



Fiscal consolidation path in India: Role of finance commission

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Abstract

The overall approach of Thirteenth Finance Commission (FC-XIII) is to foster 'inclusive and green growth promoting fiscal federalism'. Inclusive growth is the cornerstone of India's development project. India's recent economic growth performance has, indeed, been creditable. However, such growth must take a demonstrable difference to the lives of the poorest and most vulnerable citizens. On this, as reflected in the Millennium Development Goals (MDGs) there is global consensus, of which our nation is a part. India has the potential and the means to secure such a future for its citizens. The stress laid on inclusive growth in the eleventh plan has meant that such growth has been accompanied by a concerted effort, by all levels of government, to invest in the delivery of public services, particularly those which promote progress in achievement of the MDGs. But, to achieve this potential, it is necessary for the resources to be mobilized and deployed in such a manner that the recent high rates of growth are maintained and even increased. Thus, sustainable and inclusive growth are prerequisites for achieving the MDGs.

With this background present paper tries to bring out the role and impact of the Finance Commission in making fiscal consolidation of all the states as well as Union government.

Keywords: fiscal federalism, Inclusive growth, MDGs, public services

1. Introduction

The Thirteenth Finance Commission (FC-XIII) was constituted by the president under Article 280 of the Constitution on 13 November 2007 to make recommendations for the period 2010-15. Dr. Vijay L Kelkar was appointed as the chairman of the Commission. Dr. Indira Rajaraman (NIPFP), Dr. Abusaleh Shariff (NCAER), and professor Atul Sarma were appointed as full time members. Shri B.K. Chaturvedi was appointed as a part-time member. Shri Sumit Bose was appointed as secretary to the Commission.

The overall approach of the Commission is to foster 'inclusive and green growth promoting fiscal federalism'. Inclusive growth is the cornerstone of India's development project. India's recent economic growth performance has, indeed, been creditable. However, such growth must take a demonstrable difference to the lives of the poorest and most vulnerable citizens. On this, as reflected in the Millennium Development Goals (MDGs) there is global consensus, of which our nation is a part. India has the potential and the means to secure such a future for its citizens. The stress laid on inclusive growth in the eleventh plan has meant that such growth has been

accompanied by a concerted effort, by all levels of government, to invest in the delivery of public services, particularly those which promote progress in achievement of the MDGs. But, to achieve this potential, it is necessary for the resources to be mobilized and deployed in such a manner that the recent high rates of growth are maintained and even increased. Thus, sustainable and inclusive growth are prerequisites for achieving the MDGs (13th FC Report).

2. Performance of States with Projections of the FC – XIII

FC – XIII had chalked out a fiscal consolidation path for states, stipulating that states achieve revenue balance and a fiscal deficit – GSDP ratio of 3.0 percent by 2014-15. FC – XIII had also made a state – wise assessment of own receipts and select expenditures for each of the years in the award period of 2010-15. Own tax revenue – GSDP ratio of the states was increasing during the period 2010-11 to 2012-13, it was lower than the FC – XIII's assessment of the same. In case of revenue expenditure, states were placed better (Table 1).

Table 1: Performance of States according to FC-XIII Assessment (Per cent to GSDP)

Item	2010-11		2011-12		2012-13	
	Based on					
	FC-XIII Assessment	2010-11 (Accounts)	FC-XIII Assessment	Revised Estimates	FC-XIII Assessment	Budget Estimates
1	2	3	4	5	6	7
Own Revenue Receipts (1+2)	10.1	8.5	10.1	8.9	10.1	9.0
1 Own Tax Revenue	8.5	7.1	8.6	7.4	8.7	7.6
2 Own Non-tax Revenue	1.6	1.4	1.5	1.4	1.5	1.4
3 Revenue Expenditure (Interest Payments)	2.4	1.9	2.4	1.9	2.3	1.8

Source: Budget Documents of the State Governments the ratios pertaining to FC-XIII are directly taken from the FC-XIII Report

