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The devil is in the details for states' enhanced share of central taxes

The 14th Finance Commission has increased states' share in central taxes from 32 per cent to 42 per cent of the total divisible pool of central tax revenues. Business Standard examines what the move m

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MAHARASHTRA: MORE MONEY OVERALL BUT SPREAD NOT CLEAR
It is a mixed bag for the Maharashtra government, struggling to cope with public debt of Rs 3.44 lakh-crore and a revenue deficit of Rs 26,000 crore. There will be a rise in devolution from the Centre but it will have to mobilise finances to support state-specific schemes.

The government will get grants of Rs 295,000 crore between 2015-16 and 2019-20, against Rs 91,700 crore in the previous five-year period. Its share under the divisible pool will be Rs 2.6 lakh-crore against Rs 75,000 crore earlier.

Maharashtra will also get Rs 15,000 crore, against Rs 5,500 crore in the earlier five-year period, for panchayati raj institutions, Rs 12,000 crore against Rs 3,000 crore earlier for urban local bodies and Rs 7,300 crore against Rs 1,834 crore earlier for disaster management. **(DEVOLUTION SAGA)**

A senior government official said: “There will certainly be a rise in allocation of funds from the Centre. However, the state government is yet know the total outlay for the country in 2015-16 and what the state will get. Beside, the government will wait for the guidelines relating to state shares in schemes, including the Rashtriya Krishi Vikas Yojana, Sarva Shiksha Abhiyan, National Health Mission, Accelerated Irrigation Benefits Programme and the Jawaharlal Nehru National Urban Renewal Mission.”

The official said the flip side was the 14th Finance Commission saying grants were sector-specific. “The government will have to step up efforts to mobilise funds for state-specific schemes — irrigation, reduction in intra district disparities and strengthening of infrastructure, especially in Mumbai,” he added.

Nilaya Varma, head of government services, KPMG in India, says the additional devolution of almost Rs 2 lakh-crore in grants and nearly Rs 1.8 lakh-crore in share of the total pool should improve the state’s debt position. Adds D R Dogra, managing director, CARE Ratings: “The higher devolutions also mean the state has to decide on certain expenditures, as the Centre has delinked itself from eight centrally-sponsored plans and has changed the sharing ratio for another 24. It is expected that the higher resources will be used to supplement the programmes where the Centre has withdrawn.” Varma says there would also be an additional burden in funding of priority sectors such as health, education and rural livelihoods, where central support would not grow or be less. “Having said that, it also gives the state greater leeway in managing the spending on these schemes and creates room for innovation. It puts pressure on states for fiscal consolidation and management. Given the higher fund devolution, accompanied by room to reallocate funding between schemes (previously not possible due to scheme-specific central grants), it might be fair to anticipate a higher allocation to Maharashtra-specific needs such as drought relief, specific infrastructure projects and irrigation,” he adds.

The government official quoted earlier says if the state gets an additional Rs 7,000 crore from the Centre and will have to allocate for the national schemes mentioned earlier, there might not be enough money for local priorities.

The official said Maharashtra’s public debt relative to gross state domestic product (GSDP) was 18.8 per cent, well below the target of 25.3 per cent set by the Finance Commission. The norms would be adhered to and the fiscal deficit was 1.9 per cent of GSDP, below the three per cent stipulated by the Commission.

Dogra says the debt situation will depend on how the government manages its budget, through higher resource generation and prudent spending.

GUJARAT: LESS BORROWING, MORE SOCIAL SECTOR OUTLAY

In the recent state budget for 2015-16, Finance Minister Saurabh Patel stayed away from raising the government’s total market borrowing from last year’s Rs 20,450 crore. Officials say it was in anticipation of increased access to the total taxes collected by the Centre.

Now that the Union government has accepted the 14th Finance Commission recommendations, thereby allowing states access to 42 per cent of the total taxes collected by it as compared to 32 per cent earlier, open market borrowings by the Gujarat government are likely to come down, even if marginally, say officials.

"We have not estimated an increase in open market borrowings (for FY16) because we knew we would be getting more from the Commission recommendations. Even this Rs 20,450 crore we could bring down, since in the current year we are planning to borrow only Rs 15,000-16,000 crore. So, next year, we will again bring down our borrowings to that extent," says a senior official, on condition of anonymity.

The access to 42 per cent of total taxes would roughly see an increase of 30 per cent in what Gujarat gets as its share from the central government's tax revenues.

