FEDERAL FINANCE

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Meaning

- Federation means the union of two or more states. It can be defined as a form of political association in which two or more states constitutes a political unity with a common government ,but in which these member states retain a measure of internal autonomy.
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- In a federal setup there are atleast two levels of government. At the top level is the federal ,central or union government and at the lower level is the state government.
- Similarly within each state there can be two levels of government , at the top is the state government and at the lower level is the local or municipal governments.

Principles of federal finance

- Independence and responsibility: it means that central and state government should be financially independent within their own sphere. And each government should take the responsibility of taxing, spending, borrowing and raising resources in their spheres for performing their functions.

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- Adequacy and elasticity: the principle of adequacy means that the resources of centre and state governments should be adequate so that each layer of government can discharge its obligations laid upon it.
- In adequacy means that the resources should be capable of expansion in response to rapidly growing needs and responsibilities of

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- Administrative economy and efficiency: Administrative cost should be minimum and there should be no frauds and evasion in matter of finances. Corruption and inter-regional smuggling are to be avoided.
- Principle of equity: there should be proper adjustment between federal taxation so as to make the tax burden on all citizens equitable as far

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- Principle of integration and coordination: integration of financial system is an essential in contemporary federations . This should be done in a way that promotes economic development.Coodination is also important for smooth and efficient working of federal financial system.the coordination of federal

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- Principles of accountability: freedom and democracy are very essential for any financial system.Therefore in federal system such government should be accountable to its own legislature for its having and spending decisions.
- Principle of uniformity: each regional government provides an adequate level of public service without resort to higher rates of taxation substantially than those of other regions.

Functions

- Distribution of net proceeds of taxes between Centre and the States, to be divided as per their respective contributions to the taxes.
- Determine factors governing Grants-in Aid to the states and the magnitude of the same.
- To make recommendations to president as to the measures needed to augment the Consolidated Fund of a State to supplement the resources of the panchayats and municipalities in the state on the basis of the recommendations made by the **FINANCE** Commission of the state.

Centre-state financial relations

- Finance Commission: a main departure in the financial provision of the constitution from the scheme of the government of India Act, 1935 consists in the institution of a finance commission under Article 280.
- First Finance Commission- K.C.Neogy- 1952
- Second - K.Santhanam-1956

  submitted report-1957
- Third - A.K.Chanda- 1960

  submitted report-1962

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- Fourth finance commission- P.V.Rajamannar-1964

  submitted- 1965

Fifth finance commission - Mahavir Tyagi-1968

submitted- 1969

Sixth finance commission- Brahmanand Reddy-1972

submitted – 1973

Seventh finance commission- Justice J.M. Shelat-1978

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- Eighth finance commission- Y.B.Chavan- interim report – 1984-85
- Ninth finance commission- N.K.P. Salve- 1987

submitted- 1989

Tenth FC - Shri Krishna Chandra Pant 1992

submitted-1995

Eleventh FC - Prof. A.M. Khusro 1998

submitted-2000-05

Twelfth FC -C.Rangarajan-

Cont…

- Twelfth FC -C.Rangarajan-2003

  Submitted -2005-2010

Thirteenth FC - Vijay.L.Kelkar-2007

2010-15

Fourteenth FC – Dr.Y.V.Reddy-2012

2015-2020

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- Main recommendations of thirteenth FC:
- The share of states in the net proceeds of the shareable Central taxes should be 32%.This is 1.5% higher than the recommendation of 12th Finance Commission.
- Revenue deficit to be progressively reduced and eliminated, followed by revenue surplus by 2013–14.
- Fiscal deficit to be reduced to 3% of the GDP by 2014–15.
- A target of 68% of GDP for the combined debt of centre and states.
- The Medium Term Fiscal Plan(MTFP)should be reformed and made the statement of commitment rather than a statement of intent.

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- FRBM Act Fiscal Responsibility and Budget management)need to be amended to mention the nature of shocks which shall require targets relaxation.
- Both centre and states should conclude 'Grand Bargain' to implement the model Goods and Services Act(GST).To incentivize the states, the commission recommended a sanction of the grant of Rs500 billion.

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- States need to address the problem of losses in the power sector in time bound manner.
- Initiatives to reduce the number of Central Sponsored Schemes(CSS)and to restore the predominance of formula based plan grants.

