Q3

How have the recommendations of the 14th Finance Commission of India enabled the states to improve their fiscal position?

UPSC Civil Services Mains 2021 · GS II · 10 marks · Governance and Policy

Government policies and interventions for development in various sectors and issues arising out of their design and implementation.

Core demand of the question

- How have the recommendations of the 14th Finance Commission of India enabled the states to improve their fiscal position?
- Honour the official stem. Centre the 42 per cent tax devolution and the shift toward untied funds
- Keep the explanation within a 10-mark length

Revision summary

The 14th Finance Commission raised States' share in the divisible pool from 32 to 42 per cent for 2015-20.

Untied devolution, not only CSS, let States fund their own priorities and borrow on a more predictable base.

Horizontal criteria helped poorer and forested States; revenue-deficit grants closed residual gaps.

Local-body and disaster grants reduced raids on State revenue for third-tier and calamity costs.

Cesses outside the pool and later GST shocks limited the gain; the 15th FC kept devolution near that high watermark at 41 per cent.

Introduction

- **The Fourteenth Finance Commission (Chair:** Y.V. Reddy; award period 2015-20) raised States' share in the divisible pool of Union taxes to 42 per cent from 32 per cent. That single change, plus a cleaner grant design, gave States more untied money with which to repair their own fiscal position.

Body

The 42 per cent devolution

- Vertical devolution of 42 per cent was a structural jump, not a routine tweak; it moved a large block of resources from Union discretion to a formula share under Article 280.
- Untied tax devolution lets a State fund salaries, health, irrigation, or debt service according to its Assembly's priorities, which specific-purpose Centrally Sponsored Schemes never fully allowed.

- Horizontal shares used income distance, population, area, forest cover and demographic change, which helped poorer and forested States more than a pure equal-cut would have.

Grants and fiscal space

- The Commission recommended grants to local bodies and a disaster-relief architecture, which reduced the need for States to raid their own revenue for constitutionally mandated third-tier and calamity spending.
- It asked for a sharper distinction between tax devolution and grants, and for fewer overlapping CSS conditions, so State budgets were less a Union annex.
- Revenue-deficit grants for selected States were meant to close residual gaps after the 42 per cent formula, which is how fiscally weaker States were enabled without diluting the formula for all.

How the fiscal position actually improved - and the caveats

- Higher predictable devolution improved the States' bargaining power in GST-era compensation debates and in market borrowing plans under Article 293, because a larger own-share is better collateral than an uncertain scheme release.
- Several States could raise capital outlay and still keep FRBM paths in the early award years, which is the practical meaning of an improved fiscal position.
- **Caveat:** oil cesses and other non-divisible levies shrank the divisible pool in practice; GST implementation and later shocks (2016-20) meant the 42 per cent was necessary but not sufficient.
- **Recommendation:** protect the divisible pool from excessive cesses, which is the 15th Finance Commission's continuing worry after it set devolution at 41 per cent to make room for the new Union Territories.

Flow diagram

14th FC Art 280 -> 42 percent tax devolution

14th FC Art 280 -> Local body and disaster grants

42 percent tax devolution -> Untied State fiscal space

Local body and disaster grants -> Untied State fiscal space

Untied State fiscal space -> Improved State fiscal position

Conclusion

The Fourteenth Finance Commission enabled States mainly by the 42 per cent untied devolution, cleaner local-body and disaster grants, and a smaller shadow of CSS conditions. Fiscal positions improved where States used that predictability for own-priority spending and borrowing; cesses and later shocks show that devolution is the floor, not the whole house.

Facts & figures

14th Finance Commission

Y.V. Reddy Commission; award period 2015-20; vertical devolution raised to 42 per cent.

Previous share

13th Finance Commission had recommended 32 per cent; the 10-point jump is the core reform.

15th Finance Commission

Set devolution at 41 per cent for 2021-26, largely to accommodate J&K's new Union Territory status without cutting States.

Cesses and surcharges

Union levies that do not enter the divisible pool and therefore dilute the real value of a 42 per cent share.