

## THE FISCAL TRANSFER TO STATES IN THE 14TH FINANCE COMMISSION: AN EXAMINATION

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**Abstract:** The role of Finance Commission (FC) is crucial in the federal set-up from the view point of both equity and efficiency. The sharp increase in share of tax devolution to 42 per cent of the divisible pool in the 14th FC from 32 per cent in the 13th FC would result in increase in the flow of untied resources by the equivalent amount to the States, and it would thereby enhance their fiscal autonomy in terms of setting their expenditure priorities. As evident from the analysis, the FC transfers to the States are quite important for improving their revenue receipts and thereby, their revenue deficits. Further, all States may not benefit from the fiscal transfers in the 14th FC. The number of States which are expected to receive lower fiscal transfers in the 14th FC as compared with the 13th FC are – (a) 9 States under devolution of taxes, (b) 20 States under grants, (c) 9 States under overall transfers, (d) 6 States under both devolution of taxes and grants, and (e) 6 States under all three categories (devolution of taxes, grants and overall transfers). However, the fiscal position of those 9 States, which are likely to receive lower fiscal transfers in the 14th FC, may not be adversely affected as most of them are revenue surplus States.

**JEL Classification:** H7, H77

**Key Words:** Transfers, Devolution, Finance Commission, Horizontal Balance, Vertical Balance.

### INTRODUCTION

The Finance Commission (FC) is constituted by the President of India under article 280 of the Constitution of India. The first such Commission was constituted on November 19, 1951. So far, fourteen Finance Commissions have, through their recommendations, given a resolute shape to fiscal federalism in India. The 14th FC was constituted on January 2, 2013 (Chairman: Dr. Y. V. Reddy) to make recommendations for the period 2015-16 to 2019-20. The Commission submitted its report to the President on December 15, 2014. The major recommendations of the 14th FC relating to states are given briefly in Annex I.

In line with the practice followed in other federal countries, fiscal transfers in India are guided by the principle of 'equalisation', which neutralises deficiency in fiscal capacity across States but not in revenue effort. In India, the fiscal transfers from the Centre to the States take place through mechanisms provided in the Consti-

tution. As per the provisions in the Indian Constitution, the FC facilitates the division of financial resources between the Union and the State Governments. It recommends the distribution, between the Union and the States as also among the States, of the net proceeds of central taxes and also grants-in-aid of the revenue of the States. The main considerations before the FC relate to (a) determining the aggregate share of the States, (b) specifying criteria that may be used for deciding shares of the individual States, and (c) determining the weights attached to different allocation criteria. The criteria for inter se share of transfers are based on three sets of considerations, viz., needs, cost disabilities and fiscal efficiency (EPW, March 22, 2008).

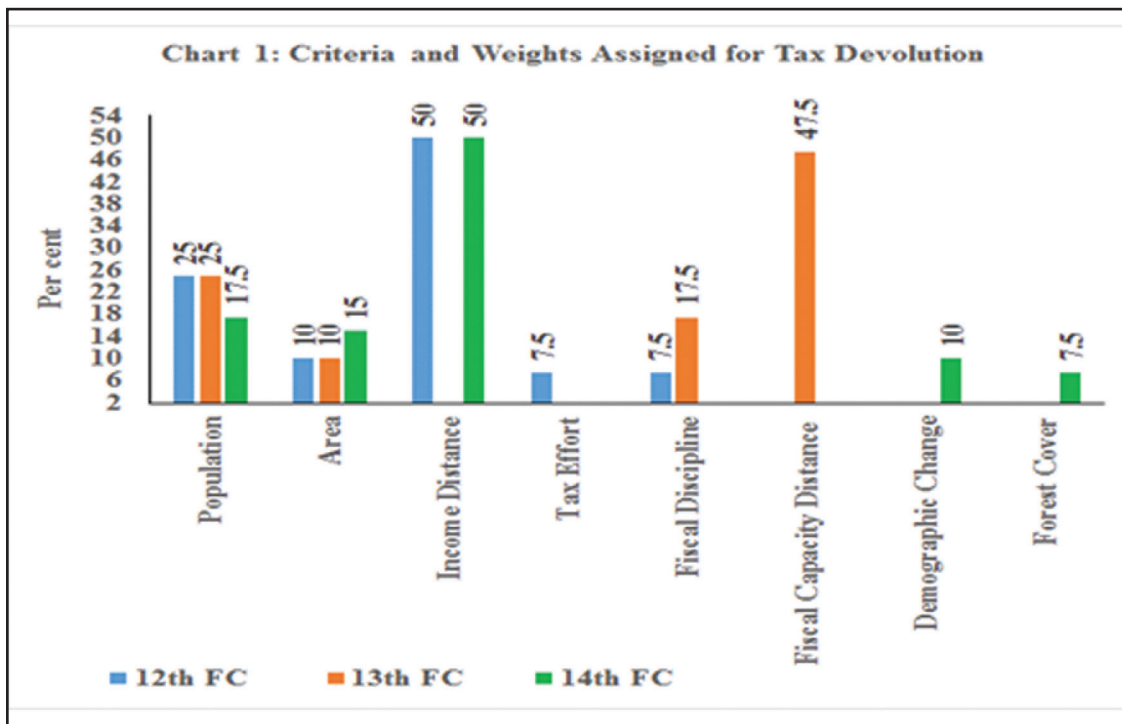
The distributive criteria along with their weights from the 12th to 14th FCs, for achieving horizontal balances among the States, are given in Table 1 and Chart 1. The weights for allocation criteria under income distance was maximum at 50 per cent in the 14th FC, followed by population (17.5 per cent) and area (15 per cent). The

weights for two new allocation criteria in the 14th FC were 10 per cent under demographic change and 7.5 per cent under forest cover. The other means of achieving horizontal balances among the States is grants-in-aid. The grants are provided in terms of absolute amounts and therefore, they remain fixed, while the amount in respect of shareable taxes varies depending upon tax mobilisation of the Central Government, as the transfer is in terms of the proportion of total taxes mobilised. Apart from statutory grants under the recommendations of the FC, there are plan grants covering central assistance for State plans as decided by the Planning Commission, as well as plan grants given by the Central Ministries for implementation of various schemes. Another type of

grant, which is much smaller in magnitude, consists of discretionary grants given by the Central Ministries to the States on the non-plan side.

Table 1: Criteria and Weights Assigned for Tax Devolution

Criteria	12 <sup>th</sup> Finance Commission	13 <sup>th</sup> Finance Commission	14 <sup>th</sup> Finance Commission
	Weight	Weight	Weight
Population	25.0	25.0	17.5
Area	10.0	10.0	15.0



Income Distance	50.0	-	50.0
Tax Effort	7.5	-	-
Fiscal Discipline	7.5	17.5	-
Fiscal Capacity Distance	-	47.5	-
Demographic Change	-	-	10.0
Forest Cover	-	-	7.5

-: Not applicable. Sources: The 12<sup>th</sup>, 13<sup>th</sup> and 14<sup>th</sup> Finance Com-

missions, Government of India.

