The Impact of the Recommendations of the Fourteenth Finance Commission

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FFC Recommendations and Related Reforms

Recommendations of the FFC

1. An increase in untied transfers to States.
2. An offsetting decrease in tied transfers to the States.
3. A change in the formula for horizontal distribution of central transfers.
4. A change in the grants-in-aid from the Centre to the States.

CSS Reforms

1. A consolidation of CSS.
2. A change in the funding pattern of CSS

The Fiscal Space of the States

Centrally Sponsored Schemes

| Schemes	2014	2016	Old pattern	New pattern
Rs. Crore				
MGNREGA	33353	38500	75,25	75,25
PMGSY	6657	19000	100	60,40
NSAP	10547	9500	100	100
KUY	16463	7580	75,25	60,40
PMKSY	13456	5717	50,50	50,50
NHM	21650	20037	85,15	60,40
SSA	9194	22500	65,35	60,40
MDM	4318	9700	75,25	60,40
ICDS+	17858	16120	50,50	50,50
SBA+	15026	16300	75,25	60,40
H	18376	20075	75,25	60,40
NLM	3433	3325	75,25	60,40
URM	7040	7296	50,50	50,50
Total	**177371**	**195650**		

Centrally Sponsored Schemes

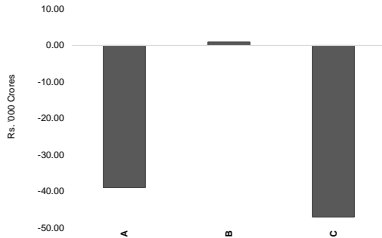A: Change in Sharing Patten while Keeping Funds Constant
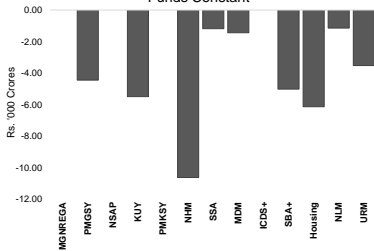
B: Change in Allocation of Funds while Keeping the Sharing Patten Constant
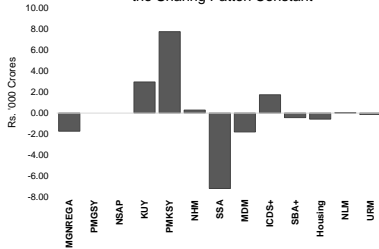
C: Both Sharing Pattern and Allocation of Funds Changing
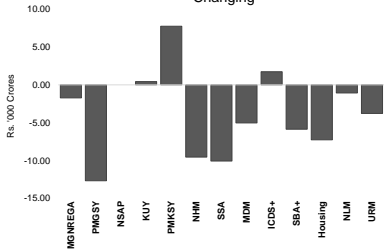
All Schemes

Central Tendencies of Key Fiscal Variables Before and After the FFC

- We calculate the cross-section sample mean of a fiscal variable as percent of GSDP at time t i.e. $\sum_{i=1}^{N} \left(\frac{Grants_{it}}{GSDPit} \right)$.

- Similarly, we also calculate the cross-section sample median.

- Data for 2014-15 and 2015-16 is Revised Estimates so that they are comparable (see Choudhury et al. 2016). Data for 2016-17 is Budget Estimates.

