Report Summary

Fourteenth Finance Commission Report

- The report of the Fourteenth Finance Commission, chaired by Y.V. Reddy, was tabled in Parliament on February 24, 2015. The Finance Commission is a constitutional body that is formed once in five years, and provides recommendations on centre-state financial relations. Recommendations of the 14th Commission include:
- **Devolution of taxes to states:** Tax devolution should be the primary source of transfer of funds to states. The share of taxes of the centre to states is recommended to be increased from 32% to 42%.
- Additional budgetary needs of the states will be filled by grants-in-aid to the states. The total revenue deficit grant to states in the 2015-20 period is recommended to be Rs 1,94,821 crore.
- **Weights of indicators for share in taxes:** The weights of various indicators in the calculation of states' share of taxes have been fixed at the following: (i) 1971 population: 17.5%, 2011 population: 10%, (ii) area: 2% for smaller states, 15% for general weight, (iii) forest cover: 7.5%, and (iv) income distance (distance of state's income from the state having the highest income): 50%.
- **Fiscal deficit**: Fiscal deficit of states should be aimed at 3% of the Gross State Domestic Product (GSDP) during the period 2015 to 2020.States will be eligible for a flexibility of 0.25% over this limit. They will be eligible for this flexibility if their debt-GSDP ratio is less than or equal to 25% in the previous year.
- States will also have an option for an additional borrowing of 0.25% of their GSDP, if their interest payments are less than or equal to 10% of their revenue receipts in the previous year.
- **Compensation to states for GST:** An autonomous and independent Goods and Services Tax (GST) Compensation Fund is to be set up in order to facilitate compensation to states. Revenue compensation to states for the GST should be for five years. 100% compensation should be paid to states in the first three years, 75% compensation for the fourth year, and 50% compensation should be paid in the fifth year.
- **Grants to local governments:** The total grant to local governments for 2015-20 has been fixed at Rs 2,87,436 crore, of which Rs 2,00,292 crore is recommended to panchayats and Rs 87,144 crore to municipalities.
- Grants to local governments should be in two parts- a basic grant and a performance grant. For gram panchayats, 90% of the share will be basic grants, and 10% will be performance grants. For municipalities, basic grants and performance grants will constitute 80% and 20% of the total grants, respectively.
- Performance grants are proposed to be introduced with a view to: (i) encourage the maintenance of the states' receipts and expenditure accounts, and (ii) bring about an increase in the state's own revenues.
- **Amendments to FRBM Act:** The FRBM Act, 2003 should be amended, to remove the definition of effective revenue (difference between revenue deficit and grants for creation of capital assets).
- An independent fiscal council should be created to evaluate the fiscal policy implications of budget proposals, before the budget is announced. States are advised to amend their FRBM Acts in a similar manner.
- Alternatively, the FRBM Act may be replaced with a Debt Ceiling and Fiscal Responsibility Legislation, in order to bring greater legitimacy to fiscal management.

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