Pursuant to the recommendations of the 14<sup>th</sup> FC, central assistance to States has now been subsumed in major centrally sponsored schemes (CSS) in view of the larger devolution of the divisible pool of tax revenue (42 per cent) to States from 32 per cent earlier as per the 13<sup>th</sup> FC recommendations. According to the Union Budget of 2015-16, there are 31 CSS that are fully sponsored by the central government while 24 CSS will henceforth be run with the “changed sharing pattern”. Though many CSS on State subjects are to be delinked from central

support, those representing national priorities, especially poverty alleviation, will continue. Besides, the schemes mandated by legal obligations and those backed by cess collection will be fully supported. Consolidated State level data reveal that grants have reduced by 0.8 per cent of GDP from 2014-15 as an outcome of reduction in central assistance to State Plan Scheme. Although higher devolution will lead to an increased share in central taxes by 0.5 per cent of GDP in 2015-16, the net impact of the changed pattern of funding is a decline of 0.3 per cent in central transfer to States from the previous year (State Finance: A Study of Budgets of 2015-16, RBI).

Against the above backdrop, an attempt has been made in the paper to know whether all States are expected to benefit from the fiscal transfers in the 14<sup>th</sup> FC *vis-à-vis* 13<sup>th</sup> FC. The paper has not critically analysed the recommendations, and the criteria and weights adopted by the 14<sup>th</sup> FC for fiscal transfers to the States during 2015-16 to 2019-20, keeping in view that it would be in itself an another topic of analysis and examination. Accordingly, the paper has been divided into five broad sub-sections (including introduction). Section II covers objective behind fiscal transfers to the States under the FC. Section III examines the likely extent of fiscal transfers to the States under the 14<sup>th</sup> FC. Section IV briefly substantiates the importance of fiscal transfers for the finances of State Governments. The conclusion of the paper is provided in section V.

### **OBJECTIVE BEHIND FISCAL TRANSFERS UNDER THE FINANCE COMMISSION**

Fiscal transfers from the higher level of government to the lower levels of government is a unique feature of any federal set-up owing to the inherent vertical and horizontal imbalances built into the system by the division of revenue raising powers and expenditure responsibilities among the different layers of governments. The federal government is in a better position to raise revenues from all over the country compared to the sub-national governments. On the other hand, the expenditure responsibilities lie with those levels of government, which better understand the local needs and priorities. Thus, the efficiency of a federal set-up lies in allocating important revenue raising powers to the federal government, allocating majority of the expenditure responsibilities to the lower levels of government and equipping them to spend by transferring resources from the Centre. Thus, an efficient system of inter-governmental transfers is the

edifice of any federal set-up.

In a federal set-up, the system of inter-governmental transfers are meant to address two types of imbalances, *viz.*, vertical and horizontal. While vertical imbalance is built into the system, as explained above, on account of concentration of revenue-raising powers with the upper tier of the government and expenditure responsibilities with lower tiers of government, the horizontal imbalances may exist in an economy owing to different fiscal capacities of the different sub-national governments, different priorities and needs of the different geographical territories depending on their stage of development, and also due to the differences in the costs of providing services. The vertical imbalance is addressed by transferring a percentage of the total revenue of the federal government to the sub-national governments. The amount to be transferred vertically is usually determined by the availability of federal revenues after accounting for the relevant expenditure requirements and the need for ensuring minimum provision of services by the sub-national governments. The horizontal imbalance is addressed by distributing the vertically decided amount among the sub-national governments while adhering to the principles of equity and efficiency.

The principles of equity and efficiency demand appropriate treatment to sub-national governments that may be differently placed in terms of revenue raising abilities and their expenditure requirements. While equity demands higher transfers to the poorer States relative to the well-off, efficiency demands higher transfers to the efficient States relative to the inefficient. Experience shows that many of the poorer governments display poor tax and non-tax collection efforts coupled with inefficient expenditure allocation between productive and unproductive expenditure categories. Thus, providing more resources to the poorer States may often turn out to be biased in favour of the inefficient. The horizontal imbalance is to be corrected by allocating more resources to the poorer sub-national governments, while not penalising the better performing sub-national governments. In other words, while correcting for differences in fiscal capacities, fiscal profligacy has to be penalised and fiscal prudence has to be rewarded. This trade-off between the principles of equity and efficiency is the main challenge for correcting the horizontal imbalance in a federal set-up (EPW, March 22, 2008).

In India, vertical and horizontal imbalances in federal finances are addressed by the FC set up under Article 280 of the Constitution every 5<sup>th</sup> year or earlier, if necessary. Apart from these statutory transfers through FC awards, the Centre also provides plan grants which comprise of (i) formula-based untied transfers (the Gadgil-Mukherjee formula assigns differential weights for population, per capita income, fiscal management and special problems) under normal central assistance for the annual plans of states; (ii) additional central assistance for specific-purpose schemes and transfers; (iii) special central assistance for special category states; and (iv) special plan assistance. Funds are also transferred under central plan schemes and CSS, which are conditional upon the implementation of specified schemes and programmes. Over 70 per cent of central assistance for CSS used to be disbursed to District Rural Development Agencies (DRDA) and implementing agencies, bypassing the State Budgets. From the fiscal year 2014-15, however, the entire financial assistance in respect of CSS is being routed to the States through their con-

solidated funds (State Finance: A Study of Budgets of 2014-15, RBI).

### FISCAL TRANSFERS TO THE STATES IN THE 14<sup>TH</sup> FINANCE COMMISSION

#### Consolidated Level(All States): Fiscal Transfers

The details of devolution of taxes and transfers to the States under the 14<sup>th</sup> FC and the 13<sup>th</sup> FC are given in Annex II and III. The aggregate transfers to States as ratio to gross revenue receipts of the Centre increased from 41.2 per cent in the 13<sup>th</sup> FC to 49.4 per cent in the 14<sup>th</sup> FC (Table 2 and Chart 2). The grants as ratio to Centre's gross revenue receipts increased to 32.7 per cent in the 14<sup>th</sup> FC from 23.7 per cent in the 13<sup>th</sup> FC. The sector-specific grants (except for local bodies, disaster management and post-devolution revenue deficit) have been dispensed with in the 14<sup>th</sup> FC. The share in central taxes as ratio to Centre's gross revenue receipts increased marginally to 4.5 per cent from 4.1 per cent during the same period.

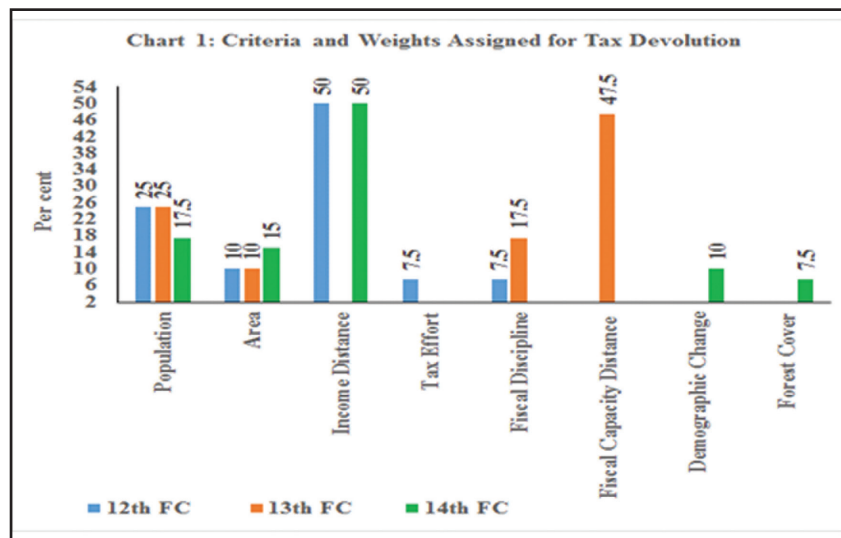


Table 2: Revenue Transfers from the Centre –Per cent of Centre's Gross Revenue Receipts

Indicators	(Per cent)			
	11th FC	12th FC	13th FC	14th FC
FC Grants	20.6	22.0	23.7	32.7
Share in Central Taxes	3.9	4.7	4.1	4.5
Other Transfers (including Plan Grants)	10.8	12.1	13.4	12.3
<b>Total Transfers</b>	<b>35.3</b>	<b>38.8</b>	<b>41.2</b>	<b>49.4</b>

Source: State Finance: A Study of Budgets of 2014-15.

