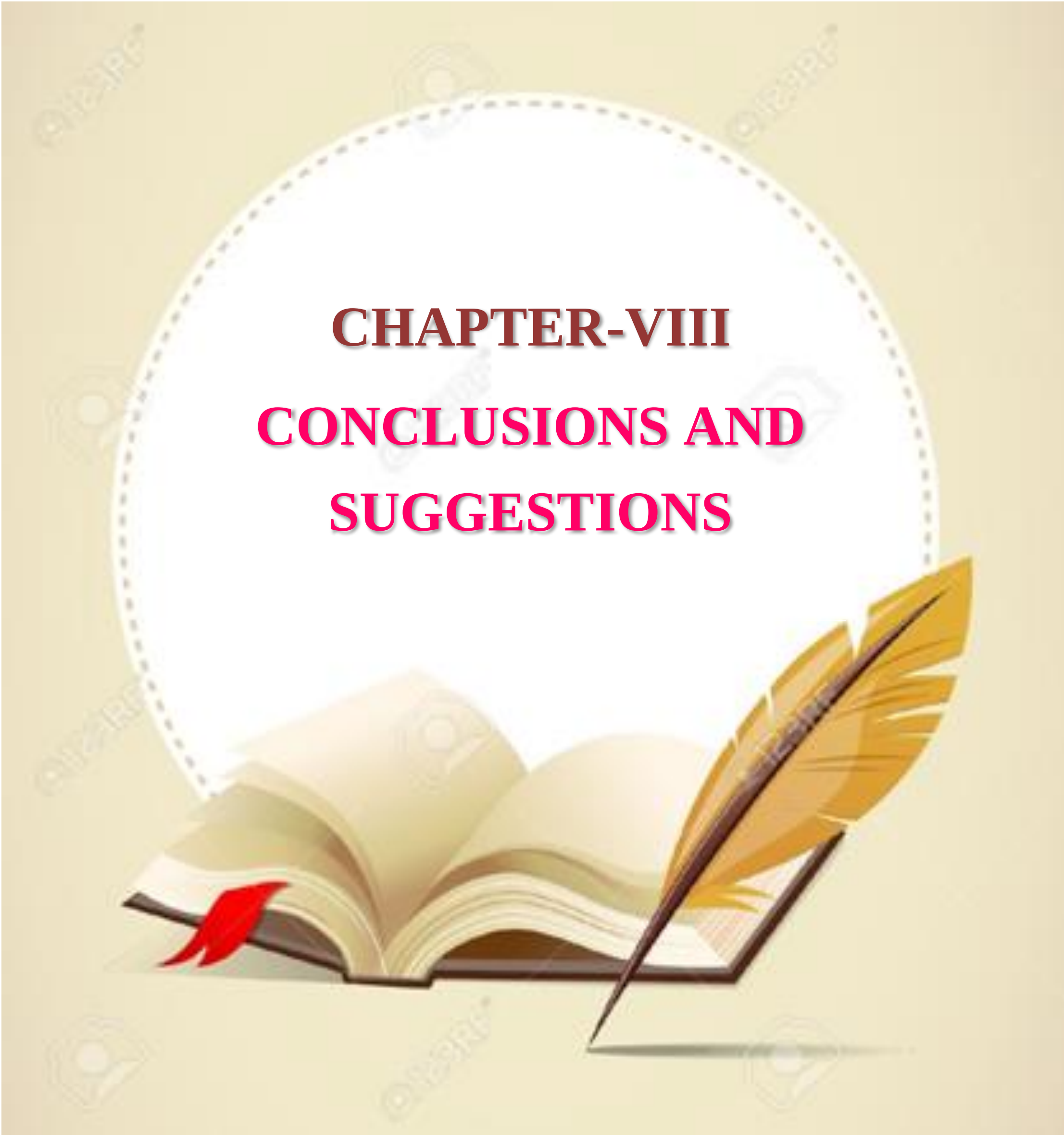
CHAPTER-VIII

CONCLUSIONS AND SUGGESTIONS



CHAPTER - VIII

CONCLUSIONS AND SUGGESTIONS

8.1 Conclusions:

Over a period of time Finance Commissions have played a distinctive role in inter-governmental fiscal relations in India. The Centre-States relations constitute the core elements of the federalism. The Central Government and State Government cooperate for the well-being and safety of the citizens of India. They work together in the field of environmental protection, terror control, family control and socio-economic planning.

