**

**Area:** The commission followed the method adopted by the 12th commission and put the floor limit at 2 percent for smaller States and assigned 15 percent weight.

**Forest cover:** The commission assigned 7.5 per cent weight to [forest cover](#) as the new criteria to balance the benefit of the huge ecological benefits and the opportunity cost in terms of area not available for other economic activities that becomes indicator of fiscal disability.

The formulae of distribution are given below;

Criteria	13th Commission Weight(%)	14th Commission Weight (%)
Population 1971	25	17.5
Population 2011	0	10
Income Distance	47.5	50
Fiscal Discipline	15	0
Area	10	15
Forest Cover	0	7.5
Sum	100	100



# Horizontal share of States

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 & 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
Total	100.000

# Fiscal plan

- Devolution to special States
  - 1.94 lakh Crores is to be used as the post devolution revenue deficit grant for the 11 states with gaping Revenue Deficits.
  - Fiscal Deficit is to be reduced to 3% of GDP, Revenue Deficit to be 0% by 2017.
  - Medium term fiscal plan (MTFP) is to be the statement of commitment instead of the statement of intent.
  - A target of 62% of GDP is to be set for the combined debt of center and states. This is improvement over the 68% set by the previous commission.
  - States are to be eligible for an additional borrowing limit of 0.25% of GSDP.
  - The current FRBM Act is to be amended to explain the nature of shocks which require relaxation from the target and to be merged with a Debt ceiling and Fiscal responsibility Act.
- Actions to address the less fiscal space with the center.
  - An independent council is to be set up to assess the fiscal policy implications.
  - Inter state council to be expanded for co-operative federalism to identify sector specific grants to states.
  - Initiatives to reduce 30 central sponsored schemes. The central government has accepted 8 of them.

# Highlights of 14<sup>th</sup> Finance Commission Report

## February 2015

### 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.

# 15th Finance Commission

- The **Finance Commission (FC)** is a **constitutional body**, that determines the method and formula for **distributing the tax proceeds between the Centre and states**, and among the states as per the constitutional arrangement and present requirements.
- Under **Article 280 of the Constitution**, the **President of India** is required to constitute a Finance Commission at an interval of five years or earlier.
- The 15<sup>th</sup> Finance Commission was constituted by the President of India in November 2017, **under the chairmanship of NK Singh**. Its recommendations will cover a **period of five years from the year 2021-22 to 2025-26**. The 15<sup>th</sup> Finance Commission was required to submit two reports. The first report, consisting of recommendations for the financial year 2020-21, was tabled in Parliament in February 2020. The final report with recommendations for the 2021-26 period was tabled in Parliament on February 1, 2021.
- Members: Shaktikanta Das; Prof. (Dr.) Anoop Singh; Ajay Narayan Jha and Prof. Dr. Ramesh Chand

## 15<sup>th</sup> Finance Commission's Recommendations

- **Vertical Devolution (Devolution of Taxes of the Union to States):**
  - It has recommended **maintaining the vertical devolution at 41%** - the same as in its [interim report for 2020-21](#).
    - It is **at the same level of 42% of the divisible pool** as recommended by the **14<sup>th</sup> Finance Commission**.
  - It has **made the required adjustment of about 1%** due to the changed status of the erstwhile State of Jammu and Kashmir into the new [Union Territories of Ladakh and Jammu and Kashmir](#).
- **Horizontal Devolution (Allocation Between the States):**
  - For horizontal devolution, it has suggested **12.5% weightage to demographic performance, 45% to income, 15% each to population and area, 10% to forest and ecology and 2.5% to tax and fiscal efforts**.
- **Revenue Deficit Grants to States:**
  - Revenue deficit grants **emanate from the requirement to meet the fiscal needs of the States** on their revenue accounts that remain to be met, even after considering their own tax and non-tax resources and tax devolution to them.
  - Revenue Deficit is **defined as** the difference between revenue or current expenditure and revenue receipts, that includes tax and non-tax.
  - It has recommended post-devolution **revenue deficit grants amounting to about Rs. 3 trillion over the five-year period** ending FY26.
    - The **number of states qualifying** for the revenue deficit grants **decreases from 17 in FY22**, the first year of the award period to 6 in **FY26**, the last year.



- **Performance Based Incentives and Grants to States:**

- These grants **revolve around four main themes.**
- The first is the **social sector**, where it has focused on **health and education.**
- Second is the **rural economy**, where it has focused on **agriculture and the maintenance of rural roads.**
  - The rural economy plays a significant role in the country as it **encompasses two-thirds of the country's population, 70% of the total workforce and 46% of national income.**
- Third, **governance and administrative reforms** under which it has recommended grants for **judiciary, statistics and aspirational districts and blocks.**
- Fourth, it has developed a **performance-based incentive system for the power sector**, which is not linked to grants but provides an important, additional borrowing window for States.