- If GSDP data for 2015-16 is not available from CSO, we have taken it from the respective state budgets. For 2016-17, GSDP data for all states has been taken from state budgets.
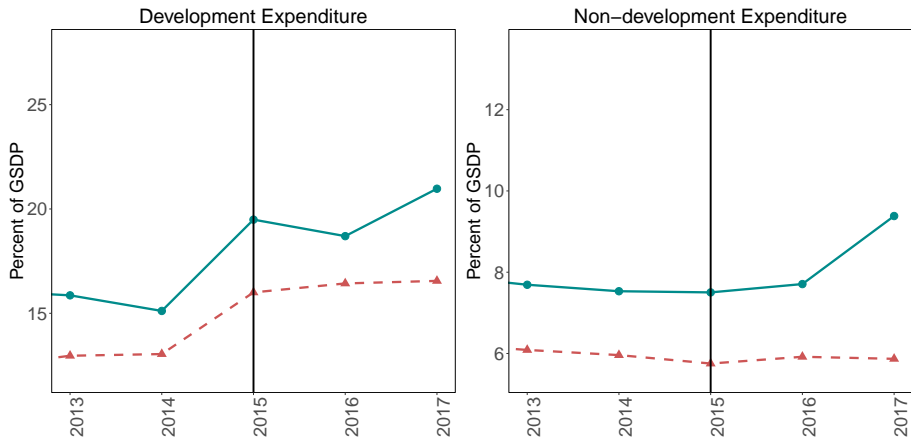
Total Transfers

Total Transfers from the Centre
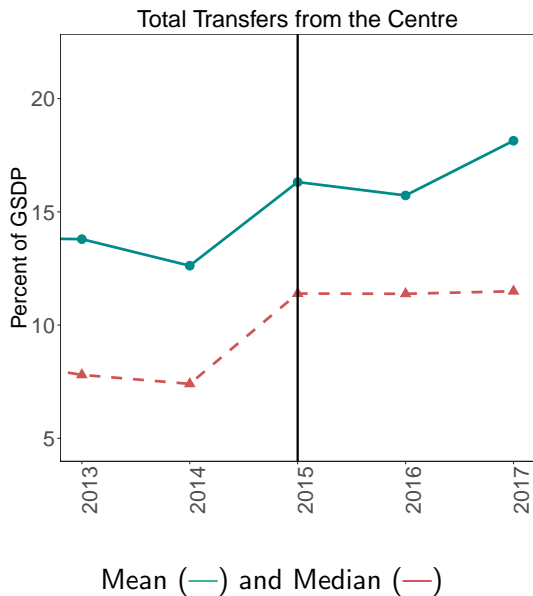
Mean (—) and Median (—)

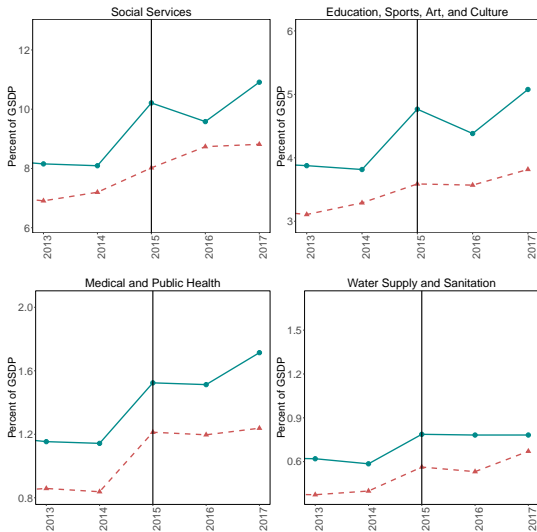# Components of Central Transfers
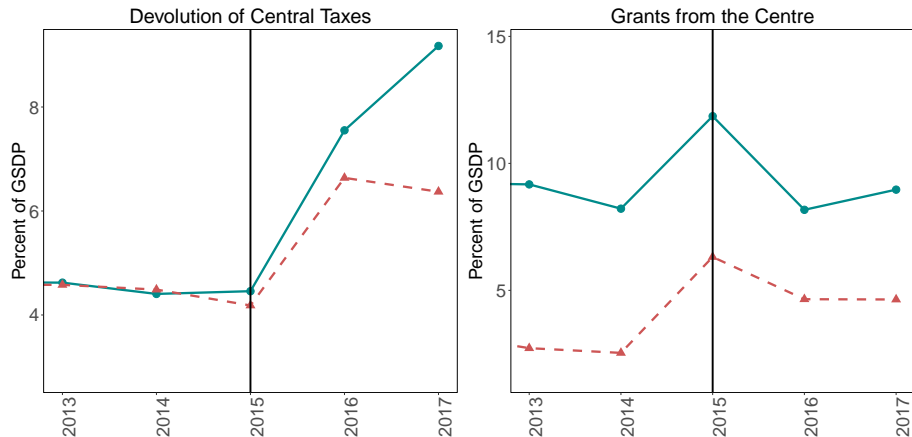
Mean (—) and Median (—)

