

Report Summary

Report of the 15th Finance Commission for 2021-26

The Finance Commission is a constitutional body formed by the President of India to give suggestions on centre-state financial relations. The 15th Finance Commission (Chair: Mr. N. K. Singh) was required to submit two reports. The first report, consisting of recommendations for the financial year 2020-21, was tabled in Parliament in February 2020. The final report with recommendations for the 2021-26 period was tabled in Parliament on February 1, 2021. Key recommendations in the report for 2021-26 include:

Share of states in central taxes

The share of states in the central taxes for the 2021-26 period is recommended to be 41%, same as that for 2020-21. This is less than the 42% share recommended by the 14th Finance Commission for 2015-20 period. The adjustment of 1% is to provide for the newly formed union territories of Jammu and Kashmir, and Ladakh from the resources of the centre.

Criteria for devolution

Table 1 below shows the criteria used by the Commission to determine each state's share in central taxes, and the weight assigned to each criterion. The criteria for distribution of central taxes among states for 2021-26 period is same as that for 2020-21. However, the reference period for computing income distance and tax efforts are different (2015-18 for 2020-21 and 2016-19 for 2021-26), hence, the individual share of states may still change. The individual share of states in the taxes devolved by the centre is provided in Table 2 in the annexure. We explain some indicators below.

Table 1: Criteria for devolution

Criteria	14 th FC 2015-20	15 th FC 2020-21	15 th FC 2021-26
Income Distance	50.0	45.0	45.0
Area	15.0	15.0	15.0
Population (1971)	17.5	-	-
Population (2011)#	10.0	15.0	15.0
Demographic Performance	-	12.5	12.5
Forest Cover	7.5	-	-
Forest and Ecology	-	10.0	10.0
Tax and fiscal efforts*	-	2.5	2.5
Total	100	100	100

Note: #14th FC used the term “demographic change” which was defined as Population in 2011. *The report for 2020-21 used the term “tax effort”, the definition of the criterion is same.

Sources: Reports of the 14th and 15th Finance Commissions; PRS.

- **Income distance:** Income distance is the distance of a state's income from the state with the highest income. Income of a state has been computed as average per capita GSDP during the three-year period between 2016-17 and 2018-19. A state with lower per capita income

will have a higher share to maintain equity among states.

- **Demographic performance:** The Terms of Reference of the Commission required it to use the population data of 2011 while making recommendations. Accordingly, the Commission used 2011 population data for its recommendations. The demographic performance criterion has been used to reward efforts made by states in controlling their population. States with a lower fertility ratio will be scored higher on this criterion.
- **Forest and ecology:** This criterion has been arrived at by calculating the share of the dense forest of each state in the total dense forest of all the states.
- **Tax and fiscal efforts:** This criterion has been used to reward states with higher tax collection efficiency. It is measured as the ratio of the average per capita own tax revenue and the average per capita state GDP during the three years between 2016-17 and 2018-19.

Grants

Over the 2021-26 period, the following grants will be provided from the centre's resources (see Table 3 and 4 in the annexure for more details):

- **Revenue deficit grants:** 17 states will receive grants worth Rs 2.9 lakh crore to eliminate revenue deficit.
- **Sector-specific grants:** Sector-specific grants of Rs 1.3 lakh crore will be given to states for eight sectors: (i) health, (ii) school education, (iii) higher education, (iv) implementation of agricultural reforms, (v) maintenance of PMGSY roads, (vi) judiciary, (vii) statistics, and (viii) aspirational districts and blocks. A portion of these grants will be performance-linked.
- **State-specific grants:** The Commission recommended state-specific grants of Rs 49,599 crore. These will be given in the areas of: (i) social needs, (ii) administrative governance and infrastructure, (iii) water and sanitation, (iv) preservation of culture and historical monuments, (v) high-cost physical infrastructure, and (vi) tourism. The Commission recommended a high-level committee at state-level to review and monitor utilisation of state-specific and sector-specific grants.
- **Grants to local bodies:** The total grants to local bodies will be Rs 4.36 lakh crore (a portion of grants to be performance-linked) including: (i) Rs 2.4 lakh crore for rural local bodies, (ii) Rs 1.2 lakh crore for urban local bodies, and (iii) Rs 70,051 crore for health grants through local governments. The grants to local bodies will be made available to all three tiers of Panchayat- village, block, and district. The health grants will be provided for: (i) conversion of rural sub-centres and primary healthcare centres (PHCs) to health and wellness centres (HWCs), (ii) support for diagnostic infrastructure for

primary healthcare activities, and (iii) support for urban HWCs, sub-centres, PHCs, and public health units at the block level.

