

Report of the 15th Finance Commission for FY 2020-21

- The Finance Commission is a constitutional body formed by the President of India to give suggestions on centre-state financial relations. The 15th Finance Commission (Chair: Mr N. K. Singh) was required to submit two reports. The first report, consisting of recommendations for the financial year 2020-21, was tabled in Parliament on February 1, 2020. The final report with recommendations for the 2021-26 period will be submitted by October 30, 2020.

Key recommendations in the first report (2020-21 period) include:

- Devolution of taxes to states:** The share of states in the centre's taxes is recommended to be decreased from 42% during the 2015-20 period to 41% for 2020-21. The 1% decrease is to provide for the newly formed union territories of Jammu and Kashmir, and Ladakh from the resources of the central government. The individual shares of states from the divisible pool of central taxes is provided in Table 3 in the annexure.

Criteria for Devolution

Table 1 below shows the criteria used by the Commission to determine each state's share in central taxes, and the weight assigned to each criterion. We explain some of the indicators below.

Table 1: Criteria for Devolution (2020-21)

Criteria	14th FC 2015-20	15th FC 2020-21
Income Distance	50.0	45.0
Population (1971)	17.5	-
Population (2011)	10.0	15.0
Area	15.0	15.0
Forest Cover	7.5	-
Forest and Ecology	-	10.0
Demographic Performance	-	12.5
Tax Effort	-	2.5
Total	100	100

Sources: Report for the year 2020-21, 15th Finance Commission; PRS.

- Income distance:** Income distance is the distance of the state's income from the state with the highest income. The income of a state has been computed as average per capita GSDP during the three-year period between 2015-16 and 2017-18. States with lower per capita income would be given a higher share to maintain equity among states.
- Demographic performance:** The Terms of Reference (ToR) of the Commission required it to use the population data of 2011 while making recommendations. Accordingly, the Commission used only 2011 population data for its recommendations.

- The Demographic Performance criterion has been introduced to reward efforts made by states in controlling their population. It will be computed by using the reciprocal of the total fertility ratio of each state, scaled by 1971 population data. States with a lower fertility ratio will be scored higher on this criterion. The total fertility ratio in a specific year is defined as the total number of children that would be born to each woman if she were to live to the end of her child-bearing years and give birth to children in alignment with the prevailing age-specific fertility rates.

- Forest and ecology:** This criterion has been arrived at by calculating the share of dense forest of each state in the aggregate dense forest of all the states.
- Tax effort:** This criterion has been used to reward states with higher tax collection efficiency. It has been computed as the ratio of the average per capita own tax revenue and the average per capita state GDP during the three-year period between 2014-15 and 2016-17.

Grants-in-aid

In 2020-21, the following grants will be provided to states: (i) revenue deficit grants, (ii) grants to local bodies, and (iii) disaster management grants. The Commission has also proposed a framework for sector-specific and performance-based grants. State-specific grants will be provided in the final report.

- Revenue deficit grants:** In 2020-21, 14 states are estimated to have an aggregate revenue deficit of Rs 74,340 crore post-devolution. The Commission recommended revenue deficit grants for these states (see Table 4 in the annexure).
- Special grants:** In case of three states, the sum of devolution and revenue deficit grants is estimated to decline in 2020-21 as compared to 2019-20. These states are Karnataka, Mizoram, and Telangana. The Commission has recommended special grants to these states aggregating to Rs 6,764 crore.
- Sector-specific grants:** The Commission has recommended a grant of Rs 7,375 crore for nutrition in 2020-21. Sector-specific grants for the following sectors will be provided in the final report: (i) nutrition, (ii) health, (iii) pre-primary education, (iv) judiciary, (v) rural connectivity, (vi) railways, (vii) police training, and (viii) housing.
- Performance-based grants:** Guidelines for performance-based grants include: (i) implementation of agricultural reforms, (ii) development of aspirational districts and blocks, (iii) power sector reforms, (iv) enhancing trade including exports, (v) incentives for education, and (vi) promotion of domestic and international tourism. The grant amount will be provided in the final report.

