How do States get revenue from the Center?

The Center-State finances is a confusing topic. Most of the states depend on the center for the large chunk of their revenue. There are different channels through which the center transfer funds to states. With many organizations like Finance Commission(FC), else while Planning Commission(PC) and the present NITI Aayog involved, people are only confused. Besides there are many formulae like the Gadgil-Mukherjee formula and Finance Commission formula. No, not over; we should also know about Special Category States!

Thanks to the recent efforts for greater flexibility for states, the center-state financial relations are not as complex as it was before. Things have changed from the days of Planning Commission. Many of the Central Assistance Plans have stopped or got subsumed into other awards.

1. States' share of taxes and Duties (As per Finance Commission recommendations)
2. Non-Plan Grants & Loans (As per Finance Commission recommendations)
3. Central Assistance for State & UT (with Legislature) Plans
4. Assistance for Central and Centrally Sponsored Schemes

In addition to this:

- Direct release of Central assistance for State/UT Plans to implementing agencies (MPLADS)
- Direct release under Central Plan to State/ District level autonomous bodies/implementing agencies – *Not applicable now.*
- Investments made from National Small Savings Fund in Special State Government Securities

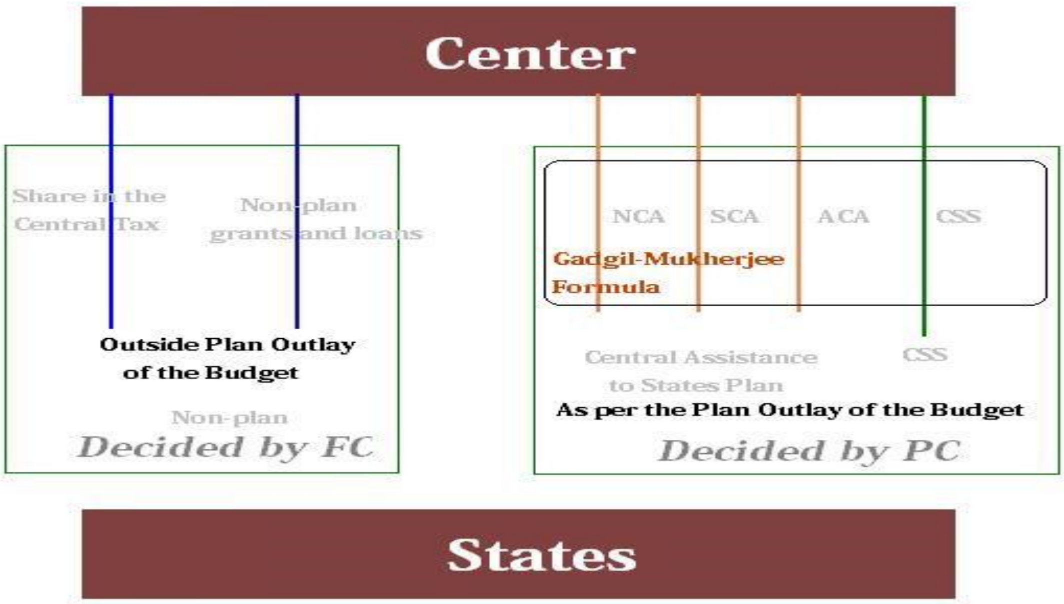
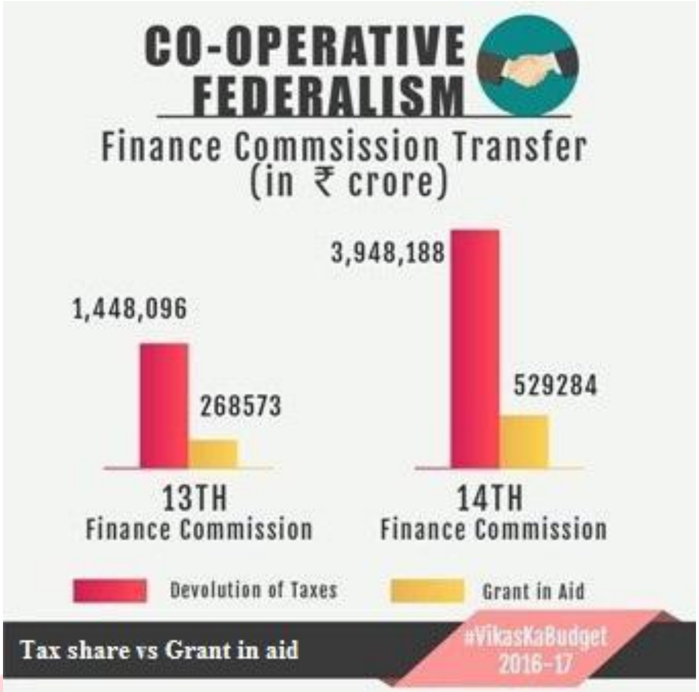