8.1.1 Vertical Imbalances:

To understand the vertical imbalances the relative shares of the Centre and States in the combined revenue receipts before and after transfers, relative shares of Union and States in combined revenue receipts before and after Union transfers and tax buoyancy of Union and States.

- ❖ The share of the States in the combined revenue receipts before Union transfers was marginally increased in Eleventh Finance Commission duration over the Tenth Finance Commission duration but significantly declined in Twelfth Finance Commission duration and further marginally increased in Thirteenth Finance Commission duration. The share of states in combined revenue receipts before union transfers (statutory + non statutory) were varied in the range of minimum 33.7 in the FC-III to the highest 41.9 per cent in the FC-I duration.
- ❖ The relative shares of the Centre and the States in the combined revenue expenditure and total expenditure indicate that States had always higher total and revenue expenditure responsibilities. Though it declined during FC-XII and FC-XIII over FC-XI but still it is high for States compare to Union. Further looking at total expenditure and revenue expenditure it seems that vertical gap is more in case of revenue expenditure compare to total expenditure.

- ❖ The buoyancy of State and Union taxes varied over the years. The buoyancy of union tax revenue was greater than buoyancy of state's tax revenue during 2002-03 to 2007-08. Thereafter buoyancy of State's tax revenue was greater than buoyancy of union tax revenue because of declined buoyancy of union tax revenue was during 2008-09 to 2011-12. But the composite buoyancy of Union and States taxes for 2001 to 2014 duration was respectively 1.12 and 1.06. This indicates that for both Union and States the instantaneous growth rate of tax revenue was relatively higher than that of instantaneous growth rate of national income. But it was more in favour of Union.

8.1.2 Horizontal Imbalances

To understand the inter-state revenue disparities initially buoyancy of State's tax revenue has been analysed, further performance of the each state in terms of collection of their own tax, non-tax, total own revenue and total revenue receipts after union transfer has been evaluated. To evaluate these items their percentages to gross state domestic product (GSDP) and per capita revenue receipts in Rs. were taken into consideration.

- ❖ The performance of states in terms of tax revenue collection have been measured by taking ratio of own tax revenue receipts to GSDP. It was varied in a large extend for special category states compare to general category states. In case of general category states low and middle income states have shown slow but steady improvement whereas ratio of own tax revenue receipts to GSDP was relatively stable for high income states.
- ❖ While comparing the composite buoyancy among the States for 2001-02 to 2013-14 it seems that buoyancy was highest in case of low income category states and was lowest in case of high income States. The composite buoyancy for middle and high income States have been fluctuated in the range of 0.6 to 1.6 during 2001-02 to 2013-14. Looking at buoyancy of tax revenue of special category states it seems that, there were great extents of fluctuations in the range of minimum 0.64 to maximum 3.81.
- ❖ Despite fiscal reforms, there are serious shortcomings in the resource transfer mechanism from the centre to the states. On the basis of own revenue-GSDP ratio it seems that the States are also not making enough effort to mobilise

their own resources. As a result these things there exists a wide range of per capita revenue receipts gap among States to match up the highest per capita revenue receipts State. Low income category States are still depended for approximately fifty per cent of their revenue receipts on Union transfers. Therefore, there is urgent need to bring institutional and governance reforms, if the issue of inter-regional inequity is to be seriously addressed.

- The low income states depend on central transfers far more than the middle and high income states. The extent of dependence is far more for the special category states. As percentage of their revenue receipts, the dependence is the highest for Jammu and Kashmir, followed by Meghalaya and then Himachal Pradesh.