Development and Non-Development Expenditure

Mean (—) and Median (—)
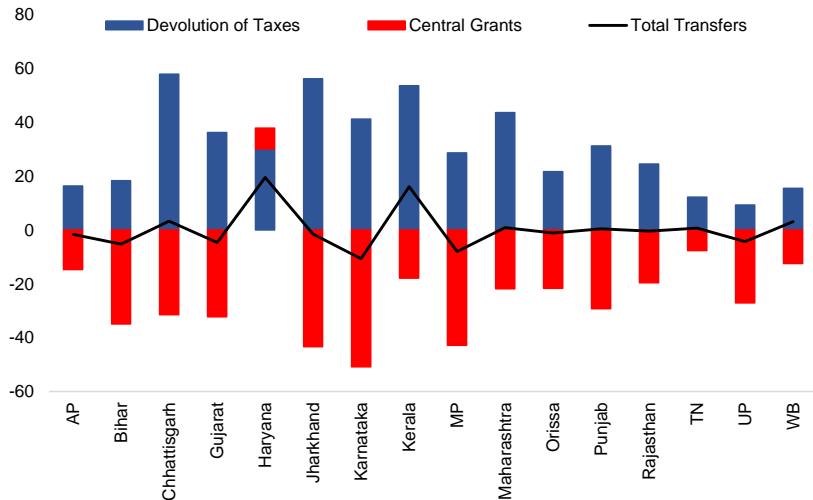
Components of Development Expenditure

Mean (—) and Median (—)

Comparing Growth Rates

- Nominal fiscal variables possess a time trend.
- Thus, in addition to looking at GSDP ratios, it is instructive to compare the year-on-year growth rates in fiscal variables in the first post-FFC year, i.e. 2015-16 with some measure of "average" growth rate.
- We use the mean growth rate of the previous five years (excluding 2014-15) as our measure of average growth rate.
- 2014-15 is excluded so that changes in the accounting treatment of CSS funds do not bias our results.
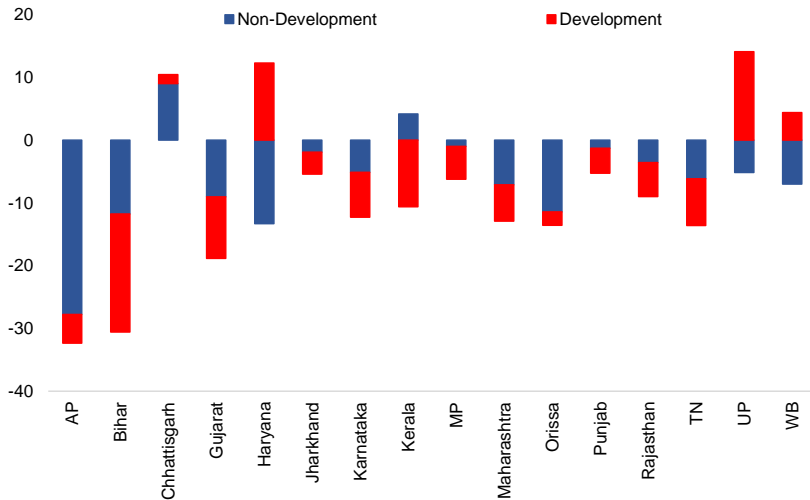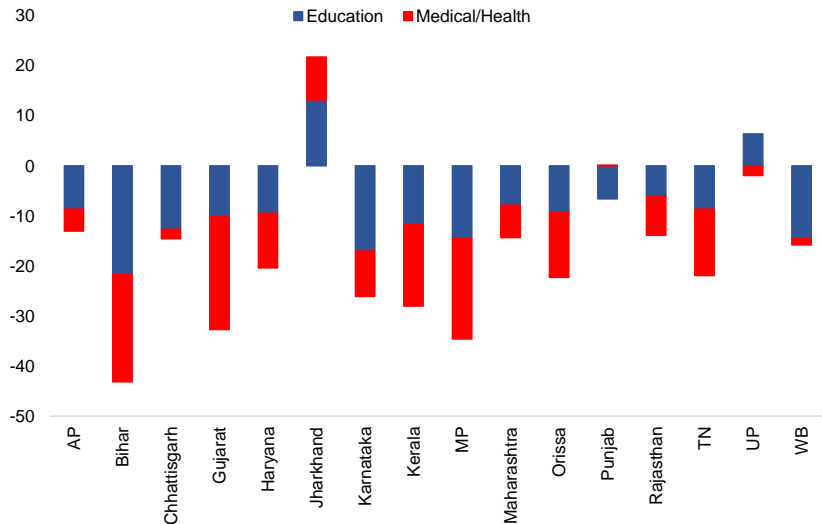
Comparing Growth Rates

