Impact of the Recommendations of the 14th FC: Central Transfers and Social Sector Expenditures in the 1st Year

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Impact of the Recommendations of the Fourteenth Finance Commission: Central Transfers and Social Sector Expenditures in the First Year

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Abstract

Recent evidence on the impact of the recommendations of the Fourteenth Finance Commission (FFC) suggests that there has been an increase in Central transfers and social sector expenditures in a number of States in 2015-16, the first year of the FFC award period. We argue that the evidence on gains through Central transfers and increases in social sector expenditures is biased upwards because of two factors. First, much of the gains have been measured with respect to a low base year, and secondly, inferences have been drawn based on comparisons between *Actuals* and *Revised Estimates* or *Revised Estimates* and *Budget Estimates*. Comparing *Revised Estimates* for the same years for fifteen major States, we find that Central transfers and expenditures on Social Services as per cent of Gross State Domestic Product (GSDP) are likely to fall in a number of States. Besides, in most States, Social Services have received a lower priority than Economic Services in the first year of the FFC award period.

Keywords: Fourteenth Finance Commission, Central Transfers, Social Sector Expenditures

JEL classification codes: H72, H77

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1. Introduction

The recommendations of the Fourteenth Finance Commission (FFC) have important implications for revenues and expenditures of State Governments. The share of States in divisible pool of taxes has increased from 32 to 42 per cent following the FFC recommendations: an increase much higher than the levels recommended by the previous Finance Commissions.[2] To accommodate this increase, the Union Government was expected to reduce conditional transfers to States in the form of grants, as the available fiscal space was inadequate to absorb the increase in tax devolution.[3] The reduction in grants, however, has been an issue of concern as much of the grants relate to Centrally Sponsored Schemes (CSS), which were initiated to support expenditures in social sectors and development of infrastructure. Although increased tax devolution has provided the States with untied resources to compensate the loss in grants, questions on what has been the net gain in resources at the State-level (after compensating the loss), and how have individual States used the increased untied resources to meet their fiscal priorities have remained matters of empirical investigation.

The FFC recommendation for increasing tax devolution to States was primarily intended to bring about a shift in the composition of Central transfers to States. With increased tax devolution, it was expected that States will receive a larger volume of untied funds relative to tied funds, and this will enhance the States' autonomy in deciding their expenditure priorities. Much of the tied transfers to States were towards CSS, which were initiated by the Central Government, but required a 'matching contribution' of funds from States. It has been pointed out by various State Governments that the requirement of matching contribution in most CSS schemes had squeezed the fiscal space of States.[4] Many of the CSS schemes were also on subjects in the 'State' and 'Concurrent' Lists of the Indian Constitution, and an expansion of these schemes have led to an increase in the Union Government's expenditure on subjects other than the 'Union' List.[5] The increased tax devolution, therefore, was not only expected to provide States with a greater degree of expenditure autonomy, but also allow the Union Government to focus more on areas that are constitutionally enlisted in the 'Union list'. The net gain or loss of resources in States will be determined by the relative increase or decrease of untied and tied funds in States. Transfers are

2 The shares of 32 to 42 per cent are not strictly comparable. The 32 per cent recommended by the Thirteenth Finance Commission (TFC) was for meeting States' non-plan revenue expenditure alone. The 42 per cent recommended by the Fourteenth Finance Commission (FFC) was meant for meeting expenditure needs of the revenue account of States (which includes both plan and non-plan). Even if one uses comparable figures, the increase in aggregate transfers to States is likely to be of the order of 3 to 4 per cent.

3 The limited fiscal space with the Union Government for increasing the share of aggregate transfers to States has been pointed out in page 90 of Volume I of the report of the Fourteenth Finance Commission.

4 Report of the Fourteenth Finance Commission, Volume I.

5 Chakraborty Pinaki (2015), "Getting Federal Transfers Right", Opinion, *The Hindu*, May 8th.

also affected by changes introduced by FFC with respect to the criteria for horizontal distribution of resources across States. The net gain or loss of transfers in States depends on the combined effect of changes in tax devolution, grants and the criteria for horizontal distribution of resources among States.[6]

