

Uniquely placed

The 15th Finance Commission (FC) is in the process of figuring out a fair formula for the distribution of net tax proceeds between the Union and the States, and among States.

The 14th FC had adopted a formula-based tax devolution approach, apart from grants-in-aid for local bodies, disaster relief, and post-devolution revenue deficit grants. The share of devolution to the States was enhanced to 42% from 32%, which gave the States considerable flexibility. However, it dispensed with sectoral grants for elementary education, the forest sector and renewable energy sector, among others. No State-specific grants were recommended. The assumption was that a higher level of devolution would offset other requirements.

The devolution formula, therefore, is central to the approach of resource transfers. The 14th FC accorded 27.5% weight to the population (of which 17.5% was of the 1971 population), 15% to area, 7.5% to forest cover and 50% to income distance. Larger States with larger populations have a greater requirement of resources. Income distance was adopted as a proxy for fiscal capacity, and forest cover was given weightage for the first time, underscoring ecological benefits.

The Northeast represents a distinct entity for developmental planning and has a special category status. Low levels of human development indices, a low resource base, and poor connectivity and infrastructure pose a different challenge which must be taken into account in the devolution formula.

Central Ministries earmark 10% of their allocations for the Northeast. By the same logic, 10% of tax proceeds could be earmarked for vertical devolution to the region. A number of centrally sponsored schemes have been rolled out where the obligation of State share is huge, adding to revenue expenditure. Sometimes the real burden (as in the case of Sarva Shiksha Abhiyan) is far more than the mandated 10%. Many centrally sponsored schemes are discontinued midway, and the burden of employee salaries falls on the States. Maintenance of assets, such as rural roads under the Pradhan Mantri Gram Sadak Yojana, require huge expenditure, especially in hilly States. A 20% cost disability was allowed by the 13th FC while allocating grants for road maintenance.

The 13th FC acknowledged the different position of the Northeast while arriving at the formula for horizontal devolution. Its twin guiding principles were equity and efficiency. It accorded 47.5% weight to fiscal capacity distance. Per capita GSDP was taken as a proxy for fiscal capacity, but States were divided into two groups, general and special category States, given that the average tax to GSDP ratio was higher for the former. Three-year per capita GSDP was computed separately in these two groups, weighted means of tax to GSDP ratio obtained, and per capita tax revenue was assessed for each State. Fiscal distance was thereafter calculated on estimated per capita revenue with reference to the highest State, which was then multiplied by the 1971 populations to arrive at the share of each State. There was much merit in this approach, which was in contrast to the 14th FC which used per capita GSDP as an indicator of fiscal capacity uniformly for all States.

The revision of the base year to 2011-12 by the Central Statistics Office from 2004-05 also created complications. Arunachal Pradesh, for instance, saw a sudden spike in per capita GSDP. This was primarily on account of the fact that 73% of the GSDP was calculated on the allocation method as compared to 34% earlier. This saw a jump in gross value added in mining, construction, electricity, etc., even with a negligible industrial base.

The Northeast also bears a disproportionate burden of natural disasters every year on account of

rainfall. The 14th FC disaster relief grants bore no correlation with vulnerability but were ad hoc extrapolations of previous allocations. The Energy and Resources Institute has computed an index of vulnerability of all States. The disaster vulnerability index is highest for the Northeast; this needs to be factored in while allocating grants. The region also has the highest forest cover and represents the largest carbon sink nationally. Allocating 10% for forest cover would encourage States to preserve the forests.

The Terms of Reference of the 15th FC also mention performance-based incentives based on improvements in GST collection, Direct Benefit Transfer rollout, etc. This would definitely infuse a spirit of competition. However, the performance of the Northeastern States must be benchmarked with other Northeastern States so that apples are not compared with oranges. The challenge for the Commission, as one member said, is “to strike a balance between those who need and those who perform”.

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