- Grants to local bodies (other than health grants) will be distributed among states based on population and area, with 90% and 10% weightage, respectively. The Commission has prescribed certain conditions for availing these grants (except health grants). The entry-level criteria include: (i) publishing provisional and audited accounts in the public domain and (ii) fixation of minimum floor rates for property taxes by states and improvement in the collection of property taxes (an additional requirement after 2021-22 for urban bodies). No grants will be released to local bodies of a state after March 2024 if the state does not constitute State Finance Commission and act upon its recommendations by then.
- **Disaster risk management:** The Commission recommended retaining the existing cost-sharing patterns between the centre and states for disaster management funds. The cost-sharing pattern between centre and states is: (i) 90:10 for north-eastern and Himalayan states, and (ii) 75:25 for all other states. State disaster management funds will have a corpus of Rs 1.6 lakh crore (centre's share is Rs 1.2 lakh crore).

Fiscal roadmap

- **Fiscal deficit and debt levels:** The Commission suggested that the centre bring down fiscal deficit to 4% of GDP by 2025-26. For states, it recommended the fiscal deficit limit (as % of GSDP) of: (i) 4% in 2021-22, (ii) 3.5% in 2022-23, and (iii) 3% during 2023-26. If a state is unable to fully utilise the sanctioned borrowing limit as specified above during the first four years (2021-25), it can avail the unutilised borrowing amount (calculated in rupees) in subsequent years (within the 2021-26 period).
- Extra annual borrowing worth 0.5% of GSDP will be allowed to states during first four years (2021-25) upon undertaking power sector reforms including: (i) reduction in operational losses, (ii) reduction in revenue gap, (iii) reduction in payment of cash subsidy by adopting direct benefit transfer, and (iv) reduction in tariff subsidy as a percentage of revenue.
- The Commission observed that the recommended path for fiscal deficit for the centre and states will result in a reduction of total liabilities of: (i) the centre from 62.9% of GDP in 2020-21 to 56.6% in 2025-26, and (ii) the states on aggregate from 33.1% of GDP in 2020-21 to 32.5% by 2025-26. It recommended forming a high-powered inter-governmental group to: (i) review the Fiscal Responsibility and Budget Management Act (FRBM), (ii) recommend a new FRBM framework for centre as well as states, and oversee its implementation.
- **Revenue mobilisation:** Income and asset-based taxation should be strengthened. To reduce excessive dependence on income tax on salaried incomes, the coverage of provisions related to tax deduction and collection at source (TDS/TCS) should be expanded. Stamp duty and registration fees at the state level have large untapped potential. Computerised property records should be integrated with the registration of transactions, and the market value of properties should be captured. State

governments should streamline the methodology of property valuation.

- **GST:** The inverted duty structure between intermediate inputs and final outputs present in GST needs to be resolved. Revenue neutrality of GST rate should be restored which has been compromised by multiple rate structure and several downward adjustments. Rate structure should be rationalised by merging the rates of 12% and 18%. States need to step up field efforts for expanding the GST base and for ensuring compliance.
- **Financial management practices:** A comprehensive framework for public financial management should be developed. An independent Fiscal Council should be established with powers to assess records from the centre as well as states. The Council will only have an advisory role. A time-bound plan for phased adoption of standard-based accounting and financial reporting for both centre and states should be prepared while eventual adoption of accrual-based accounting is being considered. The centre as well as states should not resort to off-budget financing or any other non-transparent means of financing for any expenditure. A standardised framework for reporting of contingent liabilities should be devised. Both centre and states should strive to improve the accuracy and consistency of macroeconomic and fiscal forecasting.
- States should amend their fiscal responsibility legislation to ensure consistency with the centre's legislation, in particular, with the definition of debt. States should have more avenues for short-term borrowings other than the ways and means advances, and overdraft facility from the Reserve Bank of India. States may form an independent debt management cell to manage their borrowing programmes efficiently.