The share of tax devolution to States increased sharply from 32 per cent of the divisible pool (*i.e.*, all taxes net of cess, surcharge and cost of tax collections) in the 13<sup>th</sup> FC to 42 per cent in the 14<sup>th</sup> FC (Chart 2A). The additional increase in tax devolution by 10 percentage points has resulted in increase in the flow of untied resources by the equivalent amount to the States. The sharp increase in tax devolution may result in a corresponding decline in the share of grants to the States,

possibly leading to a decline in the central assistance for State plans. However, a marginal increase in the share of non-plan grants to States, which comprised grants recommended by the 14<sup>th</sup> FC and other minor sectoral grants outside the plan from various ministries increased from 11.8 per cent of total transfers in 2014-15 (RE) to 12.9 per cent in 2015-16 (BE) [Table 3 and Charts 3-3A]. The tax devolution and non-plan grants by the 14<sup>th</sup> FC constituted more than 70 per cent of total fiscal transfers from the Centre to the States in 2015-16 (BE) (EPW, March 21, 2015).

Since the overwhelming proportion of transfers would now flow to States through the FC, it would en-

hance the fiscal autonomy of the States, besides reducing the degree of uncertainty to a large extent in flow of funds to them and thereby, it would make fiscal transfers more predictable. This would also imply that the possibility of the Centre resorting to the easy option of cutting discretionary plan grants to the States in order to achieve its fiscal balance may significantly reduce after the 14<sup>th</sup> FC award. Further, due to higher tax devolution, the Centre introduced restructuring in grants to States in the Union Budget 2015-16. The categorisation of the restructuring in Centre's grants is - (a) schemes to be fully financed by the Centre, (b) schemes to run with an altered pattern of fund sharing, and (c) schemes delinked from the Centre's support (EPW, March 21, 2015).

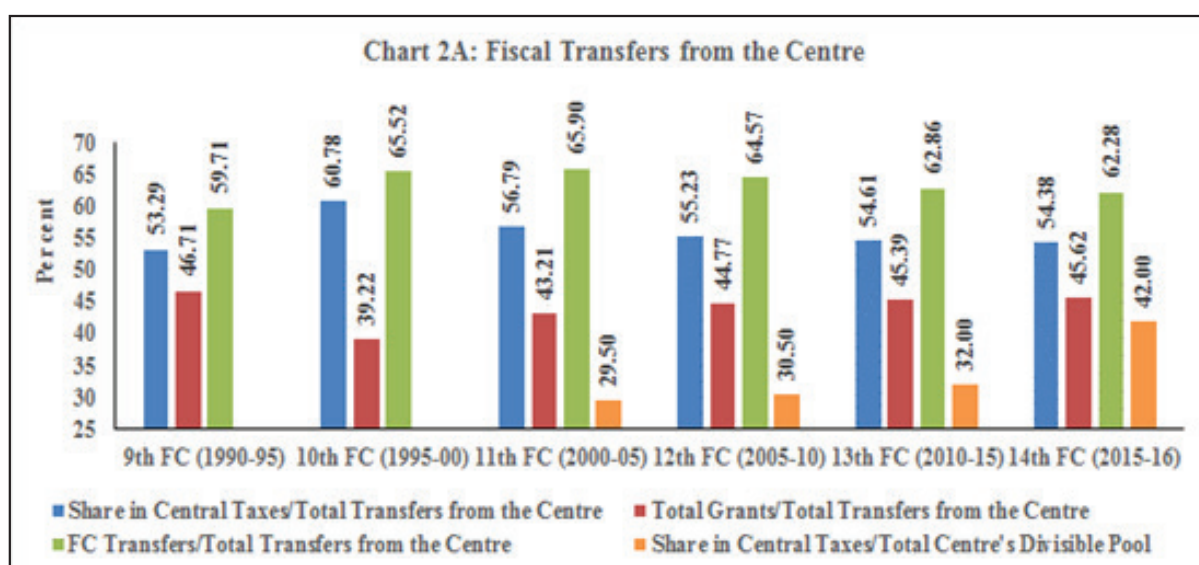
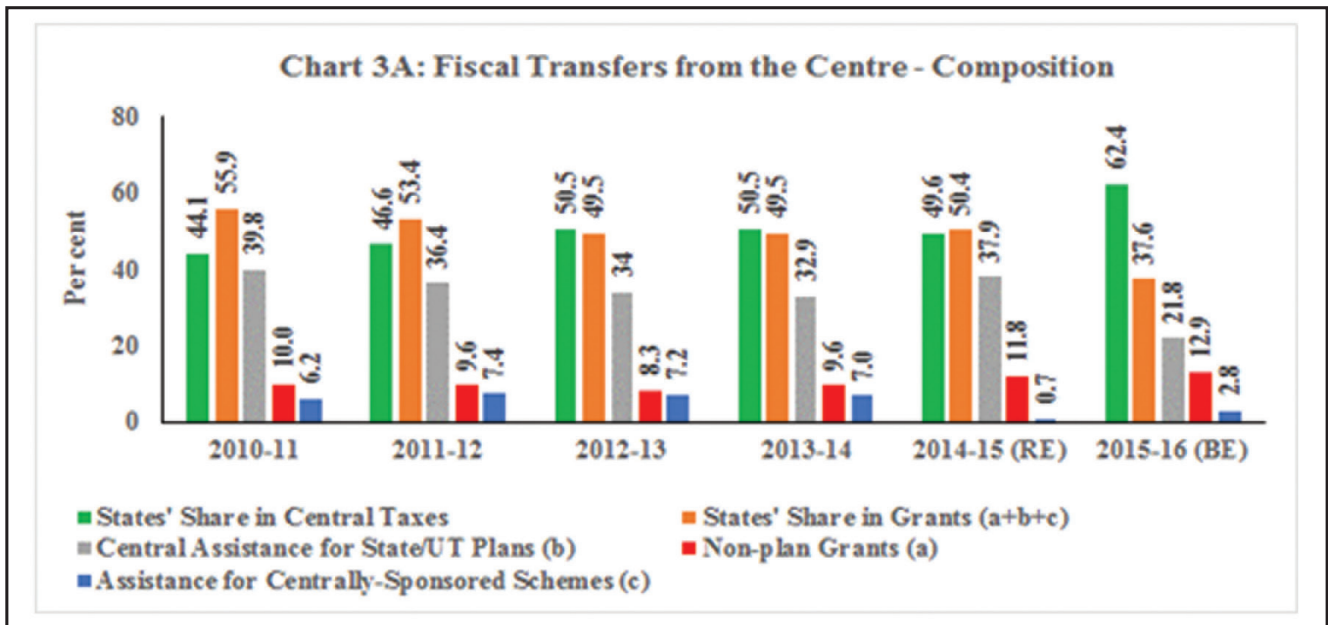
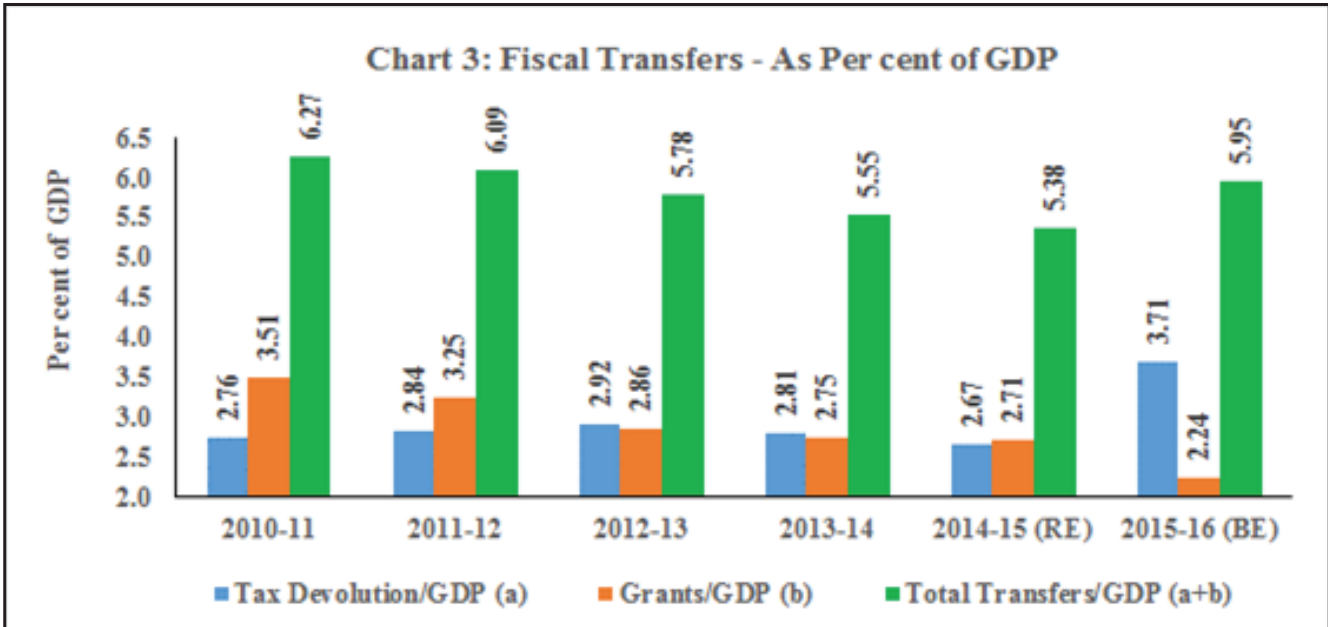