Recent evidence on receipts of Central transfers in States, almost unanimously suggests a net gain in resources following the FFC recommendations. Studies on Bihar and Odisha have shown that the estimated gain from increased tax devolution is likely to be more than adequate to compensate for the loss of grants (Chakraborty, 2016; Odisha Budget and Accountability Centre, 2015). In Maharashtra too, the increased tax devolution is likely to have expanded the fiscal space (Shetty, 2016). A more recent and broader study of 19 States for the first year of the award period of FFC has also shown that there has been a substantial increase in resources in almost every State in the first year of the FFC award period (Accountability Initiative, 2016). Similarly, a World Bank study for 20 States showed that in almost all the States, there has been a net gain in resources following the FFC recommendations (World Bank, 2016). The only contrasting evidence is provided by an early study in Karnataka, which showed that the gain in share of taxes in the State was unlikely to compensate for the loss in grants in the first year of the FFC award period (Kotasthane and Ramachandra, 2015). However, a more recent study by the same authors using updated information suggests that even in Karnataka, there is likely to be a net gain in resources (Kotasthane and Ramachandra, 2016). Additionally, it has been pointed out that social sector expenditures are likely to increase in almost every State allaying concerns of any adverse impact on social sector at the State-level following the FFC recommendations (Accountability Initiative, 2016). Specifically, expenditures on health and education are likely to increase in various States (World Bank, 2016). The existing studies on the issue are associated with two important problems. First, much of the evidence is based on a year to year comparison between 2014-15 (the last year of the Thirteenth Finance Commission (TFC) award period) and 2015-16 (the first year of the FFC award period). In all the existing studies, the base year for measuring changes in the first year of FFC has, therefore, been with reference to a single year 2014-15 of the TFC period. This is because comparable State-level figures of transfers and expenditures prior to 2014-15 are not available from budgets. Till 2013-14, much of the grants under CSS were not routed through the State treasuries and were not captured in budgetary figures of the State governments.[7] Since the last year of TFC (2014-15), these grants are being routed through State treasuries and are captured in budgetary figures. Thus, 2014-15 is the only year in the TFC period in which budgetary data on transfers and

[6] The term 'horizontal distribution' refers to the inter-se distribution of funds among States. This distribution is done based on a formulae recommended by the Finance Commission. The formulae determines the share of each State in the total pie of resources for States out of the divisible pool.
[7] These grants were being released directly to implementing agencies.

expenditures are comparable with the FFC years, and studies have used 2014-15 as the base for measuring changes in the FFC period. This may be problematic if the values for 2014-15 are unusually high or low with respect to the average of the TFC period. Secondly, the existing evidence on increase in Central transfers and social sector expenditures is likely to be biased upwards because of systematic differences in the nature of estimates used for the analyses. Much of the evidence is based on a comparison of *Actuals* to *Revised Estimates* or *Revised Estimates* to *Budget Estimates* of transfers and expenditures between 2014-15 and 2015-16. As *Actual Estimates* for both these years are not yet available, early studies have compared *Revised Estimates* for 2014-15 with *Budget Estimates* for 2015-16. More recent studies have compared *Actuals* for 2014-15 with *Revised Estimates* for 2015-16. Notably, in any year, almost invariably, *Actuals* are lower than *Revised Estimates*, and *Revised Estimates* are lower than *Budget Estimates*. A comparison of *Revised Estimates* of any year with *Budget Estimates* of the next year, therefore, induces an upward bias in the measurement of gains. Similarly, a comparison of *Actuals* of any year with *Revised Estimates* of the next year inflates the gains.

In this paper, we add to the existing analysis in two ways. First, using Union budgets we provide a comparison of aggregate share of resources devolved to States by the Union Government in 2014-15 with respect to the other years of the Thirteenth Finance Commission period. This enables us to put into perspective the existing evidence on State-level changes in the first year of the FFC award period (which has been measured with respect to a single year 2014-15) vis-a-vis the average of the TFC period. Secondly, we attempt to highlight the upward bias in existing evidence that has been induced because of systematic differences between *Actuals*, *Revised Estimates* and *Budget Estimates*. In particular, we provide a comparison of *Revised Estimates* for 2014-15 with *Revised Estimates* for 2015-16 in States. Using this approach, we revisit two questions: (a) what has been the net gain in Central transfers to States following the recommendation of FFC and (b) how has social sector expenditures fared in States following the FFC recommendations? Further, we compare the changes in expenditure on Social Services vis-a-vis Economic Services in States to examine the relative priorities of States in the two services in the first year of the FFC award period.

2. Data Sources

Information on Central transfers and expenditures pertaining to 15 major States for the years 2014-15 and 2015-16 has been drawn from State budgets for this analysis.[8] Unless mentioned otherwise, all comparisons between 2014-15 and 2015-16 in States are based on *Revised Estimates* for both the years.[9] For aggregate Central transfers to States, Gross Tax Revenues of the Union Government (net of cost of tax collection), and tied and untied transfers from the Union Government, information has been compiled from Union Budget documents for various years.

3. Changes in Aggregate Transfers

3.1 Quantum of Transfers

Analysis suggests that increase in aggregate transfers to States from the Union government in the first two years of the FFC award period has been relatively small (Figure 1). The share of States in Gross Tax Revenues of the Union Government has increased by 2 percentage points in 2015-16 (the first year of the FFC award period) over the previous year 2014-15 (Figure 1).[10] Notably, transfers in 2014-15 (the base year from which increase has been measured) were particularly low (Figure 1). In 2014-15, transfers as proportion of Gross Tax Revenues of the Union Government was the lowest among all the years in the Thirteenth Finance Commission period (Figure 1). The 2 per cent increase in transfers to States since 2014-15 is a marginal recovery from a fall of around 8 per cent since the beginning of the TFC period (Figure 1). In fact, figures for earlier years provided in the FFC report suggest that the level of transfers to States in 2014-15 was the lowest since 2008-09.[11] Part of the increase in 2015-16 over 2014-15 is, therefore, because of measurement from a low base. In the second year of the FFC award period (2016-17) too, budget estimates for aggregate transfers do not show any significant increase over 2015-16 (Figure 1). Thus, increase in aggregate transfers in the first two years of FFC period has not been particularly higher than the average of the TFC period.