8.1.3 Vertical Transfers Total

- The share of total transfers (statutory + non statutory) in combined revenue receipt during last three Finance Commission duration were approximately constant. A review of the awards by successive Finance Commissions reveals that the quantum of resources transferred to the States has grown significantly.
- The share of Union in combined revenue receipts after transfers to states has been declined up to Eleventh Finance Commission duration and comparatively increased during Twelfth Finance Commission duration but, it slightly decreased during Thirteenth Finance Commission duration.
- The dependence of all states in terms of proportion of Finance Commission's transfers to revenue expenditure it seems that the ratio significantly increased during Twelfth Finance Commission's duration over Eleventh Finance Commission i.e. from 21.2 to 27.53 and further the ratio declined from 27.53 to 25.18 during Thirteenth Finance Commission's duration over Twelfth Finance Commission. Here we should also understand that if contribution of Finance Commission transfers to States revenue expenditure is greater than the contribution of Finance Commission's transfer to State's revenue receipts then, revenue expenditure of that state is less than revenue receipts.
- The share of total Finance Commission's transfer in the total revenue transfer from the Centre to States varied from lowest 67.44 per cent in the Thirteenth Finance Commission to highest 69.38 per cent in the Eleventh Finance

Commission. This share during the Twelfth Finance Commission was 68.91 per cent.

- ❖ The ratio of total Finance Commission's transfer to gross revenue receipts of Centre shows slow but steady increasing trend. This ratio was 24.47, 26.73 and 27.87 respectively in the eleventh, twelfth and thirteenth Finance Commission. It seems that over three Finance Commission's duration total Finance Commission's transfers to states as percentage of Centre's gross revenue receipts were increased by 3.4 percentage points. This indicates the increasing role of Finance Commission's in revenue transfer from Union to States.
- ❖ The total Union transfers to States as Percentage of Gross Revenue Receipts which were 35.27 per cent in the Eleventh Finance Commission steadily increased to 38.79 per cent in the Twelfth Finance Commission and 41.33 per cent in the Thirteenth Finance Commission's duration. It seems that over three Finance Commission's duration total Union transfers to States as Percentage of Gross Revenue Receipts were increased by 6.06 percentage points.
- ❖ Actual Ratio of Finance Commission's transfer to GDP which was 2.89 in the Eleventh Finance Commission was increased to 3.35 in Twelfth Finance Commission's duration and remained constant during the Thirteenth Finance Commission.

8.1.4 Horizontal Transfers Total

- ❖ The share of general and special category states in total Finance Commission's transfers during eleventh, twelfth and thirteenth Finance Commissions were respectively 86.52 and 13.48, 85.66 and 14.42, and 87.52 and 12.48 per cent.
- ❖ The share of low income states in total Finance Commissions transfers during eleventh, twelfth and thirteenth Finance Commissions were respectively 49.34, 49.40 and 50.88 percent. The share of middle income states in total Finance Commissions transfers during eleventh, twelfth and thirteenth Finance Commissions were respectively 27.56, 26.86 and 25.88 per cent. Whereas, the share of high income states in total Finance Commissions transfers during eleventh, twelfth and thirteenth Finance Commissions were respectively 9.62, 11.17 and 11.43 per cent.

- ❖ Due to recommendation of Eleventh Finance Commission Bihar and Uttar Pradesh's share from low income category and West Bengal's share from middle income category were significantly increased, and the shares of Gujarat and Maharashtra from high income group were significantly decreased. One thing also we should note that all three i.e. Eleventh, Twelfth and Thirteenth Finance Commission recommended lower shares over the recommendation of previous Finance Commission.
- ❖ The per capita share in Rs. of general and special category states in total Finance Commission's transfers during eleventh, twelfth and thirteenth Finance Commissions were respectively 769 and 1786, 1219 and 3057, and 2587 and 5487. It seems that per capita share of special category States than general category States in total Finance Commission's transfers was 2.3 times, 2.5 times and 2.1 times respectively greater during eleventh, twelfth and thirteenth Finance Commissions.
- ❖ The per cent increase in the amounts of per capita annual average transfers were more in favour of high income states compare to low income states. It means that high income states were more benefited compare to low income states in terms of per capita transfers.

8.1.5 Tax Devolution: Vertical Transfers

- ❖ Inter se share of States in net proceeds of all shareable union taxes and duties varied from lowest 29.5 per cent in the Eleventh Finance Commission to highest 32 per cent in the Thirteenth Finance Commission. This share was 30.5 per cent in the Twelfth Finance Commission. None of the previous three Finance Commissions (XI, XII and XIII) shown courage which Fourteenth Finance Commission did by increasing the inter se share of states up to 42 per cent in the shareable taxes and duties. This would bring more fiscal autonomy to states. In other words states now will have greater autonomy on the revenue and expenditure fronts.