Table 3: Fiscal Transfers' Structure: Recent Period

	Per cent					
Item	2010-11	2011-12	2012-13	2013-14	2014-15 (RE)	2015-16 (BE)
(a) Tax Devolution/GDP	2.76	2.84	2.92	2.81	2.67	3.71
(b) Grants/GDP	3.51	3.25	2.86	2.75	2.71	2.24
<b>Total Transfers/GDP (a+b)</b>	<b>6.27</b>	<b>6.09</b>	<b>5.78</b>	<b>5.55</b>	<b>5.38</b>	<b>5.95</b>
<b>Composition of Fiscal Transfers</b>						
(a) States' Share in Central Taxes	44.1	46.6	50.5	50.5	49.6	<b>62.4</b>
(b) States' Share in Grants (i+ii+iii)	55.9	53.4	49.5	49.5	50.4	37.6
<i>of which:</i>						
(i) Non-plan Grants	10.0	9.6	8.3	9.6	11.8	<b>12.9</b>
(ii) Central Assistance for State/UT Plans	39.8	36.4	34	32.9	37.9	21.8
(iii) Assistance for Centrally-Sponsored Schemes	6.2	7.4	7.2	7.0	0.7	2.8
<b>Total Transfers (a+b)</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Chakraborty, Pinaki. 2015. 'Finance Commission's Recommendations and Restructured Fiscal Space', EPW, March 21.



**State-wise Fiscal Transfers**

**Devolution of Taxes**

The State-wise analysis indicates that 9 States (viz., Himachal Pradesh, Uttarakhand, Assam, Odisha,

Rajasthan, Tamil Nadu, Bihar, Uttar Pradesh (UP) and Andhra Pradesh) may receive lower devolution of taxes in the 14<sup>th</sup>FC as compared with the 13<sup>th</sup> FC (Table 4 and Chart 4). The reduction in share in Centre's taxes for these States may vary in the range 0.07-2.63 percentage

Table 4: States Gaining/Losing\* in the 14th FC over the 13th FC - Devolution of Taxes

(Rs. Crore)

States	13th FC		14th FC		Variation (14 <sup>th</sup> FC over 13 <sup>th</sup> FC)	
	Share (%)	Amount	Share (%)	Amount	Share (Percentage Points)	Amount
1	2	3	4	5	6	7
Andhra Pradesh	6.94	1,00,616	4.31	1,69,969	-2.63	69,353
Arunachal Pradesh	0.33	4,756	1.37	54,090	1.04	49,335
Assam	3.63	52,621	3.31	1,30,724	-0.32	78,104
Bihar	10.92	1,58,341	9.67	3,81,592	-1.25	2,23,251
Chhattisgarh	2.47	35,825	3.08	1,21,604	0.61	85,779
Goa	0.27	3,858	0.38	14,924	0.11	11,066
Gujarat	3.04	44,107	3.08	1,21,762	0.04	77,655
Haryana	1.05	15,200	1.08	42,798	0.04	27,599
Himachal Pradesh	0.78	11,327	0.71	28,151	-0.07	16,823
Jammu and Kashmir	1.55	20,183	1.85	73,199	0.30	53,017
Jharkhand	2.80	40,640	3.14	1,23,934	0.34	83,293
Karnataka	4.33	62,775	4.71	1,86,078	0.39	1,23,303
Kerala	2.34	33,954	2.50	98,705	0.16	64,750
Madhya Pradesh	7.12	1,03,269	7.55	2,98,009	0.43	1,94,740
Maharashtra	5.19	75,407	5.52	2,17,979	0.33	1,42,573
Manipur	0.45	6,541	0.62	24,360	0.17	17,819
Meghalaya	0.41	5,919	0.64	25,347	0.23	19,429
Mizoram	0.27	3,901	0.46	18,162	0.19	14,260
Nagaland	0.31	4,553	0.50	19,662	0.18	15,109
Odisha	4.78	69,316	4.64	1,83,275	-0.14	1,13,959
Punjab	1.39	20,146	1.58	62,263	0.19	42,117
Rajasthan	5.85	84,892	5.50	2,16,953	-0.36	1,32,061
Sikkim	0.24	3,467	0.37	14,490	0.13	11,023
Tamil Nadu	4.97	72,070	4.02	1,58,836	-0.95	86,765
Telangana	0	0	2.44	96,217	2.44	96,217
Tripura	0.51	7,412	0.64	25,347	0.13	17,936
Uttar Pradesh	19.68	2,85,397	17.96	7,09,055	-1.72	4,23,658
Uttarakhand	1.12	16,245	1.05	41,535	-0.07	25,290
West Bengal	7.26	1,05,359	7.32	2,89,165	0.06	1,83,807
<b>All States</b>	<b>100.00</b>	<b>14,48,096</b>	<b>100.00</b>	<b>39,48,187</b>	<b>0.00</b>	<b>25,00,091</b>