Figure: Centre-state transfers

(1) States' share of taxes and Duties



- 42% of the total share of tax of Union will go to states. This is as per the recommendations of the 14th Finance Commission.
- Note: The Finance Commission is required to recommend the distribution of the net proceeds of taxes of the Union between the Union and the States (commonly referred to as vertical devolution); and the allocation between the States of the respective shares of such proceeds (commonly known as horizontal devolution).
- Note: Among states, the horizontal distribution of tax revenue is determined by the 14th FC through a formula. The finance commission formula for horizontal devolution is as below:
    1. Fiscal capacity or Income Distance (~~47.5%~~ now 50%)
    2. Population 1971(~~25%~~ now 17.5%)
    3. Population 2011 (newly introduced by FFC – 10%)
    4. Area (~~10%~~ now 15%)
    5. ~~Fiscal discipline (17.5%)~~
    6. Forest cover (newly introduced by FFC – 7.5%)

- Update: 14th FC has taken out the 17.5% weightage given to fiscal discipline by 13th FC and allotted 7.5% to forests, additional 5% to area, additional 2.5% fiscal capacity and additional 2.5% to population.

(2) Non-Plan Grants & Loans – Finance Commission

- FC have provided **post-devolution revenue deficit grants for States** where devolution alone could not cover the assessed gap.
- While calculating grants to the States they "have departed significantly from previous Finance Commissions, by taking into consideration a States' entire revenue expenditure needs without making a distinction between Plan and Non-Plan". Taking thus into account the expenditure requirements of the States, the tax devolution to them, and the revenue mobilization capacity of the States, the FFC
- have recommended "Post-Devolution Revenue Deficit Grants" of a total of Rs. 1,94,821 crores, for the five year period.

- The States of Andhra Pradesh, Assam, J&K, Himachal Pradesh, Kerala, Manipur, Meghalaya, Mizoram, Nagaland, Tripura and West Bengal (a total of 11 States) have been identified for receiving these revenue deficit grants.
- Among 11 revenue-deficit states, Jammu and Kashmir will get the maximum grant of about Rs 60,000 crore in five-year period ending March 2020. As per the

  Recommendations, Himachal Pradesh will get Rs 40,625 crore while Andhra Pradesh will receive Rs 22,113 crore during the five-year period. Nagaland (Rs 18,475 crore) and West Bengal (Rs 11,760 crore) are also among top five beneficiary revenue deficit states.
- **Grants-in-Aid to States** *(Rs. crore)*

1	Local Government(all States)		287436
2	Disaster Management(all States)		55097
3	Post-devolution Revenue Deficit	(11 States)	194821
Total	**537354**		

Also read: UPSC CSE Mains 2017 General Studies 2 (GS 2) Question Paper

(3) Central Assistance for State & UT (with Legislature) Plans

Note: As FC have provided **post-devolution revenue deficit grants for States** where devolution alone could not cover the assessed gap, many of the Central Assistance Plans are subsumed in the award itself. But for the purpose of learning, it would be better if aspirants can go through the below table and see what was the case before.

