

## Did the States get short-changed under Modi Government?

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While presenting the Interim Budget in parliament, the acting Finance Minister claimed that the NDA government transferred significantly higher amounts to the States following the recommendations of the fourteenth Finance Commission (FC), "in the true spirit of cooperative federalism". Does this claim stand scrutiny?

While significantly enhancing the share of the states in central taxes from 32% to 42%, the fourteenth FC had projected the total devolution of central taxes to the states to increase from an average of 2.8% of GDP in the thirteenth FC period (2010-11 to 2014-15) to 4.1% on average (2015-16 to 2019-20). The actual transfer by the NDA government to the states in the five years of the fourteenth FC period, including the budget estimates for 2019-20, comes to only around 3.9% of GDP on average.

While the actual devolution of taxes has fallen far short of the FC projections on account of the significantly slower annual average growth of GDP at current prices (11%) than the projected growth rate (13.5%), central tax devolution as a proportion of GDP has also fallen short of the FC projections in four out of the five years (Table 1). Why did this happen?

**Table 1: Taxes Devolved to States: 14<sup>th</sup> FC Projections & Actuals**

	Projections by 14th FC				Actual Devolution		
	Devolution of Central Taxes	Projected GDP (current prices)	Taxes Devolved to States/GDP		Devolution of Central Taxes	Projected GDP (current prices)	Taxes Devolved to States/GDP
2015-16	579282	14628333	4.0	2015-16	506193	13771874	3.7
2016-17	668425	16586228	4.0	2016-17	608000	15362386	4.0
2017-18	772304	18836683	4.1	2017-18	673005	17095005	3.9
2018-19	893430	21373923	4.2	2018-19 RE	761454	18840731	4.0
2019-20	1034745	24232904	4.3	2019-20 BE	844605	21007439	4.0

**Source: Report of the Fourteenth Finance Commission & Union Budget Documents, Various Years**

An expansion of cess and surcharges levied by the centre shrink the size of the divisible pool of taxes in gross tax revenues. In other words, they help the centre in mobilising tax revenues, which it does not need to share with the states. The fourteenth FC had noted that a majority of the State governments were therefore of the view that cesses and surcharges imposed by the centre should either be eliminated or be made a part of the divisible pool, if they are continued beyond a specified period. The share of cess and surcharges in the centre's gross tax revenue had increased from 7.5% per cent in 2000-01

to 13% in 2013-14. This was a major reason why the fourteenth FC had recommended the enhancement of the states' share in the divisible pool of taxes from 32% to 42% and also advocated that the share of cess and surcharges in gross tax revenues to be brought down.

Disregarding this concern expressed by the fourteenth FC, however, the NDA government has continued to expand revenue mobilisation through cesses and surcharges throughout its tenure, which has eroded the transferable resources of the states. While gross tax revenues have grown at an annual average rate of 15.5% from 2015-16 to 2019-20 (BE), the divisible pool of central taxes has witnessed an annual average growth of 13.8% only, leading to a declining share of devolved taxes in gross tax revenues. Revenues collected by the centre through cess and surcharges grew at a much higher average annual rate of 24%.

**Table 2: Actual Gross Tax Revenues & Devolution to States: 13th & 14th FCs**

	13th FC Actuals	14th FC Projections	14th FC Actual
	Total: 2010-11 to 2014-15	Total: 2015-16 to 2019-20	Total: 2015-16 to 2019-20
Gross Tax Revenues	5102103	10603748	9890784
Cess, Surcharge & Cost of Tax Collection	657409	1203303	1811601
Divisible Pool	4444694	9400445	8079183
Tax Share to States	1422302	3948186	3393257
	% of Gross Tax revenue		
Cess, Surcharge & Cost of Tax Collection	12.9	11.3	18.3
Divisible Pool	87.1	88.7	81.7
Tax Share to States	27.9	37.2	34.3

**Source: Report of the Fourteenth Finance Commission  
& Union Budget Documents, Various Years**

Aggregated over the five-year period, the share of the cess and surcharges (also including total tax collection cost) in gross tax revenues was projected to decline from 13% under the thirteenth FC period to 11% under the fourteenth FC period (Table 2). This has actually risen to 18%, leading to a decline in the divisible pool. Had the centre maintained the states' share in gross tax revenues at 37%, as projected by the fourteenth FC, the states would have received an additional Rs. 2.89 trillion in the period 2015-16 to 2019-20 as their share in central taxes.

The higher revenue mobilisation by the NDA government through cess and surcharges has certainly not been in the spirit of cooperative federalism. The states have been deprived of a significant amount in central tax revenues. The CAG and the fifteenth FC Finance Commission needs to take cognizance of this in order to ensure that this trend is reversed in the next five years.

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