- **Fiscal Space for Centre:**

- **Total 15<sup>th</sup> Finance Commission transfers (devolution + grants) constitutes about 34% of estimated Gross Revenue Receipts to the Union, leaving adequate fiscal space to meet its resource requirements and spending obligations on national development priorities.**

- **Grants to Local Governments:**

- Along with grants for municipal services and local government bodies, it includes **performance-based grants for incubation of new cities** and **health grants** to local governments.
- In grants for Urban local bodies, **basic grants are proposed only for cities/towns having a population of less than a million.** For **Million-Plus cities**, 100% of the grants are performance-linked through the **Million-Plus Cities Challenge Fund (MCF).**
  - MCF amount is linked to the performance of these cities in **improving their air quality** and meeting the service level benchmarks for **urban drinking water supply, sanitation and solid waste management.**

# Horizontal Devolution Criteria

•Based on principles of need, equity and performance, overall devolution formula is as follows.

Criteria	Weight (%)
Population	15.0
Area	15.0
Forest & ecology	10.0
Income distance	45.0
Tax & fiscal efforts	2.5
Demographic performance	12.5
<b>Total</b>	<b>100</b>

# Performance incentives and grants:

S. No.	Grant Components	2021-26
1	<b>Revenue Deficit grants</b>	294514
2	<b>Local governments grants</b>	436361
3	<b>Disaster management grants</b>	122601
4	<b>Sector-specific grants</b>	129987
<i>i</i>	<i>Sectoral grants for Health</i>	31755
<i>ii</i>	<i>School Education</i>	4800
<i>iii</i>	<i>Higher Education</i>	6143
<i>iv</i>	<i>Implementation of agricultural reforms</i>	45000
<i>v</i>	<i>Maintenance of PMGSY roads</i>	27539
<i>vi</i>	<i>Judiciary</i>	10425
<i>vii</i>	<i>Statistics</i>	1175
<i>viii</i>	<i>Aspirational districts and blocks</i>	3150
5	<b>State-specific</b>	49599
	<b>Total</b>	<b>1033062</b>

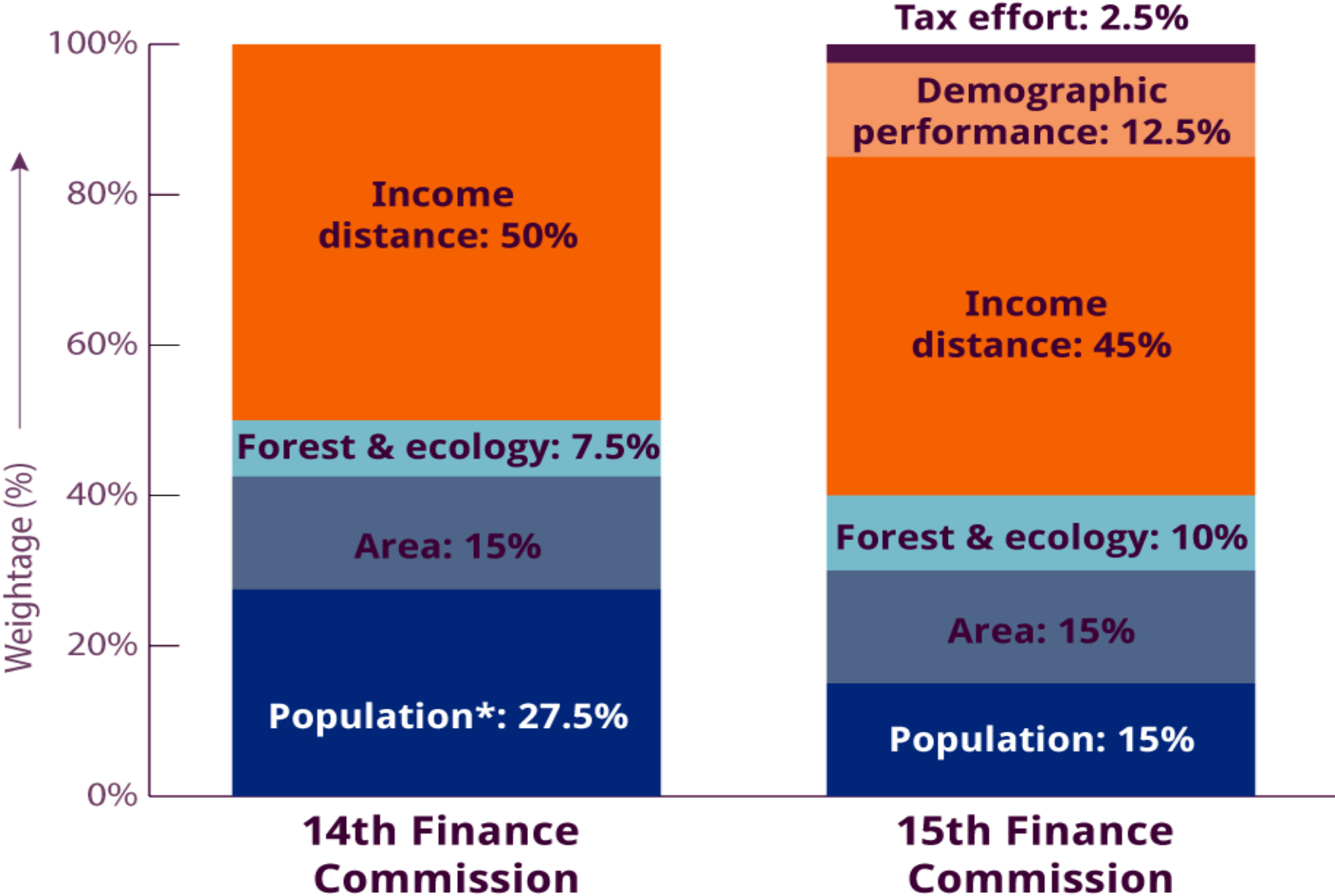
## Individual share of states in the taxes devolved by the centre (out of 100)

