

Business Standard

15th Finance Commission: Moving on

Since the 10th FC, the most important parameter in the horizontal devolution formula has been the income distance criterion

Rathin Roy April 18, 2018 Last Updated at 05:48 IST



The terms of reference (ToR) of the 15th Finance Commission (FC) have generated unprecedented debate and controversy.

The most publicly debated ToR is the requirement that the 2011 Census be used as the basis for using population in the formula for horizontal devolution, instead of the 1971 population, which was what was enjoined on previous Commissions. V Bhaskar, my colleague from the 13th FC, argues that this would result in the southern states losing out. I don't think this argument carries any ex ante validity. The impact on the share of a state of a particular criterion depends on its weight and its base. If the former is reduced, say, to acknowledge efforts of states that have made progress toward replacement rate of population growth (as the ToR also enjoins), then the impact of change of base can be nullified, even reversed. Since the 10th FC, the weight of population in the horizontal devolution formula has varied from 10 to 25 per cent. Any weight the 15th FC adopts at the lower end of this spectrum will render this controversy irrelevant.

Since the 10th FC, the most important parameter in the horizontal devolution formula has been the income distance criterion. This has been historically proxied by some measure of the inverse of the per capita income of a state. The lower the per capita income of a state, the greater its share. The weight for this criterion has varied between 50 and 60 per cent since the 10th FC. It is creditable that no state has objected to this high weight — this shows a level of fraternity and responsibility in our states, who recognise that such progressivity is desirable and should not be the object of divisive controversy.

Given this positive spirit, it would have been good if the ToR for the 15th FC had been more fraternal in its tone. Previous ToRs asked FCs to take account of the demands of the resources of the Central government for meeting its expenditure commitments on national public goods, and of the resources of the state governments for their commitments. The ToR for the 15th FC does the same, albeit in more detail, but adds a needlessly conflictual exhortation to take account of the "...impact on the fiscal situation of the Union government of substantially enhanced tax devolution to States following recommendations of the 14th FC...". When FCs undertake their analytical exercises, it is a given that they take account of the impact of previous recommendations. Previous FCs have elaborated on these at great length, to justify their own recommendations. So this is an unnecessary addition. A further item, enjoining the commission to take account of GST compensation and the abolition of some cesses is also needlessly prescriptive for the same reason, with the

further irritation that cesses on direct taxes continue to be imposed by the Centre.

There is an entirely new section of the ToR that is causing much annoyance to the states. It asks the Commission to consider proposing “measurable performance based incentives for the States” (not the Centre). This state-specific ToR would have been possibly less controversial were it not for the needless detailing that follows.

This specifies a number of indicators of progress are to be made by the states. Some of these are subject to accusation of normative bias, such as “Achievements in implementation of flagship schemes of Government of India” (why?), and “bringing behavioural change to end open defecation” (why not health or education, both state subjects?). Others are ideological (“adoption of direct benefit schemes” and “promoting digital economy”). Yet others are judgemental (“Progress made in ease of doing business”, “promoting labour intensive growth”, “Control or lack of it in incurring expenditure on populist measures”). I fail to see any cogent reason why such specific exhortations should form part of a ToR. As with previous ToRs, such considerations could have been left to the judgement of the Commission, especially given the excellent job they have done 14 times since Independence.

Despite the above, while the ToR does make the job of the 15th FC needlessly more difficult than those of its predecessors, the core recommendations regarding the vertical and horizontal devolution will continue to be guided by the Commission’s assessments per its constitutional mandate. The Commission has full authority to determine the relative weight of the parameters to be considered for the vertical and horizontal distribution. In fact, given that it will also determine the fiscal consolidation road map for the Centre and the states, it can also make recommendations regarding the relative shares of both levels — and the share of individual states — in total debt, consistent with its overall debt reduction and fiscal discipline framework. This, and its constitutional status, affords it sufficient autonomy.

I have every confidence that the 15th FC will accomplish its constitutional task as effectively as its predecessors. It is important that, the states recognise that the controversy arises largely from peripheral elements of a poorly drafted ToR, that is, nevertheless, as sound as its predecessors in its constitutional core. There is, therefore, no reason to doubt, ex ante, the ability of the 15th FC to do its job, and I would urge states to continue to repose confidence in this most important constitutional institution.

The writer is Director, NIPFP, and was Economic Advisor to the 13th Finance Commission. Views are personal.