- **Grants to local bodies:** The total grants to local bodies for 2020-21 has been fixed at Rs 90,000 crore, of which Rs 60,750 crore is recommended for rural local bodies (67.5%) and Rs 29,250 crore for urban local bodies (32.5%). This allocation is 4.31% of the divisible pool. This is an increase over the grants for local bodies in 2019-20, which amounted to 3.54% of the divisible pool (Rs 87,352 crore). The grants will be divided between states based on population and area in the ratio 90:10. The grants will be made available to all three tiers of Panchayat- village, block, and district.
- **Disaster Risk Management:** The Commission recommended setting up National and State Disaster Management Funds (NDMF and SDMF) for the promotion of local-level mitigation activities. The Commission has recommended retaining the existing cost-sharing patterns between the centre and states to fund the SDMF (new) and the SDRF (existing). The cost-sharing pattern between centre and states is (i) 75:25 for all states, and (ii) 90:10 for north-eastern and Himalayan states.

For 2020-21, State Disaster Risk Management Funds have been allocated Rs 28,983 crore, out of which the share of the union is Rs 22,184 crore. The National Disaster Risk Management Funds has been allocated Rs 12,390 crore.

Table 2: Grants for Disaster Risk Management (In Rs crore)

Funding Windows	National corpus	States' corpus
Mitigation (20%)	2,478	5,797
Response (80%)	9,912	23,186
(i) Response and Relief (40%)	4,956	11,593
(ii) Recovery and Reconstruction (30%)	3,717	8,695
(iii) Capacity Building (10%)	1,239	2,998
Total	12,390	28,983

Sources: Report for the year 2020-21, 15th Finance Commission; PRS.

Recommendations on Fiscal Roadmap

- **Fiscal deficit and debt levels:** The Commission noted that recommending a credible fiscal and debt trajectory roadmap remains problematic due to uncertainty around the economy. It recommended that both central and state governments should focus on debt consolidation and comply with the fiscal deficit and debt levels as per their respective Fiscal Responsibility and Budget Management (FRBM) Acts.
- **Off-budget borrowings:** The Commission observed that financing capital expenditure through off-budget borrowings detracts from compliance with the FRBM

Act. It recommended that both the central and state governments should make full disclosure of extra-budgetary borrowings. The outstanding extra-budgetary liabilities should be clearly identified and eliminated in a time-bound manner.

- **Statutory framework for public financial management:** The Commission recommended forming an expert group to draft legislation to provide for a statutory framework for sound public financial management system. It observed that an overarching legal fiscal framework is required which will provide for budgeting, accounting, and audit standards to be followed at all levels of government.
- **Tax Capacity:** In 2018-19, the tax revenue of state governments and central government together stood at around 17.5% of GDP. The Commission noted that tax revenue is far below the estimated tax capacity of the country. Further, India's tax capacity has largely remained unchanged since the early 1990s. In contrast, tax revenue has been rising in other emerging markets. The Commission recommended: (i) broadening the tax base, (ii) streamlining tax rates, (iii) and increasing capacity and expertise of tax administration in all tiers of the government.
- **GST implementation:** The Commission highlighted some challenges with the implementation of the Goods and Services Tax (GST). These include: (i) large shortfall in collections as compared to original forecast, (ii) high volatility in collections, (iii) accumulation of large integrated GST credit, (iv) glitches in invoice and input tax matching, and (v) delay in refunds. The Commission observed that the continuing dependence of states on compensation from the central government (21 states out of 29 states in 2018-19) for making up for the shortfall in revenue is a concern. It suggested that the structural implications of GST for low consumption states need to be considered.

Other Recommendations

- **Financing of security-related expenditure:** The ToR of the Commission required it to examine whether a separate funding mechanism for defence and internal security should be set up and if so, how it can be operationalised. In this regard, the Commission intends to constitute an expert group comprising representatives of the Ministries of Defence, Home Affairs, and Finance. The Commission noted that the Ministry of Defence proposed following measures for this purpose: (i) setting up of a non-lapsable fund, (ii) levy of a cess, (iii) monetisation of surplus land and other assets, (iv) tax-free defence bonds, and (v) utilising proceeds of disinvestment of defence public sector undertakings. The expert group is expected to examine these proposals or alternative funding mechanisms.