"For the next year, we had already projected Rs 13,000 crore of tax revenues from the Centre, slightly more than the 32 per cent share. Now, with the share being 42 per cent to all states, we would be getting Rs 16,000 crore. We will get a clearer picture once the first instalment comes in by April," says another senior official.

As a result, Gujarat would be getting Rs 3,500-4,000 crore more than what it had projected so far as tax revenue from the Centre. "What it will help us to do is develop greater depth in sectors which are a priority for us, such as health, housing, sanitation and water supply. Again, this will depend on the schemes the Government of India continues or abolishes. The good thing is that in the Union Budget, the central government has indicated it will continue to sponsor schemes in agriculture, health and education, among others. Whichever schemes they wind up, we can bring in our own in that sector, apart from the focus ones," the official further said.

Water supply is an area the state government would be looking to spend more, as 68 per cent of the land in Gujarat is water-stressed.

It is poised well on debt.

Recently, in its budget, the government estimated public debt at below 19 per cent of gross state domestic product (GSDP) as against a self-laid cap of 27 per cent. According to the official, it could also bring down the state's fiscal deficit, currently 2.41 per cent of GSDP. "We would have a greater revenue surplus to plough into capital outlay," the official adds.

WEST BENGAL: STATE'S PROBLEM IS HUGE PAST OVERHANG

With debt accumulation nearing Rs 3 lakh-crore, the 14th Finance Commission's recommendations amount to only a cosmetic touch-up to the distorted finances of the West Bengal government.

The estimation from higher tax devolution and grants are for additional revenue of Rs 16,714 crore in 2015-16 over 2014-15. On the surface, this makes Bengal the second biggest gainer among the general category states, after Uttar Pradesh which is slated to get an additional Rs 24,608 crore in 2015-16 over 2014-15.

However, the gains are half of the Bengal government's annual loan and interest repayment bill, slated at Rs 32,567 crore for 2015-16, according to the state's budget document. The debt dues, says the budget, were Rs 2,74,800 crore in 2014-15 (revised estimate), set to touch Rs 2,99,274 crore in 2015-16 (budget estimate).

A closer look shows Bengal's anticipated annual gain could also be much less — a little more than Rs 6,650 crore. According to the state budget document, in 2015-16 the government anticipates Rs 31,966 crore as its share of Union tax and duties, and Rs 32,257 crore as grants from the central government.

Bringing the total anticipated contribution from the central government in total revenue receipts to Rs 64,223 crore.

In 2014-15, the total contribution of the share of Union tax and duties and grants from the central government was Rs 54,201 crore (Rs 28,241 crore and Rs 25,960 crore, respectively). Thus, the government was anticipating an increase of Rs 10,000 crore from the central government in 2015-16. Against this, the gains presented by the central government's Economic Survey on account of the 14th Finance Commission are pegged at Rs 16,714 crore, about Rs 6,700 crore more.

"The Commission's report seems to be in the right direction, as states will have more funds and more freedom in using these. At the same time, assistance from some centrally-sponsored schemes might go down. For Bengal, the difference comes out to be a positive number, close to a little more than Rs 5,000 crore. However, this amount is too little, compared to the state's overall debt," said Dipankar Dasgupta, former professor of economics, Indian Statistical Institute.

Notably, apart from increasing the devolution from the divisible pool to 42 per cent from the earlier 32 per cent, the Finance Commission also proposed additional grants for 11 states, including Bengal, for meeting the revenue deficit. The additional grant for Kolkata will be Rs 11,760 crore, spread only over two years.

Bigger push required

In 2011, West Bengal got a grant of Rs 8,750 crore but it was linked to the development of backward regions, not for reducing the debt burden.

According to the Commission, with the additional grants, Bengal's revenue deficit is expected to come down from Rs 8,449 crore in 2015-16 to Rs 3,311 crore in 2016-17 to nil in 2017-18. In fact, the state government has been making efforts to reduce its revenue deficit, which came down by Rs 8,554 crore in the past one year, according to the state budget.

"West Bengal's tax to GSDP (gross state domestic product) ratio has improved but, ultimately, it has to come out of the debt trap. This will happen only if the state focuses on increasing economic activity, along with an efficient tax administration and curtailment of wasteful expenditure," said Devendra Pant, chief economist and senior director, India Ratings and Research.