Assistance to the States under State Plans were released as per the Scheme of Financing approved by the else while Planning Commission. Assistance is released for each scheme in a definite pattern as shown in the following table. Terms & Conditions for transfer of Central Plan Assistance to States from Ministry of Finance:

Plan Scheme	Nodal Ministry/Department recommending the release	Mode of transfer of funds	Criterion for release of funds	Grant Ratio
1. Normal Central Assistance (NCA)	M/o Finance Department of Expenditure	12 Monthly Installments	As per allocations made by Planning Commission	100% Grant

2. Additional Central Assistance (ACA) for Externally Aided Projects	M/o Finance, Department of Economic Affairs (CAA&A)	Weekly based on the recommendations of CAA&A	Based on the recommendations of CAA&A	1. Non-special category States: on Back-to-Back Basis (from 1.4.2005) 2. Special category States: NCA pattern
3. Special Central Assistance (SCA) for Hill Areas Development Programme (HADP) and Western Ghat Development Programme (WGDP)	Planning Commission	2 Installments at 75%, 25% of Annual allocation	1^{st} installment: on receipt of Sub-Plan / Annual Plan and 2^{nd} after 60% of the 1^{st}Installment has been utilized	90% of Project Cost
4. Special Plan Assistance	M/o Finance, Department of Expenditure	Lump sum	As per allocation / recommendation made by Planning Commission	NCA Pattern
5. Special Central Assistance (SCA)	M/o Finance, Department of Expenditure	Monthly installment	As per allocations made by the Planning Commission	NCA Pattern
6. Mission Mode Project (Treasury Computerization) under National E-Governance Action Plan (NEGAP)	M/o Finance, Department of Expenditure	3 Installments; 40%, 30% and 30%	1st installment 40% on approval of treasury computerization plan. 2nd installment 30% utilization of the amount released earlier on purchase of hardware/software, training of staff etc.3rd installment 30% on utilization of amount released earlier and state share of 25% & operationalization of all modules.	100% grant Central grant up to 90% of the project cost subject to Rs 90 lakh per district for North Eastern States and up to 75% of the project cost subject to Rs 75 lakh per district for other States.

Note: Normal Central Assistance, Special Plan Assistance, Special Central Assistance and Additional Central Assistance for other purposes are **subsumed** in the award of FC itself.

Also read: Indian Federalism - 15 Issues that Challenge the Federal Structure of India

Difference between Normal Central Assistance, Additional Central Assistance and Special Central Assistance:

Read carefully to understand where exactly Gadgil-Mukherjee formula was used.

(a) Normal Central Assistance(NCA):

70 percent of NCA will go to 18 states while 30 percent will go to **11 special category states**. The share of NCA is mostly as grants in case of special category states (90:10), while it being mostly loans in case of other states, ie 30:70 (grants: loans).

- **Special Category states** – For allocation among special category states, there are no explicit criteria for distribution. Funds are allocated on the basis of the state's plan size and previous plan expenditures.
- **Non-special Category States** – Gadgil Mukherjee formula: Allocation **between non-special category states** is determined by the **Gadgil Mukherjee formula**.

Gadgil Mukherjee formula – Gives weight to:

1. Population (60%)
2. Per capita income (25%)
3. Fiscal performance (7.5%)
4. Special problems (7.5%).

- However, as a proportion of total centre-state transfers NCA typically accounts for a relatively small portion (around 5% of total transfers).
- Note: PC dealt with the horizontal distribution of finance, ie between states. PC had say in announcing discretionary grants to certain states (Eg: Special Category States).
- Note: Finance Commission- Statutory Grants; Planning Commission – Discretionary Grants.