8.1.6 Tax Devolution: Horizontal Transfers

- ❖ It seems that there are three phases of criteria to determine the horizontal distribution of shareable taxes and duties. In the first phase (FC- I to VII) separate criteria were used for Income tax and Union tax duties. In the second phase (FC- VIII to X) common criteria were used for Income tax and Union tax duties. In the third phase (FC- XI to XIV) which is known as full convergence common criteria were used for horizontal sharing of the net proceeds of all Central taxes and duties except earmarked cesses and surcharges and Article 268/269 taxes.

❖ The Eleventh Finance Commission introduced a new index of fiscal discipline; tax effort and the index of fiscal discipline were together given a weight of 12.5 per cent. The Twelfth Finance Commission evolved a new formula that balanced equity with fiscal efficiency. Equity considerations, however, dominated in the scheme of federal transfers implementing the equalisation principle. The Thirteenth Finance Commission recommended using the concept of 'fiscal capacity distance instead of 'income distance'. Instead of using a single average of GSDP to assess the fiscal distance between States, it recommended estimation of per capita fiscal capacity at reasonably comparable levels of taxation from their respective group averages of non-special category and special category States. The Fourteenth Finance Commission has removed the distinction between non-special and special category states. It has accorded greater importance to fiscal capacity, with indicators of cost and revenue disabilities being assigned a combined weight of 72.5 per cent as against 57.5 per cent assigned by the Thirteenth Finance Commission.

❖ To determine the formula for horizontal distribution of inter se shares of States, the basic aim of the Finance Commissions has been to correct the differentials in revenue capacity and cost disability factors inherent in the economies of States and to foster fiscal efficiency among States. The choice, definition and weight of the variables used to define a devolution formula kept changing across the Finance Commissions.

❖ The per cent share of general and special category states in tax devolution during eleventh, twelfth and thirteenth Finance Commissions were respectively 92.7 and 7.99, 91.91 and 8.09, and 90.54 and 9.46. This shows that the share of special category states was steadily increased over last three

Finance Commissions. The share of special category states in central taxes is higher than their share in population partly because of the use of a ‘floor’ in the index of ‘area’.

- The per capita share in Rs. of general and special category states in tax devolution during eleventh, twelfth and thirteenth Finance Commissions were respectively 713 and 837, 1062 and 1392, and 2271 and 3528. It seems that per capita share of special category States than general category States in tax devolution was 1.2 times, 1.3 times and 1.6 times respectively greater during eleventh, twelfth and thirteenth Finance Commissions.
- Among the general category of states low income states were respectively recommended 53.76, 53.83 and 53.70 per cent share in tax devolution by eleventh, twelfth and thirteenth Finance Commissions. The share of middle income states in tax devolution during eleventh, twelfth and thirteenth Finance Commissions were respectively 29.19, 26.86 and 25.88 per cent. Whereas, the share of high income states in tax devolution during eleventh, twelfth and thirteenth Finance Commissions were respectively 9.75, 11.21 and 10.96 per cent. Among the high income states the most affected state is Maharashtra. The recommended share of Maharashtra state has been declined from highest 18.75 per cent in the First Finance Commission’s duration to lowest 4.63 per cent in the Tenth Finance Commission’s duration.
- Considering all the states, it seems that over the Finance Commission each one recommended higher proportionate increase in per capita annual average transfers. Here one thing is observed that except XIII FC, whose recommended increase in per capita tax share for low, middle and high income category states is approximately equal, high income states were recommended high per cent growth and low income states were recommended low per cent growth in per capita annual average transfers.

8.1.7 Grants-in-aid: Vertical Transfers

- The grants-in-aid are mainly targeted towards achieving a degree of equalisation. Consequent to the 73rd and 74th amendments to the Constitution, the FC-X introduced exclusive grants for rural and urban local bodies. The

FC-XI established the practice of conditionalities for grants from the Centre to the states. It also placed an indicative ceiling on the total transfers to the states (including transfers by the Planning Commission and Union ministries), regardless of the channels of transmission. The overall ceiling for transfers in terms of gross revenue receipts has been marginally increased by subsequent FCs.