Apart from the Finance Commission, the Union Budget mentioned special financial assistance for Bihar and West Bengal, on the lines of Andhra Pradesh. State finance minister Amit Mitra had said Andhra got special assistance of only Rs 850 crore, which when divided between Bengal and Bihar would be much less. Chief Minister Mamata Banerjee had described the special assistance as 'bunkum'.

As of now, the only quick panacea for mending the broken finances might come through a debt waiver or moratorium, which the government has been demanding. According to Dasgupta, there is a precedent in the case of Punjab. In 1997, the central government had written off the entire Rs 8,500 crore debt, accumulated since 1984 as a special-term loan for fighting militancy.

"However, compared to West Bengal, Punjab's debt was hardly anything. At present, no government can write off a debt of nearly Rs 3 lakh-crore," says Dasgupta.

KARNATAKA: NOT ENOUGH EXTRA TO FEEL HAPPY

The decision to raise the share of states in the Centre's tax collection to 42 per cent from the present 32 per cent isn't much to be happy about, feels the Karnataka government.

"The Centre's decision to increase the devolution of its taxes has been neutralised by the huge reduction of funds for central government-sponsored programmes in the Budget," says Chief Minister Siddaramaiah.

For instance, he said, central government allocation for the country's housing schemes had been reduced by Rs 14,287 crore and for education by Rs 32,912 crore. "This will only increase states' financial burden," he said.

I S N Prasad, principal secretary, finance, said in many of the centrally sponsored schemes (CSS), the Centre's share would fall from 90 per cent to 40-50 per cent. "At this stage, we don't know what would be the increase in our funds. We are waiting for a clear picture to emerge from the Centre," he said.

According to the 14th Finance Commission recommendations, Karnataka's share of central taxes has gone up to 4.713 per cent from 4.328 per cent in the 13th Commission. Its share in service tax is calculated at 4.822 per cent.

At the most, said Prasad, they'd get an additional Rs 6,000-8,000 crore annually. "We will have to compensate for the loss in CSS. We cannot neglect schemes like National Rural Health Mission, Rashtriya Krishi Vikas Yojana and the mid-day meal programme in schools, among others," he said.

He said it is too early to think of using the higher funds to reduce the state's liabilities. These were estimated at Rs 1,57,681 crore at the end of 2014-15 or 23.01 per cent of the gross state domestic product (GSDP). This is also within the limit of 25.2 per cent for 2014-15 mandated in the Karnataka Fiscal Responsibility Act. However, these liabilities have been growing at a compounded annual rate of 17 per cent since 2007-08. The fiscal deficit is expected to be Rs 20,041 crore or 2.92 per cent of GSDP for FY15.

The state expects to receive Rs 16,560 crore by way of the share in central tax and another Rs 20,135 crore as grants from the Centre in 2014-15.

"Karnataka has been presenting a revenue-surplus budget for many years. With the higher allocation coming, it should be able to use those funds for capacity building in areas like irrigation, education, primary health and infrastructure projects like roads and railways," said B T Manohar, chairman, state taxes committee, Federation of Karnataka Chambers of Commerce and Industry.

In the current financial year, he said, the state would lose around Rs 550 crore in tax revenue due to the fall in crude oil prices and subsequent reduction in fuel prices. The challenge was how it managed to fund the flagship Annabhagya scheme (30 kg rice to below-poverty line families at Rs 30 a month), Ksheerabhagya, Krishibhagya and low-interest loan schemes for farmers in the coming budget.

ANDHRA PRADESH: 'WILL BADLY AFFECT ANDHRA'S DEVELOPMENT'
According to the Andhra Pradesh (AP) government, there is no net gain for the state. "The Centre has increased states' share in central taxes by withdrawing monetary support to centrally-sponsored schemes (CSS). The 10 per cent rise in central taxes to states is only a re-distribution of resources," said Parakala Prabhakar, advisor (communications) to the state government.

"Overall, the dispensation under the 14th Finance Commission is likely to reduce, which would have an adverse impact on the development dynamics of AP," he said.

He said finance minister Arun Jaitley had stated that before the increase, Rs 68 of every Rs 100 of the central resources was going to states in some form or the other; however, now only Rs 62 would be going to states.

He, however, termed the increase in states' share in the Central divisible pool important because "it gives some room for the state to design and monitor its own schemes".