Table 3: Share of States in the Centre's Taxes

State	14 th Finance Commission		15 th Finance Commission		
	Share out of 42%	Share in Divisible Pool	Share out of 41%	Share in Divisible Pool	Devolution for FY2020-21 Rs Crore
Andhra Pradesh	1.81	4.31	1.69	4.11	35,156
Arunachal Pradesh	0.58	1.38	0.72	1.76	15,051
Assam	1.39	3.31	1.28	3.13	26,776
Bihar	4.06	9.67	4.13	10.06	86,039
Chhattisgarh	1.29	3.07	1.4	3.42	29,230
Goa	0.16	0.38	0.16	0.39	3,301
Gujarat	1.3	3.1	1.39	3.4	29,059
Haryana	0.46	1.1	0.44	1.08	9,253
Himachal Pradesh	0.3	0.71	0.33	0.8	6,833
Jammu and Kashmir	0.78	1.86	-	-	-
Jharkhand	1.32	3.14	1.36	3.31	28,332
Karnataka	1.98	4.71	1.49	3.65	31,180
Kerala	1.05	2.5	0.8	1.94	16,616
Madhya Pradesh	3.17	7.55	3.23	7.89	67,439
Maharashtra	2.32	5.52	2.52	6.14	52,465
Manipur	0.26	0.62	0.29	0.72	6,140
Meghalaya	0.27	0.64	0.31	0.77	6,542
Mizoram	0.19	0.45	0.21	0.51	4,327
Nagaland	0.21	0.5	0.23	0.57	4,900
Odisha	1.95	4.64	1.9	4.63	39,586
Punjab	0.66	1.57	0.73	1.79	15,291
Rajasthan	2.31	5.5	2.45	5.98	51,131
Sikkim	0.15	0.36	0.16	0.39	3,318
Tamil Nadu	1.69	4.02	1.72	4.19	35,823
Telangana	1.02	2.43	0.87	2.13	18,241
Tripura	0.27	0.64	0.29	0.71	6,063
Uttar Pradesh	7.54	17.95	7.35	17.93	1,53,342
Uttarakhand	0.44	1.05	0.45	1.1	9,441
West Bengal	3.08	7.33	3.08	7.52	64,301
Total	42	100	41	100	8,55,176

Sources: Reports of 14th and 15th Finance Commission; PRS.

Table 4: Some of the Grants-in-aid for FY 2020-21 (in Rs crore)

State	Revenue Deficit Grants	Grants to Rural Local Bodies	State's Share in Grants for Rural Local Bodies	Grants to Urban local Bodies	State's share in Grants for Urban Local Bodies
Andhra Pradesh	5,897	2,625	4.32	1264	4.32
Arunachal Pradesh	-	231	0.38	111	0.38
Assam	7,579	1,604	2.64	772	2.64
Bihar	-	5,018	8.26	2,416	8.26
Chhattisgarh	-	1,454	2.39	700	2.39
Goa	-	75	0.12	36	0.12
Gujarat	-	3,195	5.26	1538	5.26
Haryana	-	1,264	2.08	609	2.08
Himachal Pradesh	11,431	429	0.71	207	0.71
Jharkhand	-	1,689	2.78	813	2.78
Karnataka	-	3,217	5.29	1549	5.29
Kerala	15,323	1,628	2.68	784	2.68
Madhya Pradesh	-	3,984	6.56	1,918	6.56
Maharashtra	-	5,827	9.59	2,806	9.59
Manipur	2,824	177	0.29	85	0.29
Meghalaya	491	182	0.3	88	0.3
Mizoram	1,422	93	0.15	45	0.15
Nagaland	3,917	125	0.21	60	0.21
Odisha	-	2,258	3.72	1087	3.72
Punjab	7,659	1,388	2.29	668	2.29
Rajasthan	-	3,862	6.36	1,859	6.36
Sikkim	448	42	0.07	20	0.07
Tamil Nadu	4,025	3,607	5.94	1737	5.94
Telangana	-	1,847	3.04	889	3.04
Tripura	3,236	191	0.31	92	0.31
Uttar Pradesh	-	9,752	16.05	4,695	16.05
Uttarakhand	5,076	574	0.95	278	0.95
West Bengal	5,013	4,412	7.26	2,124	7.26
Total	74,341	60,750	100	29,250	100

Sources: Report for the year 2020-21, 15th Finance Commission; PRS.