Note: Figures in parentheses are percentages to GDP

A comparison of states' revenue deficit and fiscal deficit in terms of GSDP with the targets of FC – XIII reveals that the performance of all states, NSC and SC states in respect of the revenue deficit – GSDP ratio was better than the FC–XIII's targets in 2011-12 which is depicted in the Table-3.18. State – wise data shows that with the 'exception of Goa, Haryana, Kerala, Maharashtra, Punjab and West Bengal, the rest of the states performed better than their respective FC – XIII targets. The fiscal deficit – GSDP ratio of all states and NSC states was lower than the FC – XIII target. The same was higher than the FC – XIII target for SC states. Among NSC states, the GFD – GSDP ratios of Bihar, Goa, Jharkhand, Punjab and West Bengal were higher than the FC – XIII target. Within SC

states, the GFD – GSDP ratio is expected to be higher than the FC – XIII target in all states, barring Himachal Pradesh, Meghalaya, Tripura and Uttarakhand. The revenue account position of all states, NSC states and SC states is budgeted to be better than the FC – XIII target for 2012-13, whereas the revenue deficit – GSDP ratios of Goa and Haryana are higher than the Commission's targets.

The performance of the states vis-à-vis the FC – XIII's deficit targets indicates that the states at the consolidated level were able to better the FC – XIII's targets for revenue account in 2011-12 (RE) and 2012-13 (BE) (State Finances : A study of Budgets of 2012-13).

Table 2: Deficit Indicators in Comparison with FC-XIII Targets (Per cent to GSDP)

States		Revenue Deficit				Gross Fiscal Deficit			
		2011-12		2012-13		2011-12		2012-13	
		FC-XIII	RE	FC-XIII	BE	FC-XIII	RE	FC-XIII	BE
1		2	3	4	5	6	7	8	9
I Non-Special Category									
1	Andhra Pradesh	0.0	-0.1	0.0	-0.6	3.0	2.6	3.0	2.6
2	Bihar	0.0	-0.3	0.0	-2.7	3.0	5.4	3.0	2.9
3	Chhattisgarh	0.0	-1.6	0.0	-1.8	3.0	2.8	3.0	2.8
4	Goa	0.0	0.3	0.0	0.2	3.0	4.1	3.0	3.8
5	Gujarat	0.0	-0.3	0.0	-0.5	3.0	2.2	3.0	2.6
6	Haryana	0.0	0.8	0.0	0.7	3.0	2.5	3.0	2.1
7	Jharkhand	0.0	-0.5	0.0	-3.3	3.0	3.2	3.0	2.1
8	Karnataka	0.0	-0.7	0.0	-0.2	3.0	2.9	3.0	2.9
9	Kerala	1.4	1.7	0.0	0.9	3.5	3.5	3.0	2.7
10	Madhya Pradesh	0.0	-2.6	0.0	-1.9	3.0	2.6	3.0	3.0
11	Maharashtra	0.0	0.2	0.0	0.0	3.0	1.7	3.0	1.7
12	Odisha	0.0	-1.4	0.0	-0.9	3.0	0.9	3.0	1.8
13	Punjab	1.8	2.2	1.2	1.1	3.5	3.8	3.0	3.1
14	Rajasthan	0.0	-0.1	0.0	-0.2	3.0	2.1	3.0	2.1
15	Tamil Nadu	0.0	-0.1	0.0	-0.3	3.0	2.9	3.0	2.9
16	Uttar Pradesh	0.0	-1.3	0.0	-0.8	3.0	2.9	3.0	3.0
17	West Bengal	1.6	3.1	1.1	1.1	3.5	3.9	3.5	2.5
Total I		0.3	0.1	0.2	-0.3	3.1	2.7	3.1	2.5
Maxima		Punjab and West Bengal			1.1	Goa			3.8
Minima		Jharkhand			-3.3	Maharashtra			1.7
II Special Category									
1	Arun. Pradesh	0.0	-19.7	0.0	-23.1	3.0	16.9	3.0	3.2
2	Assam	0.0	-0.3	0.0	-1.1	3.0	3.9	3.0	3.0
3	Him.Pradesh	0.0	-0.8	0.0	-0.6	3.0	2.9	3.0	2.9
4	J & K	0.0	-4.9	0.0	-7.6	4.7	6.1	4.2	2.9
5	Manipur	0.0	-3.4	0.0	-14.2	3.5	15.5	3.5	4.2
6	Meghalaya	0.0	-4.0	0.0	-5.5	3.0	2.6	3.0	2.1
7	Mizoram	0.0	-2.8	0.0	-7.8	6.4	7.0	5.2	3.3
8	Nagaland	0.0	-6.0	0.0	-9.9	3.5	5.8	3.5	3.5
9	Sikkim	0.0	-13.2	0.0	-17.5	3.5	4.8	3.5	3.5
10	Tripura	0.0	-7.0	0.0	-5.7	3.0	2.0	3.0	2.6
11	Uttarkhand	0.0	-0.3	0.0	-0.4	3.5	3.1	3.5	3.4
Total II		0.0	-2.5	0.0	-3.7	3.4	4.5	3.3	3.1
Maxima		Uttarkhand			-0.4	Manipur			4.2
Minima		Arunachal Pradesh			-23.1	Meghalaya			2.1
All States		0.2	-0.1	0.2	-0.5	3.1	2.8	3.1	2.5