- ❖ The pattern of transfers from Centre to States by Finance Commissions indicates that recommended share of grants (11. 98 per cent) of Fourteenth Finance Commission is low compare to previous three Finance Commissions period. The actual share of grants in total Finance Commission transfers during last three Commissions (XI, XII and XIII) was around 16 per cent. Actual transfer from all agencies show that share of Grants was greater than share in taxes during second, third and fourth Finance Commission. Whereas, during last three Finance Commission's period share of grants in total transfers from all agencies was around 42 per cent. In view of the need to ensure a larger role for equalisation of transfers, the Twelfth Finance Commission had proposed to increase the share of grants in the total transfers. However, the Thirteenth Finance Commission has recommended a lower share of grants in total transfers, as States are expected to revert to the fiscal consolidation path and reduce their non-plan revenue deficit.
- ❖ The approach of the Finance Commissions while defining the distribution criteria and principles for distributing grants has changed with a focus on relevant issues and concerns of the States. However per cent share of three grants viz. Post-devolution Revenue Deficit, Local Body and Disaster (Calamity) Relief Grants in total Finance Commission's Grants was respectively 91.51, 68.61 and 63.35 during eleventh, twelfth and thirteenth Finance Commissions. Whereas fourteenth Finance Commission recommended 100 per cent share to these three grants.
- ❖ It seems that none the last three Finance Commission's recommended allocations have been fully released by government of India. Out of the total allocations for grants-in-aid 90.15, 95.32 and 91.38 per cent of funds were respectively released of Eleventh, Twelfth and Thirteenth Finance Commission. One common thing among the three Finance Commission's grants-in-aid can be observed that 100 per cent allocations were released under

the post-devolution revenue deficit grants. For the disaster management also 98 to 100 per cent allocations were released, but among the other important grants-in-aid, under the local body 83.54, 96.31 and 88.18 per cent allocations were released respectively by Eleventh, Twelfth and Thirteenth FC.

❖ The actual amounts drawn out of the allocated amounts of local body grant were always less. The amount not drawn was highest 18.04 per cent and lowest 3.69 per cent respectively during Tenth and Twelfth Finance Commission's duration. The amount not drawn during the Thirteenth Finance Commission's duration was 11.82 per cent.

❖ The analysis of the share of respective grants in total Finance Commission's transfers shows that the FC-XI increased the share of post-devolution revenue deficit grants from 34.16 per cent to 60.53 per cent, but succeeding Finance Commissions Twelfth and Thirteenth respectively brought down to 39.86 and 20.03 per cent, further FC-XIV increased it to 36.26 per cent. The FC-XI reduced the share of local body grants form 24.24 per cent to 17.07 per cent, but the recommended share of local body grants in the Twelfth, Thirteenth and Fourteenth Finance Commission's total grants respectively were 17.53, 33.32 and 53.49. The recommended share of disaster (calamity) relief grants in total Finance Commission's grants steadily reduced by FC-X to FC-XIII from 21.32 to 10 per cent. Overall it can be observed that significance of the local body grants in total FC's grants is being increased to strengthen the decentralisation process in India.

❖ The per cent growth in amount of local body grants over previous Finance Commission, it seems that Twelfth Finance Commission onwards there is significant increase in the amounts of PRIs and ULBs but comparing growth of these two grants thirteenth and fourteenth Finance Commissions have recommended more grants in favour of ULBs due to increase in urbanisation.

8.1.8 Grants-in-aid: Horizontal Transfers

❖ The recommended share of special category States in post-devolution revenue deficits grants was increased from 81.69 per cent by FC-XI to 100 per cent by FC-XIII, whereas recently FC-XIV reduced the upto 77.73 per cent. The per cent share of special category States in recommended disaster relief grants steadily increased from 10.83 per cent by Eleventh Finance Commission to 15.37 per cent by Thirteenth Finance Commission, Further it was reduced to 12.13 per cent by Fourteenth Finance Commission.