AP is among the 11 revenue-deficit states identified by the Finance Commission. In view of this, it recommended an allocation of Rs 22,113 crore to the state in the next five years. However, even after 42 per cent devolution, Prabhakar said AP would have a net revenue deficit of Rs 22,112 crore over the next five years.

TELANGANA: 'NO NET IMPACT ON FINANCES'

The views of the Telangana government are similar to that of Andhra Pradesh. "There is no extra money. What is being given with one hand is taken away by the other hand," said G R Reddy, financial advisor.

The central tax devolution following the 10 per cent rise has increased from Rs 3.82 lakh crore in 2014-15 to an estimated Rs 5.23 lakh crore in 2015-16, he said. At the same time, he added, Central assistance to Plan expenditure has declined from Rs 3.3 lakh crore in 2014-15 to Rs 1.96 lakh crore in 2015-16.

Reddy said the leverage the state expected to have due to higher devolutions was "just not available" due to the presence of centrally-sponsored schemes, which now have to be funded by states.

According to estimates, after 42 per cent devolution, Telangana would have a surplus of Rs 1,18,678 crore over the next five years. Reddy said Telangana had always been a surplus state even before the hike and would continue remain so even if there was no hike.

On the whole, Reddy feels there would not be any net impact on the state's finances on account of the rise of its share in central taxes.

CHHATTISGARH: ADVANTAGE FOR THE STATE

When 14th Finance Commission members led by Y V Reddy visited Chhattisgarh in June 2014, state government officials demanded the weightage to population in the devolution formula be brought down 25 per cent to 15 per cent. The Commission eventually gave 17.5 per cent weightage to population , a move that would benefit less-populated states such as Chhattisgarh (25 million).

"We are happy that the Commission has accepted our suggestion, though not the figure suggested by us," said a senior official.

The new formula helps Chhattisgarh gain a 0.6 per cent rise in the allocation of share in the Central taxes. The state was getting Rs 9,500 crore a year under the 13th Finance Commission formula. This would now rise to about Rs 15,900 crore, an increase of Rs 6,400 crore.

According to Chief Minister Raman Singh, bringing down the weightage on population will help newly-carved and less-populated states. He said Chhattisgarh would be able to use the additional amount (Rs 6,400 crore) the way it wants, because it's "untied money".

Chhattisgarh had big expectations from the 14th Finance Commission. It has even delayed its annual budget to rework on the plans. The budget is now scheduled to be presented in the second week of March.

PUNJAB: CLARITY ON MODALITIES WILL REVEAL IMPACT

Punjab's share in central taxes will go up overall by Rs 2,200 crore but its effect on the state's economy will be evident only after all modalities have been worked out.

Finance Minister Parminder Singh Dhindsa told Business Standard: "Punjab would get Rs 2,200 crore more from the Union government after the 14th Finance Commission recommendations. However, we are yet to get information on how much the state would get under different heads such as grant in aid from the Centre, share from central taxes, and grants under centrally sponsored schemes."

At present, Punjab gets Rs 5,000 crore a year from the Centre.

He said: "Only once everything becomes clear will we be in possession to comment on the impact on increase in tax devolution to 42 per cent from 32 per cent earlier."

The transfer to the states include a portion of the tax revenue, grants in line with the Commission, grants for plan purposes and grants for centrally sponsored schemes.

Also, recently, while welcoming the decision of the Government of India to enhance the states' share in the devolution of central taxes, Chief Minister Parkash Singh Badal said this would have substance only if the funds meant for Centre-sponsored schemes were also transferred directly to the states.

"Along with the hike, the states need to know how the funds for the schemes would be transferred to the states," he said.

TAMIL NADU: 'THIS STATE IS WORST-HIT'

The Centre's acceptance of the recommendations of the 14th Finance Commission would adversely affect Tamil Nadu, state government officials said. "Tamil Nadu would be worst-hit since the horizontal devolution percentage has been reduced significantly," said a senior official, who did not want to be named. The horizontal devolution percentage dropped from 4.96 to four per cent.

"The incremental flow is not much. It is the grant-in-aid going to the devolution grant which will give more flexibility to the state government. One needs to quantify how much of grant-in-aid will transfer to devolution grant and what is the incremental flow of fund to the state government. For Tamil Nadu, this is definitely not favourable," the official added.