Transfers

Comparing Growth Rates

Development and Non-Development Expenditure

Comparing Growth Rates

Social Expenditures: Health and Education

Going Beyond Public Spending: Vertical Fiscal Imbalances (VFI)

Vertical Fiscal Imbalances and their Importance

- VFIs measure the gap between the own-revenues and own-expenditure of a sub-national government (SNG).
- Old idea but it has seen a resurgence in recent literature.
- Large levels of VFIs have a detrimental impact on fiscal discipline (see for instance, Eyraud and Lusinyan (*JME* 2013))
  1. The tendency of SNGs to treat public funds as a common pool of resources.
     - ⋆ High transfer-dependency may break the link between taxes (i.e. the cost) and the benefits of public spending (Rodden, 2003).
  2. A softening of sub-national budget constraints due to bailout expectations
     - ⋆ Pressure from voters and creditors may leave the central government with no option but to bail-out SNGs who enjoy limited tax autonomy (von Hagen and Eichengren (*AER* 1996)).

Measuring VFI

- VFI_1: The share of sub-national own-spending that is not financed through own-revenues.

$$VFI_1 = 1 - \frac{\text{SNG own-revenue}}{\text{SNG own-spending}} \qquad (1)$$

- VFI_2: The share of sub-national own-spending that is covered through central transfers and sub-national borrowing.

$$VFI_2 = \text{Transfer Dependency} + \text{SNG Borrowing} \qquad (2)$$

- We include states' share in central taxes as own–revenue.
  - ▶ They are guaranteed by the constitution.
  - ▶ 'Collected' by the Centre for efficiency in tax administration.

VFI: details

$$
\begin{aligned}
VFI_1 &= 1 - \frac{\text{SNG own-revenue}}{\text{SNG own-spending}} \\
&= 1 - \frac{(Trev^{own} + NTrev^{own} + NDCR)}{(TExp - Grants_{local})}
\end{aligned}
$$

$$
\begin{aligned}
VFI_2 &= \text{Transfer dependency} + \text{SNG deficit} \\
&= \frac{\text{Net transfers}}{\text{SNG own-spending}} + \frac{\text{SNG borrowing}}{\text{SNG own spending}} \\
&= \frac{(\text{Share in Central Taxes} + \text{Grants from Centre} - Grants_{local})}{(TExp - Grants_{local})} \\
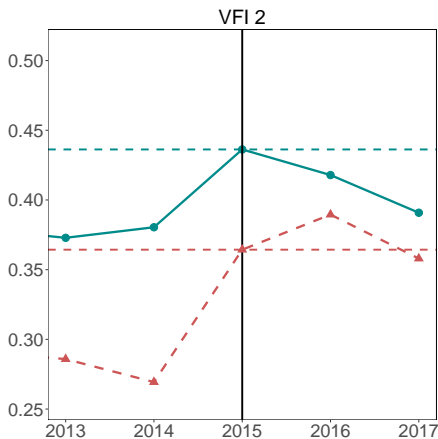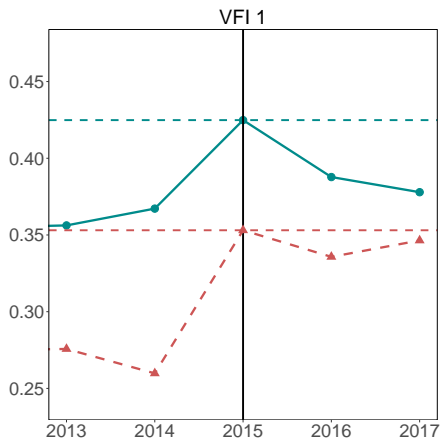&+ \frac{\text{Gross Fiscal Deficit}}{(TExp - Grants_{local})}
\end{aligned}
$$