Special Category status and center-state finances

The concept of a special category state was first introduced in 1969 when the 5th Finance Commission sought to provide certain disadvantaged states with preferential treatment in the form of central assistance and tax breaks. Though initially only three states were grouped as special category states, now there are 11 states enjoying special category status. They are:

1. Assam
2. Nagaland
3. Jammu & Kashmir
4. Arunachal Pradesh
5. Himachal Pradesh
6. Manipur
7. Meghalaya
8. Mizoram

9. Sikkim
10. Tripura
11. Uttarakhand

The rationale for special status is that certain states, because of inherent features, have a low resource base and cannot mobilize resources for development. Some of the **features required for special status are:**

- (i) hilly and difficult terrain;
- (ii) low population density or sizable share of the tribal
- population; (iii) strategic location along borders with neighboring
- countries; (iv) economic and infrastructural backwardness; (v)
- non-viable nature of state finances.

Advantage of being tagged as special category:

Special category states also receive specific assistance addressing features like hill areas, tribal sub-plans, and border areas. Beyond additional plan resources, special category states can enjoy concessions in excise and customs duties, income tax rates and corporate tax rates as determined by the government.

(b) Special Central Assistance(SCA):

SCA were provided for special projects/programs e.g., Western Ghats Development Programme (WGDP), Border Areas Development Programme etc. This special plan assistance is given **only to special category states** to bridge the gap between their Planning needs and resources. In other words, SPAs are Additional Central Assistance (ACA) to special category States. Special Plan Assistance (SPA) is provided to the Special Category States for funding of projects identified by the States that are not covered by any Central scheme and for non-recurrent expenditure of a developmental nature, based on the recommendation of the Planning Commission. From 01.04.2015 onwards, there is no allocation under SPA and SCA (untied).

Also read: Indian Economy : Growth, Development and Employment

(c) Additional Central Assistance(ACA):

This is provided for implementation of externally aided projects (EAPs), and for which presently there is no ceiling. There can be one time ACA and advance ACA. Just like Centrally Sponsored Schemes, Center give funds to aid projects in states through the ACA route.

Note: The term Plan Grants (Block Grants) consists of Normal Central Assistance (NCA), Backward Regions Grant Fund (BRGF)- Scheme (State Component), Additional Central Assistance (ACA) for Externally Aided Projects (EAPs), Special Central Assistance (SCA), Special Plan Assistance (SPA), etc. States had full flexibility in utilising this. Since 2015-16, pursuing the recommendations of the 14th Finance Commission, some of the schemes like NCA, SCA (untied), SPA, Additional Central Assistance for Other Projects (ACAOP), Other ACA, SCA for Hill Areas Development Programme (HADP/WGDP), SCA under Backward

Regions Grant Fund (BRGF), National e-governance Plan (Mission mode project) and ACA for Left-wing Extremism (LWE) Affected Districts have been discontinued or subsumed under higher devolution of taxes.

(4) Assistance for Central and Centrally Sponsored Schemes

The erstwhile Planning Commission used to allocate funds for ACA (assistance for externally aided projects and other specific project) and funds for Centrally Sponsored Schemes (CSS). State-wise allocation of both ACA and CSS funds are prescribed by the centre.

Central Schemes and Centrally Sponsored Schemes(CSS) are already discussed in detail in the previous posts. The central government has been trying to restructure many of the CSS and to limit its number. Most of the states prefer direct funds which offer greater flexibility. CSS offers less flexibility.

The Changes: NITI Aaayog, 14th Finance Commission Recommendations etc.

Summary: 14th Finance Commission (FFC) substantially enhanced the share of the States in the Central divisible pool from the current 32 % to 42 %, which is the biggest ever increase in vertical tax devolution. Such tax devolution is untied and can be spent as desired by the States.

FC provides **post-devolution revenue deficit grants for States** where devolution alone could not cover the assessed gap. Normal Central Assistance, Special Plan Assistance, Special Central Assistance and Additional Central Assistance for other purposes are **subsumed** in the award itself.

CSS is now the biggest component of central assistance to state plans and is now synonymous to Central Assistance (CA).