State	14th FC 2015-20	15th FC 2020-21	15th FC 2021-26
Andhra Pradesh	4.305	4.111	4.047
Arunachal Pradesh	1.370	1.760	1.757
Assam	3.311	3.131	3.128
Bihar	9.665	10.061	10.058
Chhattisgarh	3.080	3.418	3.407
Goa	0.378	0.386	0.386
Gujarat	3.084	3.398	3.478
Haryana	1.084	1.082	1.093
Himachal Pradesh	0.713	0.799	0.830
Jammu & Kashmir	1.854	-	-
Jharkhand	3.139	3.313	3.307
Karnataka	4.713	3.646	3.647
Kerala	2.500	1.943	1.925
Madhya Pradesh	7.548	7.886	7.850
Maharashtra	5.521	6.135	6.317
Manipur	0.617	0.718	0.716
Meghalaya	0.642	0.765	0.767
Mizoram	0.460	0.506	0.500
Nagaland	0.498	0.573	0.569
Odisha	4.642	4.629	4.528
Punjab	1.577	1.788	1.807
Rajasthan	5.495	5.979	6.026
Sikkim	0.367	0.388	0.388
Tamil Nadu	4.023	4.189	4.079
Telangana	2.437	2.133	2.102
Tripura	0.642	0.709	0.708
Uttar Pradesh	17.959	17.931	17.939
Uttarakhand	1.052	1.104	1.118
West Bengal	7.324	7.519	7.523
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>

# Defence and Internal Security

- Keeping in view the extant strategic requirements for national defence in the global context, XVFC has, in its approach, re-calibrated the relative shares of Union and States in gross revenue receipts. This will enable the Union to set aside resources for the special funding mechanism that XVFC has proposed.
- **The Union Government may constitute in the Public Account of India, a dedicated non-lapsable fund, Modernisation Fund for Defence and Internal Security (MFDIS). The total indicative size of the proposed MFDIS over the period 2021-26 is Rs. 2,38,354 crore.**
- **Disaster Risk Management:**
- Mitigation Funds should be set up at both the national and State levels, in line with the provisions of the Disaster Management Act. The Mitigation Fund should be used for those local level and community-based interventions which reduce risks and promote environment-friendly settlements and livelihood practices.
- For SDRMF, XVFC has recommended the total corpus of Rs.1,60,153 crore for States for disaster management for the duration of 2021-26, of which the Union's share is Rs. 1,22,601 crore and States' share is Rs. 37,552 crore.
- XVFC has recommended six earmarked allocations for a total amount of Rs. 11,950 crore for certain priority areas, namely, two under the NDRF (Expansion and Modernisation of Fire Services and Resettlement of Displaced People affected by Erosion) and four under the NDMF (Catalytic Assistance to Twelve Most Drought-prone States, Managing Seismic and Landslide Risks in Ten Hill States, Reducing the Risk of Urban Flooding in Seven Most Populous Cities and Mitigation Measures to Prevent Erosion).
- **Fiscal consolidation**
- Provided range for fiscal deficit and debt path of both the Union and States.
- Additional borrowing room to States based on performance in power sector reforms.
- A threshold amount of annual appropriation should be fixed below which the funding for a CSS may be stopped. Below the stipulated threshold, the administering department should justify the need for the continuation of the scheme. As the life cycle of ongoing schemes has been made co-terminus with the cycle of Finance Commissions, the third-party evaluation of all CSSs should be completed within a stipulated timeframe. The flow of monitoring information should be regular and should include credible information on output and outcome indicators.

# Revenue-sharing formulas in the 14th and 15th Finance Commissions



# Criticism

- **Performance based incentives dis-incentivizes independent decision-making.** Any conditions on the state's ability to borrow will have an adverse effect on the spending by the state, particularly on development thus, **undermines cooperative fiscal federalism.**
- **It does not hold the Union government accountable for its own fiscal prudence** and dilutes the joint responsibility that the Union and States have.