The low increase in aggregate transfers indicated in Union budget, is also reflected in transfers reported in State budgets. A State-wise comparison of *Revised Estimates* of transfers between 2014-15 and 2015-16, suggest that the increases in transfers vary between 2 to 20 per

8 Telangana was carved out of Andhra Pradesh in June 2014. The accounts of these States for the financial year 2014-15 are therefore, not strictly comparable with other States. The two States have therefore, been excluded from this analysis.

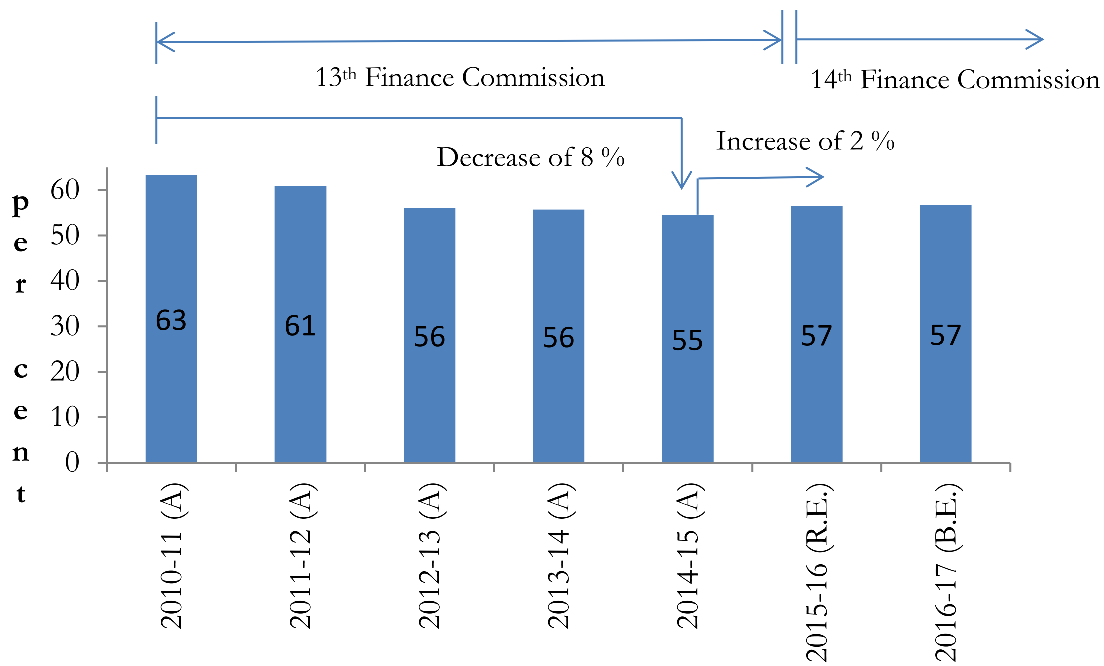
9 It may be noted that *Revised Estimates* are based on *Actual* figures for at least three quarters of the financial year, and estimates for the fourth quarter.

10 Gross Tax Revenue (GTR) of the Union Government in this analysis is net of cost of tax collection.

11 Report of the Fourteenth Finance Commission, Volume I, Page 52.

cent in nominal terms (except Haryana and Kerala) (Figure 3). In 7 of the 15 States for which GSDP deflators are available, the changes in real terms vary from a fall of 4 per cent in Karnataka to an increase of about 10 per cent in Jharkhand (Figure 4).[12] The magnitude of these increases is much smaller than the extent of increases (21 to 65 per cent) documented in the study by Accountability Initiative (2016), using comparisons of *Actuals* to *Revised Estimates* (Figure 2). Also, it is important to recognize that as the gains or losses in aggregate transfers to States are measured in this study relative to the base year 2014-15, as in all existing studies because of non-availability of comparable figures for earlier years. With the Union budget indicating that aggregate transfers to States in 2014-15 was one of the lowest in recent times, even the relatively low gains documented here are partially because of measurement from a low base year.

