**15th FINANCE COMMISSION**

The Finance Commission (FC) is constituted by the President of India every fifth year under Article 280 of the Constitution.

The 15th 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 April 2020 to March 2025

**Recommendations of the 15th Finance Commission**

**Vertical Devolution**

**41% of the divisible pool** to be devolved to the States in the year 2020-21.

FC-XIV which had recommended 42%, had a view that tax devolution should be the primary route of transfer of resources to States as they are a more objective form of transfer of resources as compared to other forms. The XV-FC also agrees with this view but reduced the States’ share to 41% because of the re-organization of the State of Jammu & Kashmir into UTs of Ladakh and Jammu & Kashmir through the Jammu & Kashmir Re-organization Act, 2019.

**Horizontal Devolution**

Horizontal devolution is done primarily to enable the States to provide basic public goods and services with equivalent tax effort. The various criteria to be considered for horizontal devolution are classified into three broad groups as follows.

* **Need-based criteria**: **Population, area and forest & ecology** form the need-based criteria. This is needed to address the fiscal gap of States existing due to the structural mismatch between the States’ resources and their expenditure liabilities.
* **Equity-based criterion**: **Income distance** forms the equity-based criterion to ensure fiscal equalization given the large differences in the resource base available and status of development within the country.
* **Performance-based criteria**: **Demographic performance and tax effort** are part of the performance-based criteria that is framed to reward and incentivize States to perform better, in terms of utilization of resources available to them.
* **Population**: Only 2011 Census numbers are used as per the ToR. Population criterion is assigned a weight of only 15 per cent as some of the other criteria will also be scaled by it.
* **Area**: A moderate weight of 15 per cent for the area criterion is assigned larger area incurs some additional administrative costs but it may not lead to a proportional increase in the cost of providing services.
* **Forest and Ecology**: This criterion is for the ecological services being provided by a State’s forest cover to the country as a whole and is arrived at by calculating the share of the dense forest of each State in the aggregate dense forest of all the States. A weight of 10 per cent is assigned for the forest and ecology criterion.
* **Income Distance:**Distance of per capita income is the criteria used to make the devolution formula more equalizing and progressive, and provides higher devolution to States with lower per capita income and lower own tax capacity. The XV-FC retained the income distance criterion with a weight of 45 per cent.
* **Demographic Performance**: An abrupt change from 1971 Census data to 2011 Census data should not unfairly penalize some States which have performed well on population control. Hence, the commission recommended introducing a new performance-based criterion to reward States who have performed well on the demography front. This criterion of demographic performance is computed by using the reciprocal of TFR of each State, scaled by the population data of Census 1971. States which have achieved lower TFR will be scored higher and vice versa. This criterion is assigned a weight of 12.5 per cent.
* **Tax Effort**: The inclusion of tax effort as a performance-based criterion will reward the States with higher tax collection efficiency and encourage all States to be more tax efficient. It is computed by taking the ratio of the average of per capita own tax revenue of a State over three years and its per capita GSDP and scaling this ratio by the population of the State. Total weight of 2.5 per cent has been assigned to this criterion.

Uttar Pradesh and Bihar have received the largest devolutions for 2020-21 while Karnataka and Kerala saw the largest decreases in the share of the divisible pool

**Grants in Aid**

**Revenue Deficit Grants**: 14 states are estimated to face a revenue deficit post-devolution.  The Commission has recommended revenue deficit grants worth Rs 74,341 crore to these 14 states.  Furthermore, the three states of Karnataka, Mizoram, and Telangana received special grants to make up the shortfall between untied transfers received by these States in the form of tax devolution plus revenue deficit grant in 2020-21 vis-a-vis the corresponding amount in 2019-20.

**Sectoral Grants**: The XV-FC is considering recommending sectoral grants for nutrition, health, pre-primary education, judiciary, rural connectivity, railways, statistics and police training, and housing during its tenure. Of these, grants for nutrition, to augment the efforts of the States towards reducing and ultimately eliminating malnutrition, is specifically recommended even in 2020-21.

**Performance-based Incentives**: Six broad areas are identified to provide performance-based incentives to States.

* Implementation of Agriculture Reforms
* Development of Aspirational Districts and Aspirational Blocks
* Power Sector Reforms
* Enhancing Trade including Exports
* Incentives for Education
* Promotion of Domestic and International Tourism

**Empowering Local Bodies**

Some significant changes made by XV-FC compared to previous Finance Commissions:

* To recommend grants to all tiers of the Panchayati Raj to enable pooling of resources to create durable community assets and improve their functional viability.
* To give grants to the Fifth and Sixth Schedule areas and Cantonment Boards.
* To provide for tied grants in the critical sectors of sanitation and drinking water to ensure additional funds to the local bodies over and above the funds allocated for these purposes under the centrally sponsored schemes (CSS), Swachh Bharat and Jal Jeevan Missions.
* To account for increasing urbanization the share of urban local bodies in Finance Commission grants to local bodies should be gradually increased to 40 per cent over the medium term.
* Since larger cities will tend to grow faster with the agglomeration effect, the fifty Million-Plus cities in the country need differentiated treatment, with special emphasis on meeting the challenges of bad ambient air quality, groundwater depletion and sanitation.

**Grants to Local Bodies**:

* The Commission has recommended a total of Rs 90,000 crore for grants to the local bodies in 2020-21.
* This amounts to 4.31% of the divisible pool.
* These grants will be made available to all three tiers of Panchayat- village, block, and district.
* The inter-se distribution of grants for local bodies among the States may be based on population and area in the ratio of 90:10.
* For 2020-21, the proportion of grants between rural and urban local bodies recommended by the XV-FC is in the ratio of 67.5:32.5.
* For all urban bodies, the distribution of grants for 2020-21 is based on population.

**Disaster Risk Management**

* To promote local-level mitigation activities, mitigation funds shall be set up at both national and state levels in the form of NDMF and State Disaster Mitigation Funds (SDMF), following the Disaster Management Act.
* The Commission recommended the creation of funds for disaster mitigation along with disaster response, which will now together be called as National Disaster Risk Management Fund (NDRMF) and State Disaster Risk Management Funds (SDRMF).
* Recommended grants for the State Disaster Risk Management Fund is Rs 28,983 crore. Out of this, the share of SDRF shall be 80 per cent and the share of SDMF 20 per cent. The allocation for the National Disaster Risk Management Fund is Rs 12,390 crore.
* Allocations for NDRF / SDRF will be further sub-divided into
  + Response and Relief – 40 per cent
  + Recovery and Reconstruction – 30 per cent
  + Capacity Building – 10 per cent

## Conclusion

* Several challenges have emerged since these recommendations were made by the XV-FC in the form of the global economic slowdown, lower tax revenue realization and above all, the enormous disruption to the economy created by the Coronavirus pandemic.
* These will necessitate several additional demands for allocations to be made in the coming years.
* Further, several policy issues like streamlining GST, Direct Tax Code, improving expenditure outcomes, etc. will need special focus from the government to achieve the noble objectives set before the Finance Commission.