NDCR: Recoveries of loans and advances and miscellaneous capital receipts;
Grants_{local}: Assignments to local bodies & Panchyati Raj Institutions (grants given by states)

VFI 1 (—) and VFI 2 (—) after the FFC
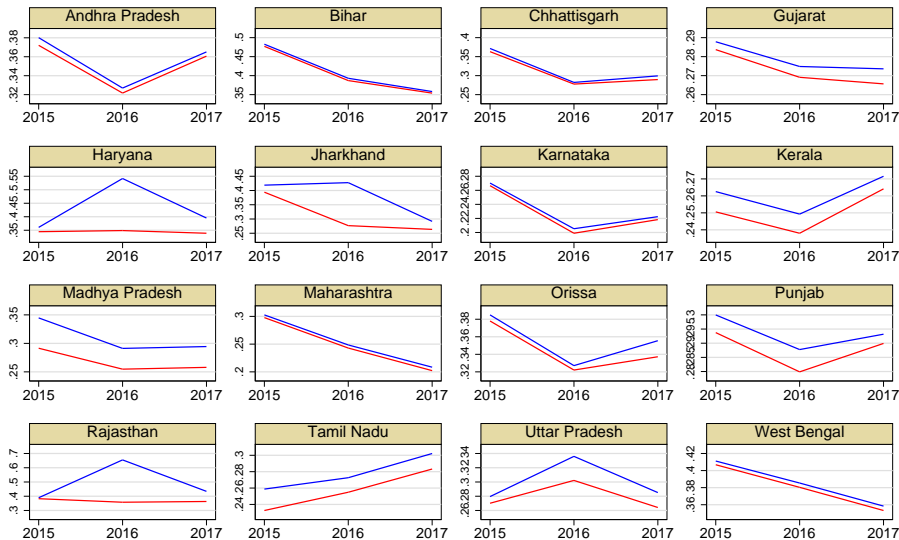
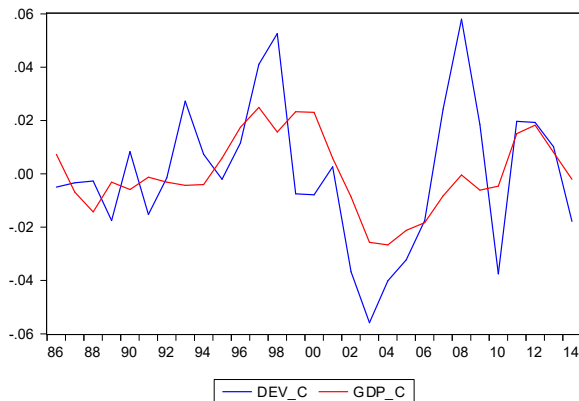# Mean (—) and Median VFI (—) before and after the FFC

Going Beyond Public Spending: Cyclicality of Sub-National Resources

GDP and Grants from the Centre: HP Cycle

GDP and the Devolution of Central Taxes: HP Cycle

Cyclicality in State Finances

- Additional revenue uncertainty for the states? (WB India Development Update (June 2016))
- Impact on state budgets?

Thank you