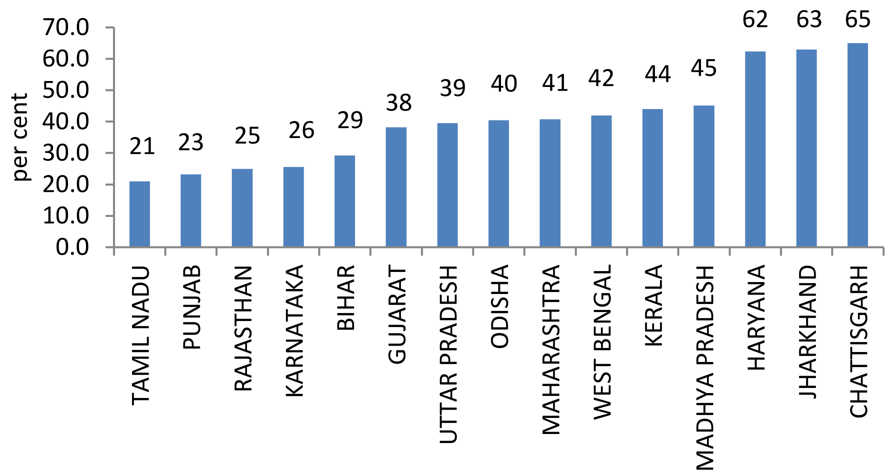
Figure 1:. Aggregate transfers to States as per cent of Gross Tax Revenues (GTR) of the Union Government (net of cost of tax collection)



Source: Budget Document of the Union Government for various years

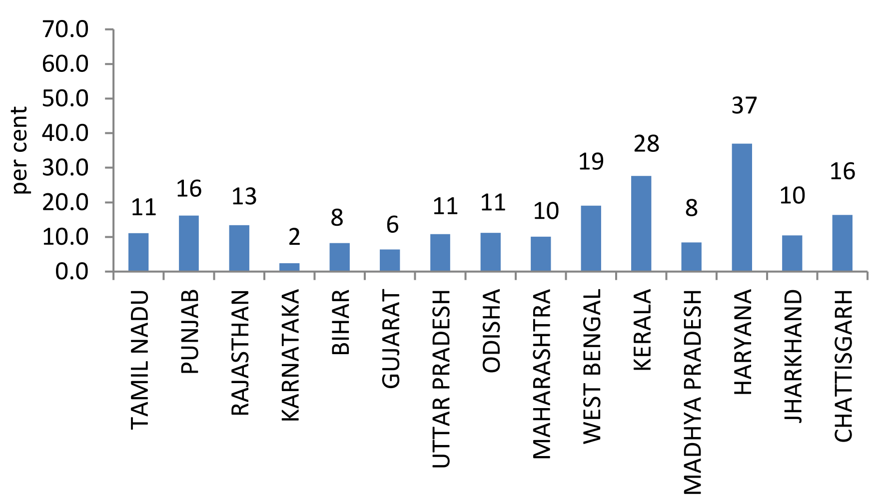
[12] The seven States for which GSDP deflators are available include Bihar, Jharkhand, Karnataka, Madhya Pradesh, Odisha, Tamil Nadu and Uttar Pradesh. Figures on GSDP deflators have been computed using information provided by the Central Statistics Office (CSO) as on 27/07/2016.

Figure 2: Percentage change in Central Transfers in 2015-16 (R.E.) over 2014-15 (Actuals)



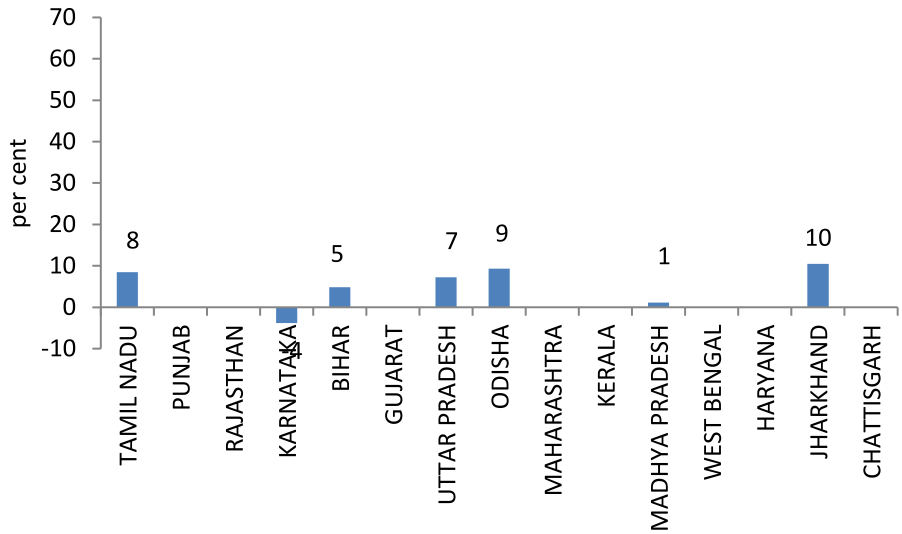
***Source**:* State Budget Documents for 2016-17

Figure 3:. Percentage change in Central Transfers in 2015-16 (R.E.) over 2014-15 (R.E.)



***Source*:** State Budget Documents for the years 2015-16 and 2016-17

Figure 4:. Percentage change in Central Transfers in 2015-16 (R.E.) over 2014-15 (R.E.) at constant (2011-12 prices) in selected States



***Source*:** Central transfers have been sourced from State Budget Documents for the years 2015-16 and 2016-17. GSDP deflators have been sourced from CSO.