\*: Based on the difference between share of each head in the respective total in the 14<sup>th</sup> FC and the share of corresponding head in the respective total in the 13<sup>th</sup> FC. Positive (+) sign in the Table indicates gain in the 14<sup>th</sup> FC over the 13<sup>th</sup> FC while negative (-) sign denotes loss during the same period.

Source: Computed by Authors based on Tables given in Annex II and III.

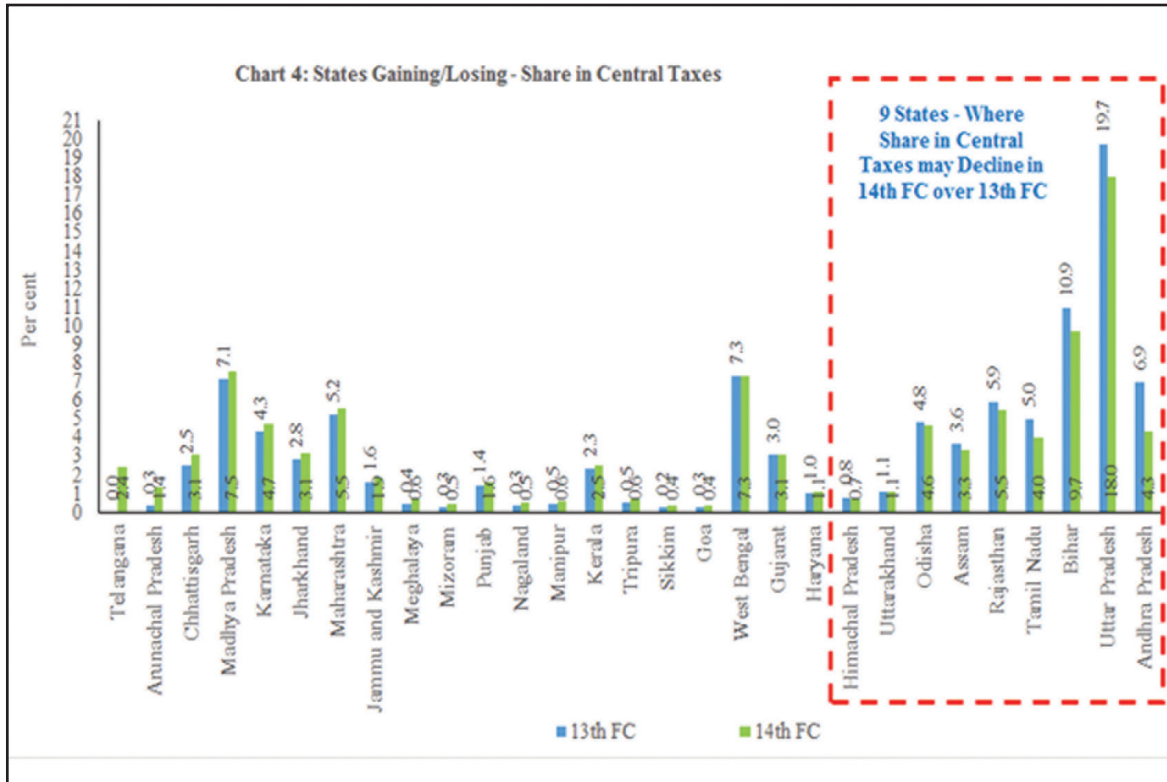


Table 5: States Gaining/Losing in the 14th FC over the 13th FC - Grants

(Rs. Crore)

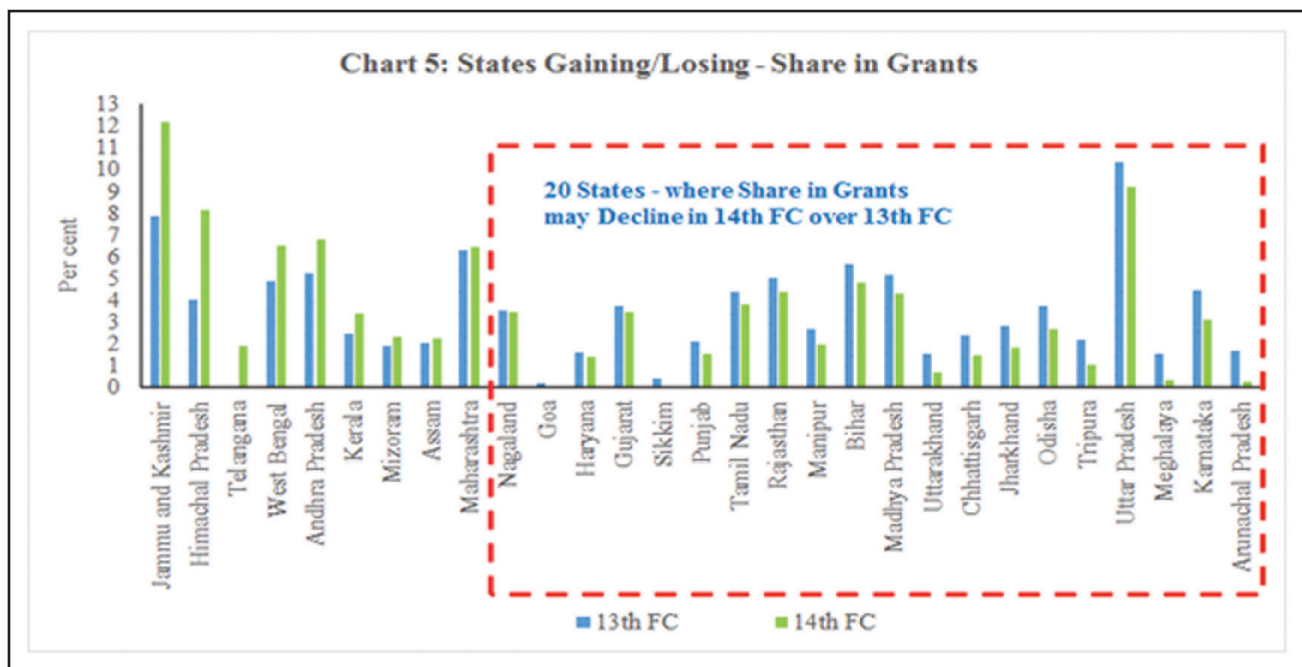
States	13 <sup>th</sup> FC		14 <sup>th</sup> FC		Variation (14th FC over 13th FC)	
	Amount	Share (%)	Amount	Share (%)	Amount	Share (Percentage Points)
1	2	3	4	5	6	7
Andhra Pradesh	13,532	5.2	36589	6.8	23057	1.6
Arunachal Pradesh	4,348	1.7	1322	0.2	-3026	-1.4
Assam	5,212	2.0	12053	2.2	6841	0.2
Bihar	14,603	5.6	26026	4.8	11423	-0.8
Chhattisgarh	6,176	2.4	8028	1.5	1853	-0.9
Goa	516	0.2	372	0.1	-145	-0.1
Gujarat	9,683	3.7	18546	3.5	8863	-0.3
Haryana	4,271	1.7	7492	1.4	3222	-0.3
Himachal Pradesh	10,364	4.0	43811	8.2	33446	4.1
Jammu and Kashmir	20,256	7.8	65703	12.2	45447	4.4
Jharkhand	7,238	2.8	9770	1.8	2532	-1.0
Karnataka	11,601	4.5	16521	3.1	4919	-1.4
Kerala	6,372	2.5	18120	3.4	11748	0.9
Madhya Pradesh	13,325	5.2	23096	4.3	9771	-0.9
Maharashtra	16,303	6.3	34825	6.5	18522	0.2
Manipur	7,026	2.7	10701	2.0	3674	-0.7
Meghalaya	3,924	1.5	1922	0.4	-2002	-1.2
Mizoram	4,904	1.9	12387	2.3	7483	0.4
Nagaland	9,191	3.6	18651	3.5	9460	-0.1



