FINANCE TRANSFERS TO STATES – ECONOMY

NEWS: Transfers favour poor States, but have not raised capacity to increase social, economic spends.

WHAT'S IN THE NEWS?

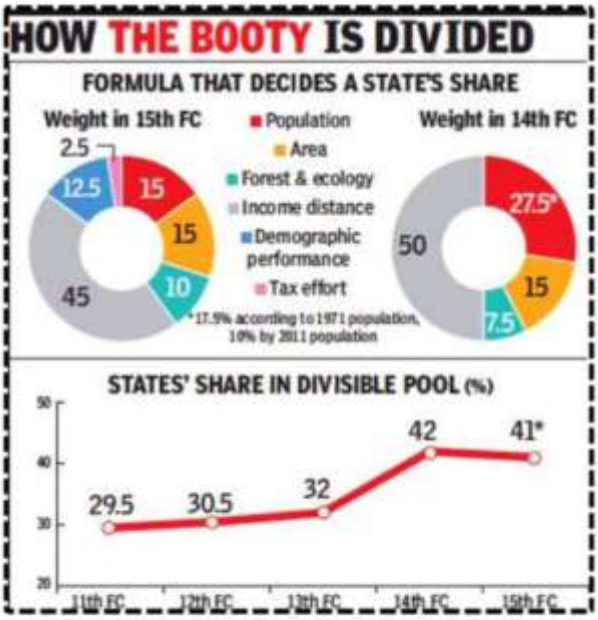
- **Significance of Resource Transfers**
    - Transfers from the Centre account for over 40% of the total revenue receipts of States.
    - These transfers are largely based on the Finance Commission's (FC) recommendations, which are constitutionally mandated every five years.
- **Parameters Used by Finance Commissions**
    - **Need-Based Factors**: Population size.
    - **Cost Considerations**: Geographical area.
    - **Performance Metrics**: Tax-to-GSDP ratio.
    - **Revenue Foregone**: Forests and ecological contributions.
    - **Fiscal Capacity**: Dominant factor, with weights exceeding 40%, calculated on per capita income, normalized by population.

Bias Towards Poorer States

- **High Weight to Fiscal Capacity**
    - Heavily favors poorer States with lower per capita incomes.
    - Poorer States often have limited capacity to absorb and utilize large resource inflows effectively.

Tax Transfers and Revenue Dependence

- **Diverse Tax Transfer Dependence**
    - Share of tax transfers in revenue receipts ranges widely:
        - **High Dependence**: Arunachal Pradesh (69%), Bihar (58%).
        - **Low Dependence**: Haryana (12.5%), richer States like Tamil Nadu, Kerala, Maharashtra, and Punjab (<20%).
- **Equity-Based Allocation**
    - Poorer States such as Uttar Pradesh, Bihar, Madhya Pradesh, and West Bengal received >7% of divisible pool funds.
    - Richer States like Gujarat, Karnataka, and Maharashtra received less than their population share in divisible pool transfers.



TOP GAINERS

State	14th FC (% all taxes)	15th FC (% all taxes)	% change in share
Arunachal	1.37	1.76	28.5
Meghalaya	0.64	0.77	20.3
Manipur	0.62	0.72	16.1
Nagaland	0.5	0.57	14
Punjab	1.58	1.79	13.3

TOP LOSERS

State	14th FC (% all taxes)	15th FC (% all taxes)	% change in share
Andhra	4.3	4.11	-4.4
Assam	3.31	3.13	-5.4
Telangana	2.44	2.13	-12.7
Kerala	2.5	1.94	-22.4
Karnataka	4.71	3.65	-22.5

Per Capita Income and GSDP Outcomes

- **Lack of Convergence in Per Capita Income**
  - Wide disparity persists in per capita income levels across States.
  - Bihar's per capita income remains at 33% of the all-India average, while Sikkim's is 3.19 times the national average.
  - High-income States like Tamil Nadu, Karnataka, and Haryana maintain incomes >1.7 times the all-India average.
- **Static Inter-State Economic Positions**
  - Share of poorer States in GSDP is 34.1%, but they receive 64% of divisible pool funds.
  - Richer States account for 58% of GSDP but receive only 28% of divisible pool funds.
  - No significant improvement in GSDP share despite larger allocations to poorer States.

Per Capita Revenue Realization and Development Spending

- **Disparity in Revenue Realization**
  - Poorer States (e.g., Uttar Pradesh, Bihar) realize per capita revenue below ₹270.
  - Richer States (e.g., Maharashtra, Telangana) have per capita revenues exceeding ₹300.
- **Implications for Social and Economic Services**
  - Lower per capita revenues limit expenditure on critical social and economic services like health, education, and sanitation.
  - Equity-based transfers failed to bridge the expenditure gap on essential services.

Challenges in Equity Considerations

- **Merit Services and Inter-State Externalities**
  - 14th FC emphasized national priorities in health, education, and sanitation, highlighting the need for central intervention.
  - Direct grants for merit services were seen as essential but inadequately emphasized in previous FC awards.
- **Mixed Success of Equity Measures**
  - Equity measures helped poorer States but did not achieve broader economic convergence.
  - Equalizing per capita income or ensuring adequate development funding remains a challenge.

Recommendations for the 16th Finance Commission

- **Increased Focus on Merit Services**
  - Higher grant allocation for critical sectors like health, education, and water.
  - Reduce reliance on equity criteria for generalized transfers.
- **Balancing Equity and Efficiency**
  - Ensure better targeting of resources to enhance development outcomes and inter-State economic convergence.
  - Explore refined criteria that promote equitable development without undermining efficiency and fiscal discipline.