Source: State Finances: A study of Budgets of 2012-13

Note: Negative (-) sign indicates surplus. The ratios pertaining to FC-XIII are directly taken from the FC-XIII Report

In Non-Special category States, in the year 2012-13, revenue deficit was high in Punjab and West-Bengal (1.1 per cent) and very low in Jharkhand (-3.3). Gross fiscal Deficit was high in

Goa (3.8) and very low in Maharashtra (1.7). In case of Special Category States, Revenue deficit in the year 2012-13 was high in Uttarkhand (-0.4) and low in Arunachal Pradesh (-

23.1). Gross Fiscal Deficit of Manipur witnessed for 4.2 per cent which is very high and very low in Meghalaya (2.1).

3. Trends in Inter- governmental Transfers

In India, resource transfer takes place from the centre to states, comprising statutory and non – statutory transfers, which take

place through different channels. Statutory transfers in the form of share in central taxes and non – plan grants are based on the recommendations of the Finance Commissions. Non – statutory revenue transfers are in the form of plan grants from the Planning Commission, as well as plan and non – plan grants from the central ministries.

Table 3: Share of the Centre in Combined Revenue Receipts before and after Transfers (Per cent)

Commission	Share of the Centre in Combined Revenue Receipts			FC Transfers to states/Combined Revenue Receipts	Total Transfers to states/ Combined Revenue Receipts
	Before Transfers	After FC Transfers	After Total Transfers		
1	2	3	4	5	6
FC-VIII	65.4	49.1	38.7	16.3	26.7
FC-IX	62.8	45.6	35.3	17.2	27.5
FC-X	60.8	44.1	36.3	16.7	24.5
FC-XI	58.5	40.4	33.3	18.1	25.2
FC-XII	62.6	42.4	35.7	20.2	26.9

Source: Thirteenth Finance Commission Report. (Whole table is taken from the Report)

Table 3 shows the relative shares of the centre and states in the combined revenue receipts as well as combined expenditure show the vertical imbalances in the Indian federation. The total transfers as a proportion of combined revenue receipts have remained stable since FC – VIII. There has been much share of Finance Commission transfers in combined revenue receipts.

4. Consolidated Fiscal Road map for Centre and States

Based on the fiscal reform path prescribed for the centre and states, the consolidated position during the award period will

be as per Table – 3.25. Average lending from the centre to states on account of external aid, for the period 2006 to 09, of Rs.6050 crore. The stock of central loans consolidated as per the recommendation of FC – XII and loans of these states whose loans have not yet been consolidated, put together, amount to Rs. 1.23 lakh crore. Assuming that these have to be paid in twenty equal installments, the recovery from these loans would be Rs.6175 crore, which is almost equal to the average disbursement of loans. Thus, we have assumed that there would be no net disbursement of loans from the centre to states during the projection period.

Table 4: Consolidated Fiscal Reform Path for the Centre and States (Per cent of GDP)

S. No.		2009- 10	2010- 11	2011- 12	2012- 13	2013- 14	2014- 15
	1	2	3	4	5	6	7
1.	Fiscal Deficit - States	2.8	2.6	2.5	2.5	2.4	2.4
2.	Fiscal Deficit- Centre	6.8	5.7	4.8	4.2	3.0	3.0
3.	Net Central Loans to States	0.1	0.0	0.0	0.0	0.0	0.0
4.	Fiscal Deficit- consolidated	9.5	8.3	7.3	6.7	5.4	5.4
5.	Debt Stock-States	27.1	26.6	26.1	25.5	24.8	24.3
6.	Debt Stock- Centre	54.2	53.9	52.5	50.5	47.5	44.8
7.	Outstanding Central Loans to States	2.5	2.2	2.0	1.7	1.5	1.3
8.	Consolidated Debt	78.8	78.3	76.6	74.3	70.8	67.8

Source: Report of Thirteenth Finance Commission (2010-2015): Government of India, New Delhi.