The increase in Central transfers could be partly because of an increase in the revenue base reflected in GSDP. To control for this, we examine the changes in transfers as per cent of GSDP between 2014-15 and 2015-16.[13] Figures indicate that the ratio of Central transfers to GSDP is likely to either fall or remain unchanged in at least 7 of the 15 States under analysis (Table 1). The fall is likely to be significant in the two States of Bihar and Madhya Pradesh. In contrast, Chhattisgarh is likely to gain significantly. In most of the remaining States, the gain or loss is marginal: around 0.5 per cent of GSDP or less. Notably, again, a State-wise comparison of transfers to GSDP ratios using comparisons of *Actual* and *Revised Estimates* in an earlier study indicated much higher gains (World Bank, 2016).

[13] Figures of GSDP in 2015-16 have been taken from budget documents of respective State Governments. For GSDP in 2014-15 data have been taken from the Central Statistics Office (CSO). The ratios are not comparable across States as the GSDP figures provided in State budget documents of 2016-17 are with respect to the 2004-05 GSDP series for some States and 2011-12 GSDP series for others. Within States, the changes are measured with respect to the same base of GSDP series.

Table 1: Central Transfers as per cent of GSDP between 2014-15 (R.E.) and 2015-16 (R.E.)

States	2014-15 (R.E.)	2015-16 (R.E.)	Increase/Decrease
Bihar	16.7	14.9	-1.8
Chhattisgarh	10.4	11.4	1.0
Gujarat	3.1	3.0	-0.1
Haryana	2.3	2.7	0.4
Jharkhand	12.6	12.2	-0.4
Karnataka	5.2	5.0	-0.2
Kerala	3.4	3.8	0.4
Madhya Pradesh	11.0	10.0	-1.0
Maharashtra	2.7	2.7	0.006
Odisha	11.9	12.3	0.4
Punjab	3.0	3.2	0.1
Rajasthan	7.1	7.3	0.2
Tamil Nadu	3.5	3.5	0.004
Uttar Pradesh	12.8	13.0	0.2
West Bengal	6.8	7.0	0.3

Source: Central transfers have been taken from State Budget Documents for the years 2015-16 and 2016-17. Figures of GSDP in 2015-16 have been taken from budget documents of respective State Governments. For GSDP in 2014-15 data have been taken from the Central Statistics Office (CSO).
Note: The ratios are not comparable across States as the GSDP figures provided in State budget documents of 2016-17 are with respect to the 2004-05 GSDP series for some States and 2011-12 GSDP series for others. Within States, the changes are measured with respect to the same base of GSDP series.

3.2 Composition of Transfers

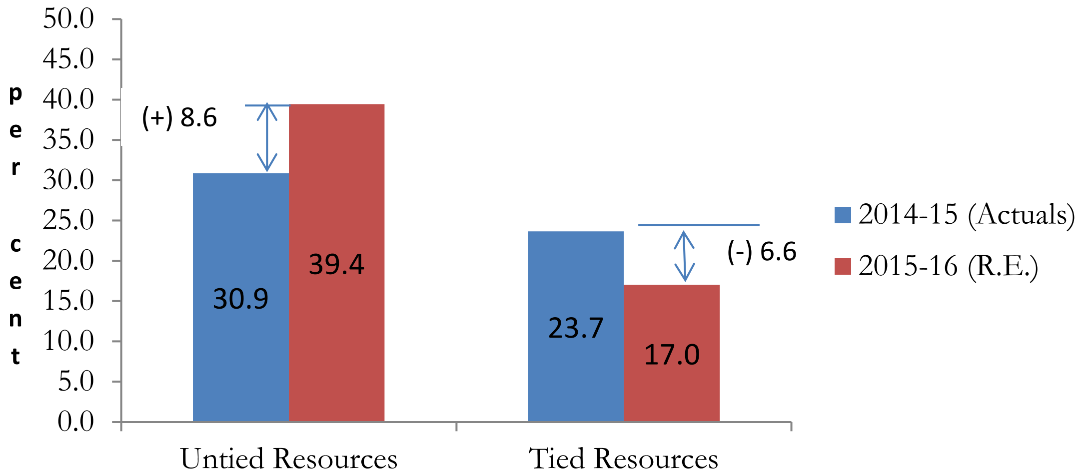
With little fiscal space available with the Union Government to increase aggregate transfers, the increased tax devolution was primarily intended to change the composition of Central transfers to States. It was expected that the Union Government would withdraw some of the transfers on CSS schemes and reduce tied transfers to States. Untied transfers were expected to rise because of increase in the share of tax devolution. Thus, the composition of transfers to States was expected to change in favor of more untied resources.