Odisha	9,659	3.7	14340	2.7	4681	-1.1
Punjab	5,540	2.1	8482	1.6	2942	-0.6
Rajasthan	12,950	5.0	23631	4.4	10681	-0.6
Sikkim	1,059	0.4	353	0.1	-705	-0.3
Tamil Nadu	11,367	4.4	20386	3.8	9019	-0.6
Telangana	0	0.0	10127	1.9	10127	1.9
Tripura	5,716	2.2	5816	1.1	100	-1.1
Uttar Pradesh	26,743	10.3	49382	9.2	22639	-1.2
Uttarakhand	4,063	1.6	3741	0.7	-322	-0.9
West Bengal	12,639	4.9	35161	6.5	22522	1.7
<b>All States</b>	<b>2,58,581</b>	<b>100.0</b>	<b>537354</b>	<b>100.0</b>	<b>278773</b>	<b>0.0</b>

Note: Gain/loss as defined in Table 3.

Source: Computed by Authors based on Tables given in Annex II and III.



points in the 14<sup>th</sup>FC over 13<sup>th</sup> FC. *Grants*

Grants

Twenty States (viz., Arunachal Pradesh, Chhattisgarh, Madhya Pradesh (MP), Jharkhand, Karnataka, Goa, Punjab, Sikkim, Nagaland, Meghalaya, Manipur, Haryana, Gujarat, Tripura, Uttarakhand, Odisha, Rajasthan, Tamil Nadu, Bihar and UP) may receive lower grants in the 14<sup>th</sup>FC as compared with the 13<sup>th</sup> FC (Table 5 and Chart 5). The reduction in share in total grants for these States may vary in the range 0.1-1.4 percentage points in the 14<sup>th</sup>FC over 13<sup>th</sup> FC.

Total Fiscal Transfers

Nine States (viz., Tripura, Uttarakhand, Assam, Odisha, Rajasthan, Tamil Nadu, Bihar, UP and Andhra Pradesh) may receive lower overall fiscal transfers in the 14<sup>th</sup> FC as compared with the 13<sup>th</sup> FC (Table 6 and Chart 6). The reduction in share in total fiscal transfers for these States may vary in the range 0.1-2.1 percentage points in the 14<sup>th</sup> FC over 13<sup>th</sup> FC. The likely decline in overall fiscal transfers to these States in the 14<sup>th</sup> FC may not put their fiscal position under stress as most of them are revenue surplus States (Table 7).

Table 6: States Gaining/Losing in the 14th FC over the 13th FC - Total Transfers

(Rs. Crore)

States	13th FC		14th FC		Variation (14th FC over 13th FC)	
	Total Transfers (Amt.)	Share (%)	Total Transfers (Amt.)	Share (%)	Total Transfers (Amt.)	Share (Percentage Points)
1	2	3	4	5	6	7
Andhra Pradesh	1,14,148	6.7	2,06,558	4.6	92,410	-2.1
Arunachal Pradesh	9,104	0.5	55,412	1.2	46,308	0.7
Assam	57,833	3.4	1,42,778	3.2	84,945	-0.2
Bihar	1,72,944	10.1	4,07,618	9.1	2,34,674	-1.0
Chhattisgarh	42,001	2.5	1,29,632	2.9	87,631	0.4
Goa	4,374	0.3	15,296	0.3	10,922	0.1
Gujarat	53,790	3.2	1,40,308	3.1	86,518	0.0
Haryana	19,470	1.1	50,291	1.1	30,821	0.0
Himachal Pradesh	21,692	1.3	71,961	1.6	50,269	0.3
Jammu and Kashmir	40,439	2.4	1,38,903	3.1	98,464	0.7
Jharkhand	47,879	2.8	1,33,704	3.0	85,825	0.2
Karnataka	74,376	4.4	2,02,599	4.5	1,28,222	0.2
Kerala	40,326	2.4	1,16,825	2.6	76,499	0.2
Madhya Pradesh	1,16,593	6.8	3,21,105	7.2	2,04,512	0.3
Maharashtra	91,710	5.4	2,52,804	5.6	1,61,094	0.3
Manipur	13,568	0.8	35,061	0.8	21,494	0.0
Meghalaya	9,842	0.6	27,269	0.6	17,426	0.0
Mizoram	8,805	0.5	30,549	0.7	21,744	0.2
Nagaland	13,744	0.8	38,313	0.9	24,569	0.0
Odisha	78,975	4.6	1,97,615	4.4	1,18,640	-0.2
Punjab	25,687	1.5	70,745	1.6	45,058	0.1
Rajasthan	97,842	5.7	2,40,584	5.4	1,42,742	-0.4
Sikkim	4,526	0.3	14,843	0.3	10,318	0.1
Tamil Nadu	83,437	4.9	1,79,221	4.0	95,784	-0.9
Telangana	0	0.0	1,06,344	2.4	1,06,344	2.4
Tripura	13,128	0.8	31,163	0.7	18,036	-0.1
Uttar Pradesh	3,12,140	18.3	7,58,437	16.9	4,46,297	-1.4
Uttarakhand	20,308	1.2	45,275	1.0	24,967	-0.2
West Bengal	1,17,997	6.9	3,24,326	7.2	2,06,328	0.3
<b>All States</b>	<b>17,06,677</b>	<b>100.0</b>	<b>44,85,541</b>	<b>100.0</b>	<b>27,78,864</b>	<b>0.0</b>

Note: Gain/loss as defined in Table 3.

Source: Computed by Authors based on Tables given in Annex II and III.