It is important to recognize that for successive fiscal consolidation, the key lies in maintaining the growth dynamism of our economy. There is a two-way relationship between growth and fiscal consolidation ; or what is called the ‘strategy of expansionary fiscal consolidation’, where fiscal consolidation, leads to higher growth due to higher levels of public and private investments, which in turn, further facilitate the maintenance of fiscal stability (FC – 13 Report, p. 141).

5. Equity and Fiscal Incentives: Thirteenth Finance Commission

In an important clarification concerning the terms of reference

of the Thirteenth Finance Commission, it has been pointed out that the finance commission is an independent constitutional authority vested with the task of dividing the fiscal resources as an important arbiter and therefore, has to take into consideration the revenue potential of the Centre and the States on the one hand and genuine expenditure needs of the Centre and the States on the other.

Table 5: State-wise Share in Total Transfers (Tax Devolution + Grants) as Recommended by Finance Commission after Reform Period: 1990 to 201 (In Percent)

States	Finance Commission			
	Ninth	Tenth	Eleventh	Twelfth
Andhra Pradesh	6.83	7.08	7.13	6.66
Arunachal Pradesh	0.79	0.78	0.53	0.47
Assam	3.73	3.67	3.05	3.22
Bihar	10.54	10.88	13.04	13.14
Chhattisgarh	----	----	----	2.42
Goa	0.48	0.27	0.29	0.23
Gujarat	3.50	3.92	2.76	3.39
Haryana	1.13	1.23	0.97	1.06
Himachal Pradesh	1.75	2.10	1.72	1.91
Jammu & Kashmir	3.17	3.23	3.78	2.76
Jharkhand	----	----	----	3.13
Karnataka	3.83	4.54	4.53	4.16
Kerala	3.25	3.41	2.83	2.59
Madhya Pradesh	7.40	7.10	8.05	8.55
Maharashtra	5.85	6.05	4.46	4.79
Manipur	1.02	0.94	0.74	0.91
Meghalaya	0.78	0.83	0.68	0.58
Mizoram	0.96	0.80	0.58	0.62
Nagaland	1.17	1.23	1.02	0.99
Orissa	5.21	4.28	4.77	4.89
Punjab	1.58	1.58	1.25	1.70
Rajasthan	6.15	5.03	5.42	5.47
Sikkim	0.24	0.31	0.38	0.24
Tamil Nadu	5.85	5.89	4.97	4.85
Tripura	1.35	1.27	1.00	1.11
Uttar Pradesh	16.46	15.95	18.05	19.27
Uttarakhand	----	----	----	1.61
West Bengal	6.99	6.61	8.10	6.73

Source: Report of Thirteenth Finance Commission (2010-2015): Government of India, New Delhi.

6. Criteria-Wise Weightage of Central Taxes Sharing in India

A combination of these two principles has found wide acceptability and addressed the concern of reforming states. An efficient fiscal transfer system should also be characterized by predictability and stability. Predictability of resource flows enables the sub national governments to plan ahead, and stability ensures that there will not be sudden shocks in the transfer arrangements. The consideration of the issue of equity reference is often made to its vertical and horizontal dimensions. The main conceptual issues relate to the interdependence of the vertical and the horizontal dimensions of equity and trade-off. This study also takes into account the implications of vertical and horizontal fiscal externalities.

It is important to observe that since the Tenth Finance Commission (TFC) 1995-2000), has been a distinct change or

paradigm shift in the choice of criteria. The downright discarding of the “Index of Backwardness”, “Inverse Per capita income” and the Poverty Ratio” and bringing in new criteria of fiscal performance (Tax Efforts and Fiscal Discipline) have to be viewed with concern. Such a move emphasizing fiscal performance defeats the very basic objective of the equity. The following criteria and weightage were adopted for horizontal sharing of taxes by different Finance Commissions which is: (i). Population; (ii). Per capita income distance; (iii). Index of infrastructure; (iv). Inverse per capita income; (v). Index of backwardness; (VI). Area; (vii). Tax effort; (viii). Fiscal discipline; and (ix). Fiscal capacity distance

The Criteria-wise weightage of horizontal sharing of Central taxes by different Finance Commission is given in Table-6, and Table-7.