14th Finance Commission

- **TAX DEVOLUTION TO BE BASED ON AREA, POPULATION, DEMOGRAPHY, INCOME DISTANCE & FOREST COVER**
  Highest weight of 50 per cent is given to distance from the highest per capita income district, followed by population (1971 census) at 17.5 per cent, demography (2011 census) at 10 per cent, area at 15 per cent and forest cover at 7.5 per cent

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- **CENTRE'S FISCAL AND REVENUE DEFICITS**
  Fiscal deficit should come down to 3.6 per cent of GDP in 2015-16 from projected 4.1 per cent in 2014-15 and then 3 per cent in following year and kept at that for three more years. Not different from existing roadmap, though the present time frame ends in 2016-17. Wants revenue deficit to come down from 2.9 per cent in FY15 to 2.56 per cent in FY16 and then progressively reduce to 0.93 per cent by 2019-20

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- **STATES' FISCAL AND REVENUE DEFICITS**
  Fiscal deficit should be at 2.76 per cent in FY16, to come down to 2.74 per cent by FY20 though it would increase in between. To be revenue surplus in all these years.
- **CENTRE'S DEBT**
  To come down from 45.4 per cent of GDP in FY15 to 43.6 per cent in FY16 and then progressively should reduce to 36.3 per cent by FY20

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- **STATES' DEBT**
  Projected to increase from 21.90 per cent in FY16 progressively to 22.38 per cent in FY20

- **NATIONAL SMALL SAVING FUND (NSSF)**
  States be taken away from operation of NSSF with effect from next financial year

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- **RAIL TARIFF AUTHORITY**
  Replace the advisory body with a statutory body, through necessary amendments to the Railways Act, 1989.

- **ADVERTISEMENT TAX**
  States should empower local bodies to impose this tax to augment their revenues

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- **BOOST FOR STATES' SHARE IN NET PROCEEDS OF TAX REVENUES**
  The commission has recommended states' share in net proceeds of tax revenues be 42 per cent, a huge jump from the 32 per cent recommend by the 13th Finance Commission, the largest change ever in the percentage of devolution. As compared to total devolutions in 2014-15, total devolution of states in 2015-16 will increase by over 45 per cent

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- **TAX DEVOLUTION BE PRIMARY ROUTE OF TRANSFER OF RESOURCES**
  The panel has recommended tax devolution be the primary route of transfer of resources to the states; the government has accepted the recommendations keeping in mind the spirit of National Institution for Transforming India (NITI)

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- **GRANTS FOR LOCAL BODIES BE BASED ON 2011 POPULATION**
  The commission has recommended distribution of grants to states for local bodies using 2011 population data. Grants will be divided into two broad categories on the basis of rural and urban population - (i) a grant constituting gram panchayats and (ii) a grant constituting municipal bodies

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- **GRANTS BE IN TWO PARTS - BASIC AND PERFORMANCE**
  The panel has recommended the grants to states for local bodies be in two parts, a basic grant and a performance grant. The ratio of basic to performance grant is 90:10 with respect to panchayats and 80:20 in the case of municipalities.

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- **GRANTS TO GRAM PANCHAYATS & MUNICIPALITIES**
  The total grants recommended by the commission are Rs 2,87,436 crore for a five-year period from April 1, 2015 to March 31, 2020. Of this, Rs 2,00,292.20 crore will be given to panchayats and Rs 87,143.80 crore to municipalities. The transfers for financial year 2015-16 will be Rs 29,988 crore

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- **POST-DEVOLUTION REVENUE DEFICIT GRANTS FOR STATES**
  The panel has recommended 'post-devolution revenue deficit grants' for a total of Rs 1,94,821 crore on account of expenditure requirements of the states, tax devolution and revenue mobilisation capacity of the states. These grants will be given to 11 states.

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- **SOME CENTRAL SCHEMES BE DE-LINKED**
  Eight centrally sponsored schemes will be delinked from support from the Centre. Various centrally sponsored schemes will now see a change in sharing pattern, with states sharing a higher fiscal responsibility for implementing the schemes

  OTHER RECOMMENDATIONS
  The Finance Commission has also made recommendations on cooperative federalism, GST, fiscal consolidation roadmap, pricing of public utilities and public sector undertakings