Other recommendations

- **Health:** States should increase spending on health to more than 8% of their budget by 2022. Primary healthcare expenditure should be two-thirds of the total health expenditure by 2022. Centrally sponsored schemes (CSS) in health should be flexible enough to allow states to adapt and innovate. Focus of CSS in health should be shifted from inputs to outcome. All India Medical and Health Service should be established.
- **Funding of defence and internal security:** A dedicated non-lapsable fund called the Modernisation Fund for Defence and Internal Security (MFDIS) will be constituted to primarily bridge the gap between budgetary requirements and allocation for capital outlay in defence and internal security. The fund will have an estimated corpus of Rs 2.4 lakh crore over the five years (2021-26). Of this, Rs 1.5 lakh crore will be transferred from the Consolidated Fund of India. Rest of the amount will be generated from measures such as disinvestment of defence public sector enterprises, and monetisation of defence lands.
- **Centrally-sponsored schemes (CSS):** A threshold should be fixed for annual allocation to CSS below which the funding for a CSS should be stopped (to phase out CSS which outlived its utility or has insignificant outlay). Third-party evaluation of all CSS should be completed within a stipulated timeframe. Funding pattern should be fixed upfront in a transparent manner and be kept stable.

Annexure

Table 2: Individual share of states in the taxes devolved by the centre (out of 100)

State	14th FC 2015-20	15th FC 2020-21	15th FC 2021-26
Andhra Pradesh	4.305	4.111	4.047
Arunachal Pradesh	1.370	1.760	1.757
Assam	3.311	3.131	3.128
Bihar	9.665	10.061	10.058
Chhattisgarh	3.080	3.418	3.407
Goa	0.378	0.386	0.386
Gujarat	3.084	3.398	3.478
Haryana	1.084	1.082	1.093
Himachal Pradesh	0.713	0.799	0.830
Jammu & Kashmir	1.854	-	-
Jharkhand	3.139	3.313	3.307
Karnataka	4.713	3.646	3.647
Kerala	2.500	1.943	1.925
Madhya Pradesh	7.548	7.886	7.850
Maharashtra	5.521	6.135	6.317
Manipur	0.617	0.718	0.716
Meghalaya	0.642	0.765	0.767
Mizoram	0.460	0.506	0.500
Nagaland	0.498	0.573	0.569
Odisha	4.642	4.629	4.528
Punjab	1.577	1.788	1.807
Rajasthan	5.495	5.979	6.026
Sikkim	0.367	0.388	0.388
Tamil Nadu	4.023	4.189	4.079
Telangana	2.437	2.133	2.102
Tripura	0.642	0.709	0.708
Uttar Pradesh	17.959	17.931	17.939
Uttarakhand	1.052	1.104	1.118
West Bengal	7.324	7.519	7.523
Total	100	100	100

Sources: Reports of 14th and 15th Finance Commission; PRS.**Table 3: Grants for 2021-26 (five years) (Rs crore)**

Grants	Amount
Revenue deficit grants	2,94,514
Local governments grants	4,36,361
Urban Local Bodies	1,21,055
Rural Local Bodies	2,36,805
Health Grants	70,051
Other Grants*	8,450
Disaster management grants	1,22,601
Sector-specific grants	1,29,987
Health	31,755
School Education	4,800
Higher Education	6,143
Implementation of agricultural reforms	45,000
Maintenance of PMGSY roads	27,539
Judiciary	10,425
Statistics	1,175
Aspirational districts and blocks	3,150
State-specific grants	49,599
Total	10,33,062

Note: *Other grants to local bodies comprise grants for: (i) incubation of new cities (Rs 8,000 crore), and National Data Centre (Rs 450 crore).

Source: Report of the 15th Finance Commission for 2021-26; PRS.