- ❖ Though quantum of flow of grants to local bodies increased over period of Finance Commission still these funds are not adequate to strengthen the functioning of local bodies therefore there is need to increase the sufficient funds to local bodies. Looking at per cent share of low income States in total local body grants it seems that share have been increased over a period of Finance Commissions but per capita share of low income States remained below among all other income category of States. Considering the per capita local body grants for all States, PRIs were recommended higher per capita grants than those for ULBs by all Finance Commissions though gap between these two have been come down.
- ❖ Over the period of time share of low income States in total local body grants have been declined but more significantly it was declined of middle income States. The share of low income States have been increased in the Fourteenth Finance Commission and share of middle income states have been declined. The share of high income States seems that it is relatively stable over period of four Finance Commissions.
- ❖ By recommending more funds local bodies in the total grants and allocating all PRIs funds to gram panchayats, which are directly responsible for the delivery of basic services instead of recommending funds to panchayat samities (intermediate or block panchayats) and zilla parishads which previous Finance Commissions did, it seems a strong and courageous step forward by the FC-XIV towards strengthening the decentralisation process in India.
- ❖ The per cent share of general and special category states in grants-in-aid during eleventh, twelfth and thirteenth Finance Commissions were respectively 46.79 and 53.21, 58.39 and 41.61, and 70.58 and 29.42.
- ❖ Among the general category of states the per cent share of low income states in grants-in-aid during eleventh, twelfth and thirteenth Finance Commissions were 20.93, 30.37 and 35.07 respectively recommended. The share of middle income states in grants-in-aid during eleventh, twelfth and thirteenth Finance Commissions were respectively 17.07, 16.99 and 21.47 per cent. Whereas, the

share of high income states in grants-in-aid during eleventh, twelfth and thirteenth Finance Commissions were respectively 8.79, 11.03 and 14.04 per cent.

- ❖ The per capita share in Rs. of general and special category states in grants-in-aid during eleventh, twelfth and thirteenth Finance Commissions were respectively 56 and 949, 157 and 1665, and 316 and 1959. It seems that per capita share of special category States than general category States in grants-in-aid was 17 times, 10.6 times and 6 times respectively greater during eleventh, twelfth and thirteenth Finance Commissions.
- ❖ Except the FC-XII, FC-XIII and FC-XIV recommended higher growth to high income states and lower per cent growth to low income states in per capita annual average grants. The recent trend indicates that the share of low income States in grants-in-aid were increased from FC-X to FC-XII but then steadily increased upto FC-XIV.

8.1.9 Projection Error

The projection error gives us an idea about the rate by which States were expecting greater amounts or less amounts than actual share. The positive value of projection error indicates that Finance Commission overestimated the transfers by that percentage. Whereas, the negative value of projection error indicates that Finance Commission underestimated the transfers by that percentage.

- ❖ Comparing projection error of total transfers of Eleventh, Twelfth and Thirteenth Finance Commission for all states, it seems that over the last three Finance Commissions it was declined. Comparing projection error of special and general category states it seems that general category states had higher projection error than the special category states. It also seems that during the same the same Finance Commission’s duration projection for individual states was different.
- ❖ Looking at projection error of last three Finance Commissions total transfers, that is Eleventh, Twelfth and Thirteenth Finance Commission, it seems that Thirteenth Finance Commission had minimum projection error that is 3.71 per cent compare to high projection error by Eleventh Finance Commission that is 21.33 per cent, since these errors are positive it means that states had received

less amounts by that per cent than their expectations. But, States have received actual amounts more by 8.6 per cent than their expected awards during Twelfth Finance Commission duration.

❖ Comparing the projection error of grants-in-aid of Eleventh, Twelfth and Thirteenth Finance Commission, it seems that the projection error which was 10.93 per cent for Eleventh Finance Commission's recommendations was declined up to 4.91 per cent for FC-XII and further increased to 9.43 per cent for Thirteenth Finance Commission's recommendations. Comparing the projection error of grants-in-aid of special and general category states it seems that general category states had higher projection error than those of special category states. It also seems that during the same Finance Commission's duration projection error for individual states was different.