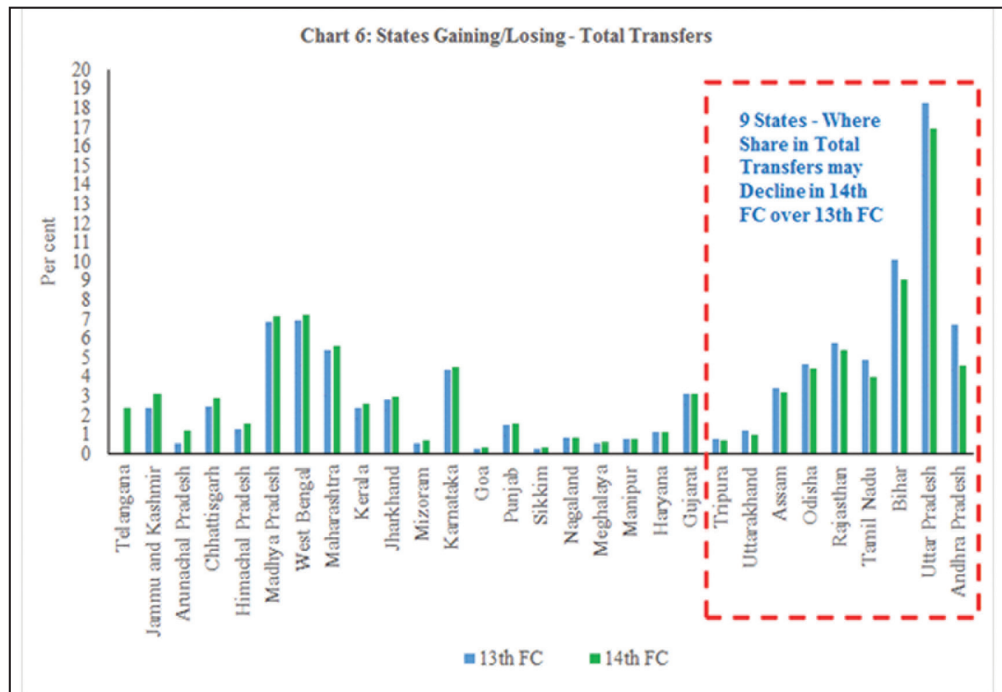
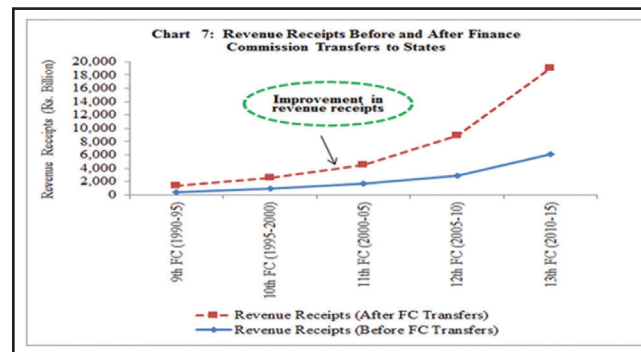


Table 7: Revenue Surplus (-)/ Deficit (+) Position: States for which Overall Fiscal Transfers may Decline in the 14th FC over 13th FC

State	2013-14	2014-15 (RE)	2015-16 (BE)
1. Andhra Pradesh	-3.4	142.4	73.0
2. Bihar	-64.4	45.1	-119.8
3. Odisha	-33.3	-33.8	-51.0
4. Rajasthan	10.4	42.2	-5.6
5. Tamil Nadu	17.9	35.4	46.2
6. Uttar Pradesh	-100.7	-324.1	-341.2
7. Assam	-2.4	50.9	-55.0
8. Tripura	-17.0	-23.6	-34.0
9. Uttarakhand	-11.0	-21.6	-0.4

RE: Revised Estimates. BE: Budget Estimates.  
Source: State Finance: A Study of Budgets of 2015-16, RBI.



Note: The fiscal transfers from the Centre to the States augment their revenue receipts.

### IMPORTANCE OF FISCAL TRANSFERS FOR THE FINANCES OF STATE GOVERNMENTS

The impact of fiscal transfers from the Centre to the State Governments is reflected in the revenue account through augmentation of their revenue receipts and consequent reduction in their revenue deficit (Chart 7). Higher devolution and transfer of resources to the State Governments, therefore, facilitate in their fiscal corrections.

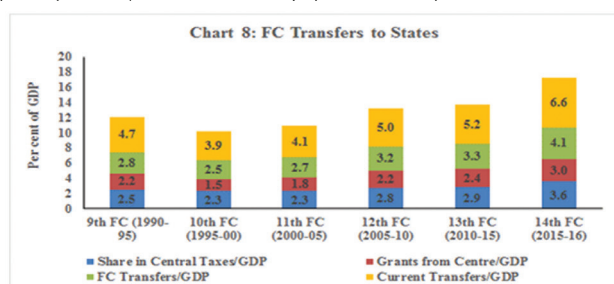
The average devolution of taxes and transfers to the States under the recent Finance Commissions have been analysed in Tables 8 to 10 (also Charts 8-10). The average transfers to the States as ratio to GDP increased marginally to 3.29 per cent in the 13<sup>th</sup> FC from 3.22 per cent in the 12<sup>th</sup> FC (Table 8 and Chart 8). In terms of GDP, the fiscal transfers to the States in the first year of the 14<sup>th</sup> FC (2015-16, BE) further increased to 4.10 per cent from 3.29 per cent in the 13<sup>th</sup> FC period. *It may be important to mention that it may be too early to conclude anything about the extent of fiscal transfers that may accrue to the States in the 14<sup>th</sup> FC, based on its*

Table 8: Finance Commission Devolution and Current Transfers (Average) to States

(Rs. Crore/Per cent)

Finance Commission	Share in Central Taxes	Statutory Grants	Finance Commission Transfer (FCT)	Non-statutory Grants	Current Transfers (CT)	FCT/CT
1	2	3	4 (=2+3)	5	6 (=4+5)	7 (=4/6)
9th FC (1990-95)	19,790 (2.49)	2,382 (0.30)	22,172 (2.79)	14,961 (1.88)	37,133 (4.67)	59.71
10th FC (1995-00)	37,608 (2.34)	2,934 (0.18)	40,542 (2.52)	21,332 (1.33)	61,874 (3.85)	65.52
11th FC (2000-05)	61,047 (2.33)	9,792 (0.37)	70,839 (2.70)	36,652 (1.40)	1,07,491 (4.09)	65.90
12th FC (2005-10)	1,38,357 (2.76)	23,392 (0.47)	1,61,749 (3.22)	88,752 (1.77)	2,50,501 (4.99)	64.57
13th FC (2010-15)	2,90,220 (2.86)	43,889 (0.43)	3,34,109 (3.29)	1,97,370 (1.94)	5,31,479 (5.23)	62.86
14th FC (2015-16)	4,85,520 (3.58)	70,505 (0.52)	5,56,025 (4.10)	3,36,775 (2.48)	8,92,800 (6.58)	62.28

first year's (2015-16, BE) fiscal transfers to the States.