Table 4: State-wise details of grants-in-aid for 2021-26 (in Rs crore)

States	Revenue deficit grants	Grants to local bodies			Disaster management	Certain sector-specific grants						State-specific grants
		Health grants	Rural local bodies	Urban local bodies		Health	PMGSY Roads	Statistics	Judiciary	Higher Education	Agriculture	
Andhra Pradesh	30,497	2,601	10,231	5,231	6,183	877	344	19	295	250	4,209	2,300
Arunachal Pradesh	0	259	900	459	1,382	133	1,508	49	20	48	107	400
Assam	14,184	1,484	6,253	3,197	4,268	2,161	3,103	57	610	171	748	1,375
Bihar	0	6,017	19,561	9,999	7,824	3,223	1,694	77	960	483	1,720	2,267
Chhattisgarh	0	1,799	5,669	2,900	2,387	588	911	54	200	146	917	1,660
Goa	0	167	293	149	63	56	0	5	15	50	63	700
Gujarat	0	3,341	12,455	6,367	7,316	1,070	330	51	310	298	2,818	2,860
Haryana	132	1,617	4,929	2,520	2,715	695	128	40	300	146	1,696	2,003
Himachal Pradesh	37,199	521	1,673	855	2,258	377	2,222	21	50	70	247	1,420
Jharkhand	0	2,370	6,585	3,367	3,138	1,014	966	48	275	179	677	1,300
Karnataka	1,631	2,929	12,539	6,409	4,369	1,233	398	45	295	299	2,290	6,000
Kerala	37,814	2,968	6,344	3,242	1,738	607	113	20	405	181	1,086	1,100
Madhya Pradesh	0	4,902	15,527	7,938	10,059	2,340	2,109	102	690	349	4,587	1,765
Maharashtra	0	7,067	22,713	11,611	17,803	2,710	613	63	1,240	520	3,285	2,750
Manipur	9,796	234	690	353	234	191	1,193	28	30	54	101	900
Meghalaya	3,137	311	711	363	363	187	544	23	30	54	86	800
Mizoram	6,544	166	362	185	259	115	546	14	15	48	86	700
Nagaland	21,249	303	486	249	228	153	372	23	10	51	124	525
Odisha	0	2,454	8,800	4,498	8,865	962	1,949	45	425	218	1,271	1,775
Punjab	25,968	2,131	5,410	2,764	2,736	902	230	43	145	156	1,966	1,545
Rajasthan	14,740	4,423	15,053	7,696	8,186	1,186	1,618	57	460	332	3,301	2,322
Sikkim	1,267	111	165	84	279	100	484	7	5	45	41	500
Tamil Nadu	2,204	4,280	14,059	7,187	5,637	1,002	506	47	250	347	2,632	2,200
Telangana	0	2,228	7,201	3,682	2,483	624	255	46	245	189	1,665	2,362
Tripura	19,890	453	746	381	378	265	502	17	85	55	228	875
Uttar Pradesh	0	9,716	38,012	19,432	10,685	6,150	1,465	114	1,825	893	5,334	3,495
Uttarakhand	28,147	797	2,239	1,145	5,178	728	2,322	25	70	83	277	1,600
West Bengal	40,115	4,402	17,199	8,792	5,587	2,106	1,114	35	1,165	428	3,438	2,100
Total	2,94,514	70,051	2,36,805	1,21,055	1,22,601	31,755	27,539	1,175	10,425	6,143	45,000	49,599

Note: Break-up of following grants is not available in the above table: (i) Sector-specific grants for school Education (Rs 4,800 crore) and aspirational districts and blocks (Rs 3,150 crore), and (ii) grants to local bodies for incubation of new cities (Rs 8,000 crore), and National Data Centre (Rs 450 crore).

Sources: Report of the 15th Finance Commission for 2021-26; PRS.

DISCLAIMER: This document is being furnished to you for your information. You may choose to reproduce or redistribute this report for non-commercial purposes in part or in full to any other person with due acknowledgement of PRS Legislative Research ("PRS"). The opinions expressed herein are entirely those of the author(s). PRS makes every effort to use reliable and comprehensive information, but PRS does not represent that the contents of the report are accurate or complete. PRS is an independent, not-for-profit group. This document has been prepared without regard to the objectives or opinions of those who may receive it.