As expected, there has been a reduction in conditional (tied) transfers and an increase in unconditional (untied) transfers to States between 2014-15 and 2015-16.[14] As per cent of Gross Tax Revenues of the Union Government, tied transfers reduced by 6.5 per cent while untied transfers increased by 8.5 per cent between the two years (Figure 5). The net increase of 2 per cent reflects the additional transfers to States in 2015-16. The decline in tied transfers has been largely brought about through a reduction of resources for CSS schemes as was recommended by FFC (Figure 6). The reduced volume of resources for CSS schemes by the Union Government is also mirrored in a decline in tied plan transfers at the state-level in almost all States (with the

[14] Here, untied transfers include States' share in taxes, Normal Central Assistance, Revenue deficit grants and grants for compensation to states for VAT/CST. Tied transfers include all transfers excluding those included in untied transfers.

exception of Tamil Nadu) (Figure 7).[15] Notably again, the decline in tied plan grants at the State-level documented here is based on a comparison of *Revised Estimates* between 2014-15 and 2015-16. This is in contrast to the evidence of significant increases in tied plan transfers (predominantly CSS) to States based on a comparison of *Actuals* to *Revised Estimates* for the two years provided in a study by Accountability Initiative (2016).

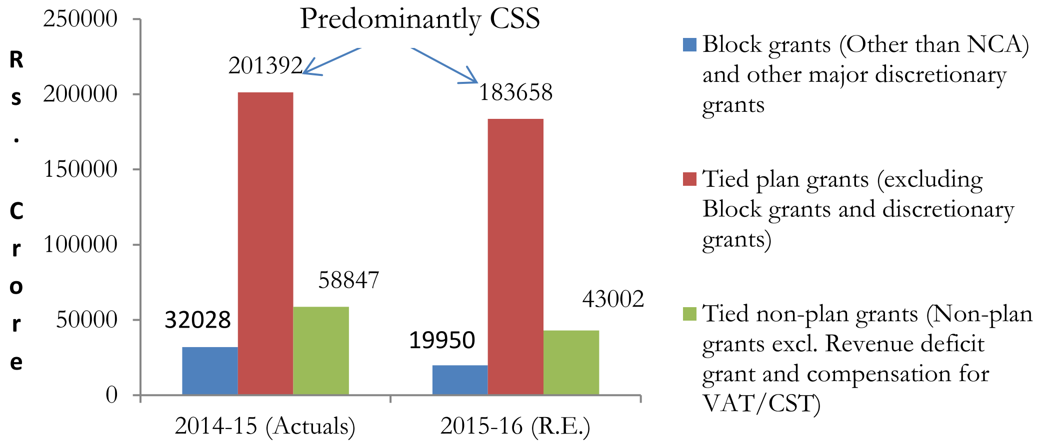
Figure 5:. Untied and Tied Transfers to States as per cent of Gross Tax Revenues (GTR) of the Union Government (net of cost of tax collection)



***Source**:* Budget Document of the Union Government for various years
Note: Untied Resources: States' share in taxes + Normal Central Assistance + Revenue deficit grants + Compensation for VAT/CST . **Tied Resources:** All transfers other than untied resources

[15] Tied plan transfers at the State-level refer to all plan grants other than Normal Central Assistance

Figure 6: Changes in 'tied grants' transferred to States between 2014-15 (Actuals) and 2015-16 (R.E.)



***Source**:* Budget Document of the Union Government for various years

Notes:

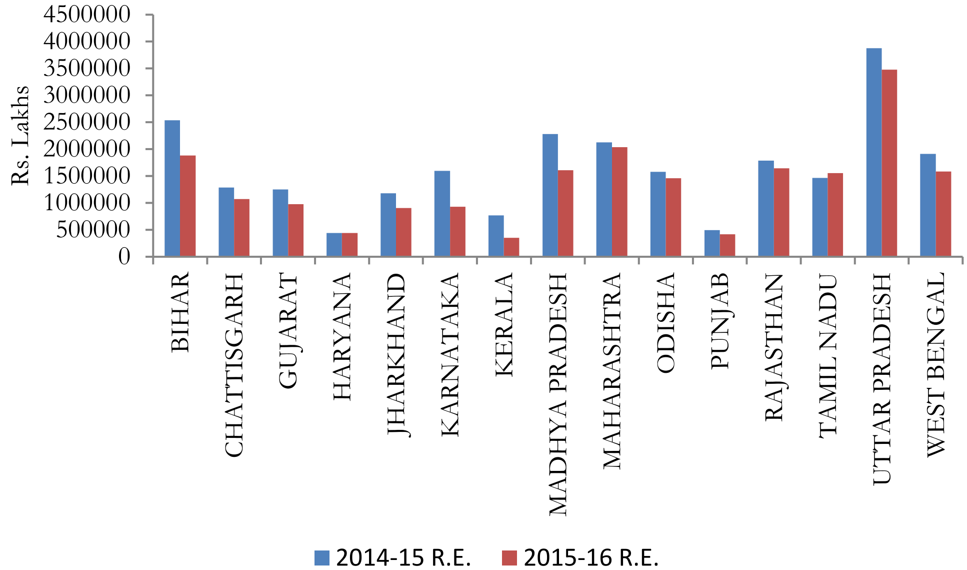
Block Grants include

(a) Normal Central Assistance
(b) Additional Central Assistance for externally-aided/other projects,
(c) Special Central Assistance
(d) Special Central Assistance – Hill Areas
(e) Special Plan Assistance
(f) National E-Governance Action Plan (NEGAP)
(g) Backward Regions Grant Fund
(h) Additional Central Assistance for LWE affected districts
(i) Other Additional Central Assistance

