15th Finance Commission's Interim Report

Why in News?

The interim report of the 15th Finance Commission (FC) has been tabled in Parliament this budget session.

What is the Finance Commission?

- **Article 280** of the Constitution of India provides for a quasi-judicial body, the Finance Commission.
- It is constituted by the President of India every fifth year or at such earlier time as he considers necessary.
- The recommendations made by the Finance Commission are only advisory in nature and hence, not binding on the government.
- The 15th Finance commission makes recommendations for the period of 2020-2025 (5 years).

How the devolution to the States is to be carried out?

- The report has largely preserved the devolution mathematics of its predecessor, belying concerns of a sizeable cut in States' share.
- (Devolution - A process in which a central government of a country grants powers to sub-national governments).
- The report has recommended a **one percentage point reduction** in the vertical split of the divisible pool of tax revenues accruing to States to 41%.
- This follows the reorganisation of the erstwhile State of Jammu and Kashmir into the Union Territories of Jammu and Kashmir and Ladakh.
- The former State's notional share based on the parameters for horizontal devolution would have been about 0.85%.
- But, the FC has cited the security and other special needs of the two territories to enhance their aggregate share to 1%, which would be met by the Centre.

How the devolution to the local bodies is to be carried out?

- Urban local bodies, especially municipalities in cities with populations of more than one million, are set to get a larger share of the devolution.
- There has been an increase in the percentage of outcome-tied funds from 10% to 50%
- This could prove vexing to the last mile providers of basic services in India's federal and highly fragmented structure of governance.

What is done to balance the financial needs?

- As part of an effort to balance the principles of fiscal needs, the following have been changed,

1. Equity and performance,
2. The need to ensure stability and predictability in transfers,
3. The criteria for the horizontal sharing of taxes among States.

What is the new added parameter?

- The **demographic performance** is the new crucial parameter that has been added to the mix.
- The mandate to adopt the population data from the 2011 Census is the reason why the FC has incorporated this additional criterion.
- This will ensure that the States which have done well on demographic management are not unfairly disadvantaged.
- The norm has been assigned a 12.5% weight, as it indirectly evaluates performance on the human capital outcomes of education and health.
- This should address the concerns voiced by several States over the switch to the 2011 Census from the 1971 data.

What does the report say about the tax system?

- Among the States, with the exception of Tamil Nadu, all the other four southern States see a reduction in the recommended share of taxes for the year 2020-21.
- Notably, the suggested devolution to Odisha and Uttar Pradesh has also shrunk in percentage terms.
- Crucially, the FC has flagged the issues dogging the GST as indirect taxes constitute almost half the total tax revenues of the Union.
- The **new tax has yet to stabilise** which leaves a majority of the States dependent on compensation from the Centre.

What was the criticism the report made?

- The FC has also been justifiably critical of the Union and State governments' tendency to finance spending through off-budget borrowings and via parastatals.
- It has done well to ask that such extra-budgetary liabilities be clearly earmarked and eliminated in a time-bound manner.

Source: The Hindu