8.1.10 Vertical and Horizontal Components of Finance Commission's Transfers

❖ Vertical transfers and horizontal transfers have been calculated using the formula: vertical transfers = per capita transfers received by the highest per capita state * population of the respective states. This amount indicates the minimum transfer that was given to every state independent of differences in fiscal capacity. Horizontal transfers = per capita horizontal transfers * populations of respective states. If, the share of horizontal transfers in total transfers is high, it indicates that transfers are aimed at to achieve more horizontal equity. Over the last three Finance Commissions (XI, XII and XIII) relative importance of horizontal transfers have been declined. The Fourteenth Finance Commission increased the some relative importance of horizontal transfers over the Thirteenth Finance Commission.

8.1.11 Regression Analysis

The progressivity of Finance Commission's Transfers has been measured by taking regression of per capita Finance Commission's transfers on per capita NSDP. The rate of responsiveness of per capita transfers to changes in per capita NSDP has been measured using the equation: $\text{Ln } Y_i = \alpha + \beta \text{ Ln } X_i + U_i$. Where, Y_i = Per Capita Transfers, X_i = Per Capita NSDP, α = Intercept and β = Slope, which indicates the average response of per capita transfers in rupees as per capita NSDP increases by one rupee.

- ❖ The slope indicates the average response of per capita transfers in rupees as per capita NSDP increases by one rupee. High value of slope indicates the most equalising scheme Finance Commissions transfer. The most equalising schemes appear to be that of the Eleventh Finance Commission, followed by the Thirteenth, Twelfth and Fourteenth Finance Commissions, in that order. All the transfer schemes indicate a negative coefficient pointing out that the overall design was aimed at achieving a degree of horizontal equity. A regression of per capita transfers on per capita NSDP indicates that in all cases relating to the four Finance Commissions reviewed here, a one per cent increase in per capita NSDP would lead to a fall in per capita transfer.
- ❖ The estimated slope of tax devolution indicates the average response of per capita tax devolutions in rupees as per capita NSDP increases by one rupee. The most equalising schemes appear to be that of the Eleventh Finance Commission, followed by the Thirteenth, Twelfth and Fourteenth Finance Commissions, in that order. All the transfer schemes indicate a negative coefficient pointing out that the overall design was aimed at achieving a degree of horizontal equity. A regression of per capita tax devolution on per capita NSDP indicates that in all cases relating to the four Finance Commissions reviewed here, a one per cent increase in per capita NSDP would lead to a fall in per capita tax devolution. The elasticity of response for recommended tax devolution was varied from (-) 0.5532 for the Fourteenth Finance Commission to (-) 0.7961 for the Eleventh Finance Commission. The actual elasticity of response of tax devolutions was -0.8013, -0.5673 and -0.5986 respectively for XI, XII and XIII FC's duration.
- ❖ Except the grants transfers of Twelfth Finance Commission, all the other transfer schemes indicate positive coefficients pointing out that the overall design is not aimed at achieving a degree of horizontal equity. The average response of per capita recommended grants to per capita NSDP have been varied from 0.1822 for the Fourteenth Finance Commission to -0.1386 for the Twelfth Finance Commission. Further, it was observed that per capita grants and per capita NSDP were very weakly associated with each other.

8.2 Suggestions:

- To increase the state's share in Union transfers the cesses and surcharges in existence for over three years, the windfall gain from spectrum and royalty of major minerals and petroleum may be made part of the divisible pool.
- Finance Commission should first look at the question of relative core competence of the States and the Centre and take a broad and progressive view as regards allocation of Central resources to and among States. The issue of intergovernmental transfers is to be looked at not from a narrow technocratic perspective or from an implicit view of a benevolent Centre giving funds to begging States, but from the right perspective of federalism where the States and the Centre are treated as equal partners in development. Further Finance Commission's allocation should balance both the objectives of promoting growth and ensuring distributive justice, by incorporating efficiency criteria in every factor that goes into the devolution formula.
- Although the revenue productivity has improved with introduction of VAT, further efforts should be made to step up tax/GDP ratio. At the State level, it is crucial to overhaul the tax collection machinery to achieve better tax compliance. Effective implementation of proposed GST would be helpful to improve the tax/GDP ratio. Keeping the rate at a reasonable level for better compliance would require broadening the tax base by phased reduction in tax breaks/exemptions and bringing more services within the tax net. Further it should take care that standard rate of proposed GST is not lower than the Revenue Neutral Rate, the revenue losses are compensated and a structured mechanism should put in place for creation of a GST Compensation Fund to protect the interest of the States.
- Formula for fiscal devolution should maintain proper balance between need, backwardness and fiscal performance. A larger weight to tax effort in the devolution formula would improve tax effort at the State level-thus increasing the amount of resources the States would collect on their own and citeris-paribus, increasing the amount of resources to be transferred from the Centre to the States.
- To bring the improvement in the own revenue collection some incentive should be in the tax devolution formula by the Finance Commission. Those