Discretionary Grants include

(a) Special assistance: A budgetary provision earmarked for spillover committed liabilities for area specific schemes/projects for which budget provision has not been made after the implementation of FFC for need-based assistance to the States because of varying socio-economic geographic factors
(b) Grants to Autonomous Councils and areas covered under the sixth schedule of the Constitution: Support to areas covered under the sixth schedule of the Constitution as these have not been covered by the FFC in order to bring such areas at par with other areas
(c) Central Pool of Resources for N-E Region and Sikkim
(d) Schemes of N-E Council
(e) Plan Schemes under provision to article 275 (1) of the Constitution
(f) Special Central Assistance to Tribal Area sub-plan
(g) Special Central Assistance to Scheduled Castes sub-plan

Figure 7*:* Receipts of 'tied plan grants' in States in 2014-15 (R.E.) and 2015-16 (R. E.)



Source: Respective budgets of the State Governments
Note: Tied plan transfers at the State-level refer to all receipts under plan grants other than Normal Central Assistance (NCA)

4. Impact on Social Sector Expenditures

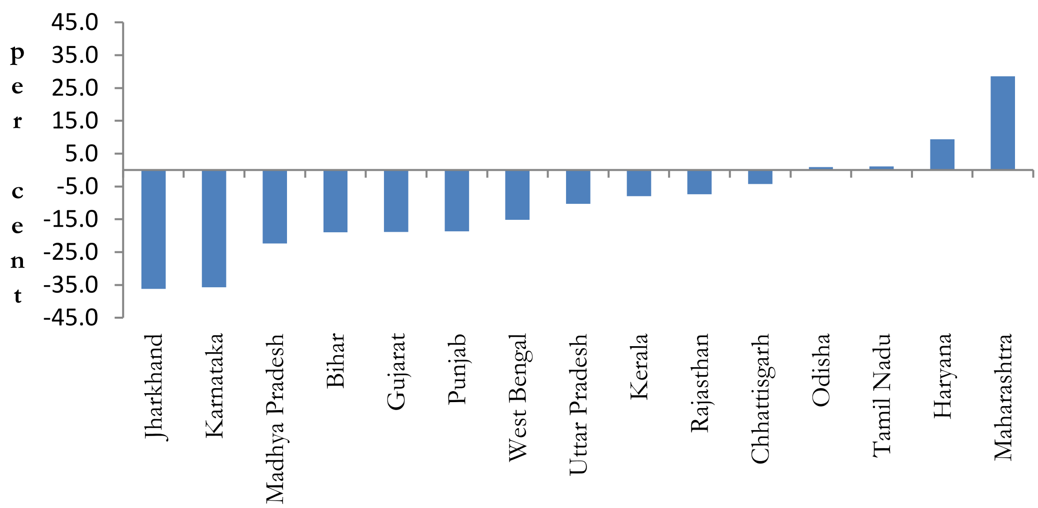
The decline in tied plan grants from the Union Government has resulted in a contraction in the volume of transfers for the social sector.[16] A comparison of the *Revised Estimates* of grants for social sector between 2014-15 and 2015-16 suggests that Central transfers in social sectors fell in 11 of the 15 major States (Figure 8). It may be noted that a part of the grants under schemes like Tribal Sub-plan, Border Areas Development Programme, Special Component Plan for Scheduled Castes, etc. are also used for social sector expenditures. However, differences in the level of disaggregation at which these grants are reported in State budgets make it difficult to identify and compare the portion of these grants that is earmarked for social sector expenditures. In most States, the amount of such grants that cannot be identified with any sector account for less than 8 per cent of total Central grants. Only in a few states like Jharkhand, Chhattisgarh and Maharashtra, these constitute more than 20 per cent. Even if we consider and add all such grants to transfers for the social sector, Central grants for the social sector have declined in 13 of the 15 major States.

[16] The term 'Social sector' in this analysis includes expenditure under the budgetary heads of 'Social services' and 'Rural Development'. Correspondingly, the term 'Economic Services' here excludes 'Rural Development'. We include 'Rural Development' in Social sector as much of the employment generation and poverty alleviation schemes are included under this head.

Most States have compensated for the decline in Central grants for the social sector through additional allocations. Between 2014-15 and 2015-16, expenditures in social sector increased in all States except Bihar, despite the decline in Central grants for social sector (Figure 9). The range of increases lies between 3.5 per cent and 21 per cent in nominal terms (Figure 9). For the 7 States for which GSDP deflators are available, estimates of real increases vary from 2 per cent in Madhya Pradesh to around 17 per cent in Uttar Pradesh (at 2011-12 prices). In real terms, social sector expenditures are likely to fall in both Bihar and Karnataka.