Table 6: Criteria-wise Weightage in Second Report of Ninth Finance Commission (1990-95)

S. No.	Indicator	Weightage (in Percent)	
		Income Tax Sharing	Union Excise Duties Sharing
1.	Population	25.0	29.94
2.	Per capita Income Distance	50.0	40.12
3.	Inverse Per capita Income	12.5	14.97
4.	Index of Backwardness	12.5	14.97

Source: Report of Ninth Finance Commission (1990-1995): Government of India, New Delhi.

Table 7: Criteria-wise Weightage in Tenth Finance Commission (1995-2000), Eleventh Finance Commission (2000-2005), Twelfth Finance Commission (2005-2010) and Thirteenth Finance Commission (2010-2015)

S. No.	Indicator	Weightage (in Percent)			
		Tenth Finance Commission	Eleventh Finance Commission	Twelfth Finance Commission	Thirteenth Finance Commission
1.	Population	20.0	10.0	25.0	25.0
2.	Per capita Income Distance	60.0	62.5	50.0	----
3.	Area	5.0	7.5	10.0	10.0
4.	Index of Infrastructure	5.0	7.5		----
5.	Tax Effort	10.0	5.0	7.5	
6.	Fiscal Discipline	----	7.5	7.5	17.5
7.	Fiscal Capacity Distance	---	----	----	47.5

Source: Various Report of Finance Commission.

The horizontal aspect of fiscal transfers of central government relates to their inter se distribution among states (Table 8).

Table 8: Share in Central Taxes: Recommended by the Eleventh, Twelfth and Thirteenth Finance Commission

States	Shares of States			Percentage Points	
	EFC	TFC	THFC	TFC-EFC	THFC-TFC
Andhra Pradesh	7.701	7.356	6.937	-0.345	-0.419
Arunachal Pradesh	0.244	0.288	0.328	0.44	0.040
Assam	3.285	3.235	3.628	-0.050	0.393
Bihar	11.589	11.028	10.917	-0.561	-0.111
Chhattisgarh	2.385	2.654	2.470	0.269	-0.184
Goa	0.206	0.259	0.266	0.053	0.007
Gujarat	2.821	3.569	3.041	0.748	-0.528
Haryana	0.944	1.075	1.048	0.131	-0.027
Himachal Pradesh	0.683	0.522	0.781	-0.161	0.259
Jammu & Kashmir	1.290	1.297	1.551	0.067	0.254
Jharkhand	3.008	3.361	2.802	0.353	-0.559
Karnataka	4.930	4.459	4.328	-0.471	-0.131
Kerala	3.057	2.665	2.341	-0.392	-0.324
Madhya Pradesh	8.838	6.711	7.120	0.258	0.409
Maharashtra	4.632	4.997	5.199	0.365	0.202
Manipur	0.366	0.362	0.451	-0.004	0.089
Meghalaya	0.342	0.371	0.408	0.029	0.047
Mizoram	0.198	0.239	0.269	0.041	0.30
Nagaland	0.220	0.263	0.314	0.043	0.051
Orissa	5.056	5.161	4.779	0.105	-0.382
Punjab	1.147	1.299	1.389	0.152	0.090
Rajasthan	5.473	5.609	5.853	0.136	0.244
Sikkim	0.184	0.227	0.239	0.043	0.012
Tamil Nadu	5.385	5.305	4.969	-0.080	-0.336
Tripura	0.487	0.428	0.511	-0.059	0.083
Uttar Pradesh	19.137	19.264	19.677	0.127	0.413
Uttarakhand	0.661	0.939	1.120	0.278	0.181
West Bengal	8.116	7.057	7.264	-1.059	-0.207
All States	100.00	100.00	100.00		
Coefficient of Variations	119	117	118	2143	-5846

Source: Various Reports of Finance Commission. Actions have been taken from the 14th FC in order to minimize vertical fiscal imbalances in India.

7. Major recommendations of 14th FC headed by Prof. Y V Reddy

- The share of states in the net proceeds of the Shareable Central Taxes should be 42%. This is 10% higher than the recommendation of 13th FC.
- Revenue deficit to be progressively reduced and eliminated.
- Fiscal deficit to be reduced to 3% of the GDP by 2017-18
- Both centre and states should conclude 'Grand Bargain' to

implement the model Goods and Services Act (GST).

All the Finance Commissions have attempted to minimize the fiscal imbalances through their recommendations. Weightage given for transfers also has been changed according to the changed fiscal scenario.

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