According to former chief minister J Jayalalithaa, the Centre has attempted to "transfer the burden of expenditure on a number of schemes to states", and this runs afoul of the increase in devolution recommended by the Finance Commission. "If the state is to take additional burden of expenditure on Central government priorities, this is an unfair expectation. In Centrally-sponsored schemes, the state's share should be limited to a maximum of 25 per cent of the scheme cost," she added.

ODISHA: DISAPPOINTMENT ON STATE'S PLATE

Recommendations of the 14th Finance Commission have little for Odisha, as it is set lose Rs 4,600 crore between 2015 and 2020 due to the revised criteria of horizontal transfer of funds.

Though the share of states in the net proceeds of shareable central taxes has been increased to 42 per cent from 32 per cent, the share of Odisha is 4.64 per cent of the divisible pool, down from 4.78 per cent earlier.

"The Commission has recommended Rs 1,84,070 crore as the state's share in the net proceeds of the central taxes and duties. Had the Commission adopted the previous criteria, the state would have been eligible to get a share of 5.35 per cent amounting to Rs 2,11,228 crore," said a senior government official.

The decrease Odisha's share is due to deletion of the criterion "fiscal discipline" and inclusion of a new criterion called demographic change (population as per 2011 Census). Sharp rise in per capita income has also affected the state's share.

As per the reworked criteria, population has 17.5 per cent weightage while demographic change has 10 per cent. Income distance, area and forest cover bear weightage of 50 per cent, 15 per cent and 7.5 per cent, respectively.

Chief minister Naveen Patnaik said he was deeply disappointed with the recommendations.

MADHYA PRADESH: STATE EXPECTS FLEXIBILITY TO SPEND FUNDS

Madhya Pradesh (MP) is among the states that had demanded flexibility in designing public-oriented schemes. "Higher tax devolution will give us more autonomy in designing our schemes according to our requirement. We had urged the Finance Commission in this regard," Finance Minister Jayant Malaiya said in his budget speech last month.

The state would get an additional Rs 10,000 crore following the rise in Central-state sales tax devolution, said Malaiya. "We will be able to prioritise our schemes." The state's share in total tax collection is pegged at Rs 30,449.65 crore in 2015-16.

Over the past 10 years, the state has spent close to Rs 1 lakh-crore on infrastructure development and social sector, he added. "As it is evident from our state Budget 2015-16, we have allocated another Rs 5,000 crore to infrastructure. Our focus remains infrastructure and social sectors. The increased share will give us more flexibility."

However, some officials expressed fear that the Centre might cut or skip releasing grants according to schedule.

"The increased share of total taxes might not have much monetary benefit, but will render total flexibility. Also, the state will get the fund on a monthly basis," said a highly-placed official in the state government.

HARYANA: LEGROOM FOR CASH-STRAPPED STATE

A higher devolution of funds from the Centre to Haryana, as promised by the 14th Finance Commission, would give the government, reeling from financial stress, more room.

In the 14th Commission, Haryana has been allotted Rs 42,798 crore as share from the central taxes — more than double of Rs 15,199 crore it was allotted in the 13th Commission. Grants have been increased to Rs 7,662.47 crore from Rs 4,270.84 crore.

The basic grant provided to local bodies is now Rs 5,159.12 crore, up from Rs 1,521.3 crore in the previous Commission.

There is no performance grant for 2015-16 for the Panchayati Raj institutions or the urban local bodies. However, for 2016-2020, the maximum performance grant available to local bodies is Rs 804.34 crore.

Under the State Disaster Response Fund, Haryana has been given Rs 1,699 crore, double of the Rs 844 crore from the previous Commission.

The previous Congress government had presented a rosy picture of the state's financial health, and had promised welfare schemes if they were voted back into power. They were voted out in October last year. After coming to power the new Bharatiya Janata Party government declared that the state was under immense financial stress.

The central government has also released a white paper on the financial health of the states that have mounting debts, shrinking revenues and growing dependence on central assistance.

Senior state government officials are yet to assess how the greater quantum of funds can be utilised. Haryana has an estimated debt burden of Rs 81,806 crore, a revenue deficit of Rs 5,013 crore in 2014-15 and power subsidy of Rs 5338.5 crore. The annual plan outlay was Rs 32,731.29 crore in FY15.

The state budget would be presented on March 17. Chief Minister Manohar Lal Khattar, Finance Minister Abhimanyu Singh and senior officials would be meeting soon to decide how to utilise the funds.