states are showing improvement in the ratio of own tax revenue to GSDP they should be awarded with higher tax devolution. This indicator should be continued by forthcoming Finance Commissions.

- ❖ If the Finance Commission has to continue the practice of using 1971 population as a criteria for devolution, should explicitly consider the impact of migration of population to developed States that puts pressure on the services provided by these States. A much better way would be to use population from the latest available Census and give explicit rewards to States that show less than average growth in the birth rate.
- ❖ The main objective of 73^{rd} and 74^{th} constitutional amendment was to strengthen the fiscal decentralisation in India. Local governments are now an integral part of the India. They have tremendous potential for bottom up planning. The per cent share of local body grants in total Finance Commission Transfer's which was 2.3 per cent in the Eleventh Finance Commission increased to 5.05 per cent in the Thirteenth Finance Commission and which is 6.41 per cent in the recommendations of Fourteenth Finance Commission could not serve the objective of amendments. Hence this share must be increased up to minimum 15 per cent. For this purpose 6 per cent of divisible pool of Central taxes as general basic grants and 2 per cent as performance grants may be granted to local bodies. At the same time compulsorily technology should bring into force to increase transparency and efficiency of local bodies. While allocating the funds to PRIs 100 per cent funds should be allocated to Gram Panchayats which are actually working at ground level and they only will have the powers of spending the same. Further it should be ensured that the State Governments are transferring the local body grants promptly and efficiently to the local Government level.
- ❖ It was observed by the Finance Commission that most of the States Finance Commissions duration is not synchronous with the Union Finance Commission and at the same time they are not submitting their due reports on time. Some incentives should be kept for those states whose States Finance Commission reports are submitted on time.
- ❖ Inspite of making recommendations by successive Finance Commissions the potential of property tax revenue could not be exploited. To augment the resources of local bodies, while allocating local body grants among states

some incentive should be given to those states showing improvement in the ratio of property tax revenue to GSDP.

- ❖ While allocating the funds to Disaster Management State's vulnerability to drought should be considered rather than the past expenditure for arriving at the size of the State Disaster Response Fund. Manmade disaster and losses should be considered for funding from NDRF/SDRF.
- ❖ The conditionalities attendant to the grants should be reduced and the release of the grants which should have pan India relevance must be related to performance and outcomes.
- ❖ From the equity point of view, the discretionary component of Centre-State financial flows must be curbed. But even with respect to non-discretionary transfers it will be necessary to require explicitly the observance of equity as the overriding consideration in their inter-state allocation. However, the states will as a group, have first to be assured beyond doubt of an adequate share of the Central resources, access to which they can gain in a manner that is not susceptible to discretionary considerations and pressures from the Centre.
- ❖ To strengthen the process of decentralisation in India, the Local Self Government's expenditure ratio to GDP should be improved. Part of this devolution would have to come from the sharply enhanced devolution from the Centre and a portion from the devolution from the states. Future finance commissions and their counterparts at the state level will have to play a more important role to make fiscal decentralisation a working reality in Indian fiscal federalism.
- ❖ The criteria being used for horizontal distribution of local body grants should be designed in such way that at least low and middle income states do not receive lower per capita local body grants in Rs. than those of higher income states. Because, it was seen that the recommended per capita local body grants in Rs. for low income states of Eleventh, Twelfth, Thirteenth and Fourteenth Finance Commissions were lower than those of middle and high income States. Even special category States compared to general category States in terms of per capita were recommended lower local body grants for ULBs by FC-XI, PRIs and ULBs by FC-XII, and PRIs by FC-XIV.