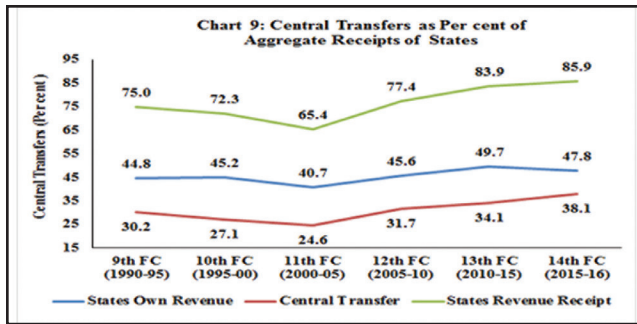
The transfers under the FC is important as it constituted around 34 per cent of the aggregate receipts of the States during the 13th FC period (Table 9 and Chart 9). The transfers are expected to increase to around 38 per cent of aggregate receipts of the States in the first year of 14th FC (2015-16, BE). Any sharp increase or decrease in such transfers, therefore, has its positive or negative impact on the finances of State Governments. The devolution of taxes and transfers vary across States on account of differences in the size of the population, revenue-generating capacity and development needs of the States.

Table 9: States Revenue Receipts as Per cent of Aggregate Receipts of States

(Per cent)

Item	9th FC (1990-95)	10th FC (1995-00)	11th FC (2000-05)	12th FC (2005-10)	13th FC (2010-15)	14th FC (2015-16)
States Revenue Receipt (I + II)	75.0	72.3	65.4	77.4	83.9	85.9
<b>I. States Own Revenue (a+b)</b>	<b>44.8</b>	<b>45.2</b>	<b>40.7</b>	<b>45.6</b>	<b>49.7</b>	<b>47.8</b>
(a) States Own Tax Rev	33.3	34.2	32.4	36.5	41.9	39.8
(b) States Own Non-Tax Rev	11.5	11.0	8.3	9.1	7.8	8.0
<b>II. Central Transfer (a+b)</b>	<b>30.2</b>	<b>27.1</b>	<b>24.6</b>	<b>31.7</b>	<b>34.1</b>	<b>38.1</b>
(a) Share in Central Taxes	16.0	16.5	14.0	17.6	19.0	20.7
(b) Grants from Centre	14.1	10.7	10.7	14.1	15.1	17.4

Sources: Computed from the Handbook of Statistics on State Government Finances and 'State Finances: A Study of Budgets', various issues, RBI.



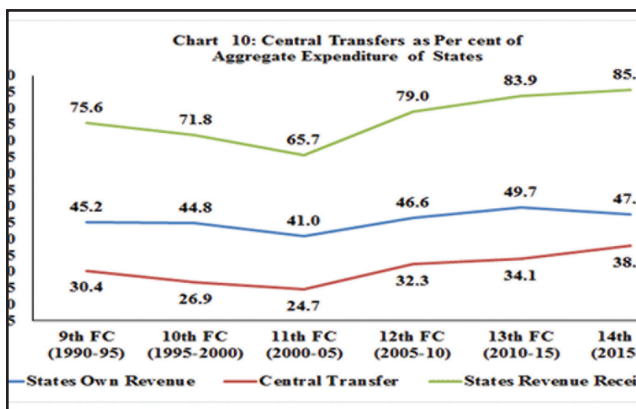
During the 13th FC period, the transfers financed around 34 per cent of the aggregate expenditure of the States (Table 10 and Chart 10). The transfers are expected to finance around 38 per cent of the aggregate expenditure of the States in the first year of 14th FC (2015-16, BE). These statistics, per se, speak the importance of fiscal transfers from the FC for the finances of State Governments.

Table 10: States Revenue Receipts as Per cent of Aggregate Expenditure of States

(Per cent)

Item	9th FC (1990-95)	10th FC (1995-2000)	11th FC (2000-05)	12th FC (2005-10)	13th FC (2010-15)	14th FC (2015-16)
States Revenue Receipt (I + II)	75.6	71.8	65.7	79.0	83.9	85.6
<b>I. States Own Revenue (a+b)</b>	<b>45.2</b>	<b>44.8</b>	<b>41.0</b>	<b>46.6</b>	<b>49.7</b>	<b>47.6</b>
(a) States Own Tax Rev	33.6	34.0	32.6	37.3	41.9	39.6
(b) States Own Non-Tax Rev	11.6	10.9	8.4	9.3	7.8	7.9
<b>II. Central Transfer (a+b)</b>	<b>30.4</b>	<b>26.9</b>	<b>24.7</b>	<b>32.3</b>	<b>34.1</b>	<b>38.0</b>
(a) Share in Central Taxes	16.2	16.3	14.0	17.9	19.1	20.6
(b) Grants from Centre	14.2	10.6	10.7	14.4	15.1	17.3

Sources: Computed from the Handbook of Statistics on State Government Finances and ‘State Finances: A Study of Budgets’, various issues, RBI.



share in central taxes forms the single largest component of the total central transfers (Chart 3A). The methodology adopted by the FC for correcting vertical and horizontal imbalances, therefore, becomes important in this regard (EPW, March 22, 2008).

## CONCLUSION

In the federal set-up, vertical and horizontal imbalances among the States may lead to uneven development of the economy, unless corrected by an efficient system of inter-governmental transfers. In this context, the role of FC becomes crucial in the federal set-up. Moreover, since majority of the expenditure responsibilities are with the State governments, it is important to ensure that they are adequately compensated through fiscal transfers from the Centre under the FC. The sharp increase in share of tax devolution to 42 per cent of the divisible pool in the 14th FC from 32 per cent in the 13th FC would result in increase in the flow of untied resources by the equivalent amount to the States, and it would thereby enhance their fiscal autonomy in terms of setting their expenditure priorities. As evident from the

analysis, FC transfers to the States are quite important for improving their revenue receipts and thereby, their revenue deficits. During the 14th FC, 9 States may receive lower overall fiscal transfers than they had received in the 13th FC (Table 11). Thus, every State may not benefit from fiscal transfers in the 14th FC. However, the fiscal position of these 9 States may not be adversely affected as most of them are revenue surplus States.

**Table 11: States Likely to Receive Lower Fiscal Transfers in the 14th FC over the 13th FC: Summary Position**

(Per cent)

States	Devolution of Taxes	Grants	Total Fiscal Transfers
Arunachal Pradesh	-	Lower	-
Chhattisgarh	-	Lower	-
Himachal Pradesh	Lower	-	-
Madhya Pradesh	-	Lower	-
Jharkhand	-	Lower	-
Karnataka	-	Lower	-
Goa	-	Lower	-
Punjab	-	Lower	-
Sikkim	-	Lower	-
Nagaland	-	Lower	-
Meghalaya	-	Lower	-
Manipur	-	Lower	-
Haryana	-	Lower	-
Gujarat	-	Lower	-
Tripura	-	Lower	Lower
Uttarakhand	<b>Lower</b>	<b>Lower</b>	<b>Lower</b>
Assam	Lower	-	Lower
Odisha	<b>Lower</b>	<b>Lower</b>	<b>Lower</b>
Rajasthan	<b>Lower</b>	<b>Lower</b>	<b>Lower</b>
Tamil Nadu	<b>Lower</b>	<b>Lower</b>	<b>Lower</b>
Bihar	<b>Lower</b>	<b>Lower</b>	<b>Lower</b>
Uttar Pradesh	<b>Lower</b>	<b>Lower</b>	<b>Lower</b>
Andhra Pradesh	Lower	-	Lower
<b>Memo Items</b>			
No. of States	9	20	9

:- Higher fiscal transfers. Source: Computed by Authors based on Tables given in Annex II and III.

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