To examine whether social sector expenditures have kept pace with growth of States' own GSDP, we analyzed social sector expenditure to GSDP ratio in States.[17] Figures suggest that increases in social sector expenditures have not kept pace with growth in States' GSDP. In most States, social sector expenditures are likely to decline as per cent of GSDP between the two years (Figure 10).

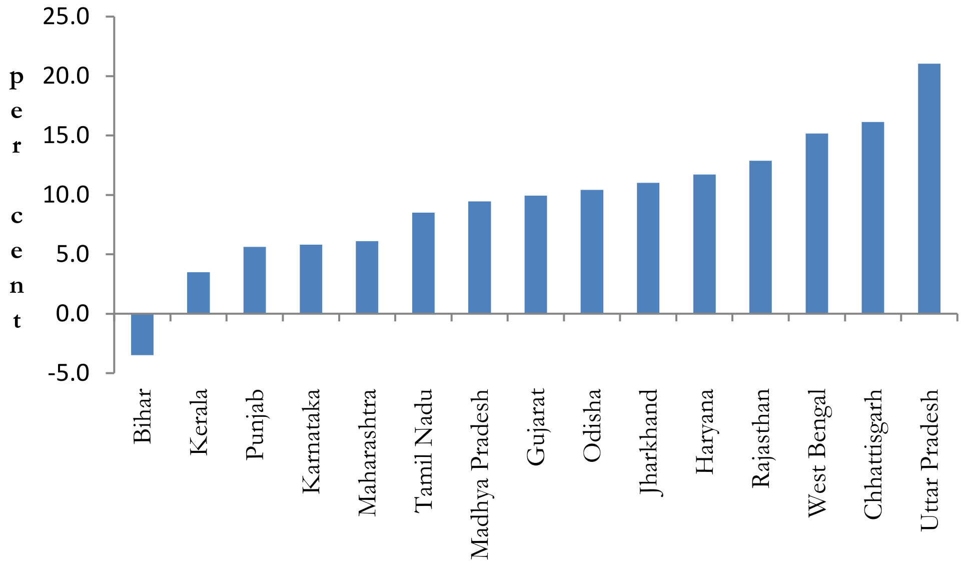
Figure 8:. Percentage change in Central Transfers for Social Sector in 2015-16 over 2014-15 (Comparison of Revised Estimates)



Source: State Budget Documents for the years 2015-16 and 2016-17

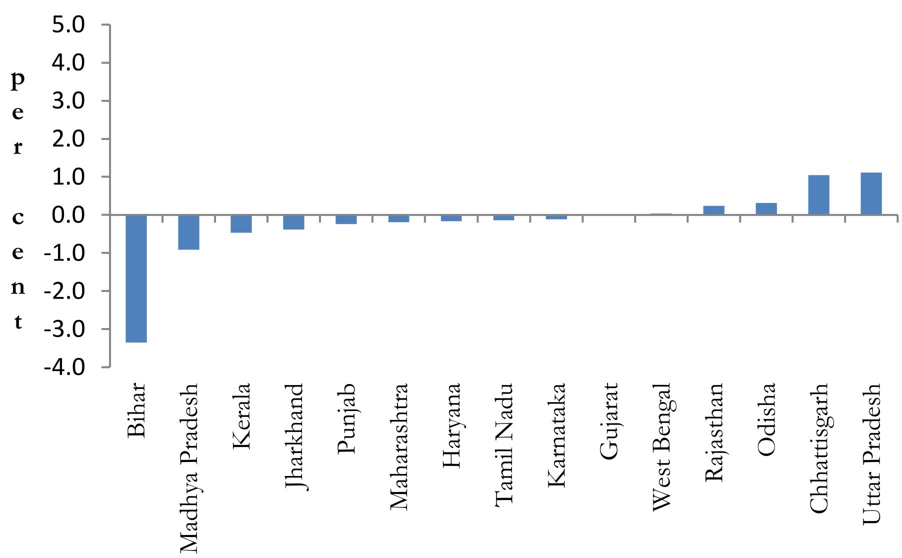
[17] Figures of GSDP in 2015-16 have been taken from the budget documents of respective State Governments. For GSDP in 2014-15 data have been taken from the Central Statistics Office (CSO). The ratios are not comparable across States as the GSDP figures provided in State budget documents of 2016-17 are with respect to the 2004-05 GSDP series for some States and 2011-12 GSDP series for others. Within States, the changes are measured with respect to the same base of GSDP series.

Figure 9: Percentage change in Social Sector expenditures in 2015-16 over 2014-15 (Comparison of Revised Estimates)



Source: State Budget Documents for the years 2015-16 and 2016-17

Figure 10: Change in Social Sector expenditures (as per cent of GSDP) in 2015-16 over 2014-15 (Comparison of Revised Estimates)



Source: Figures of social sector expenditures have been taken from the State budget documents for the years 2015-16 and 2016-17. Figures of GSDP in 2015-16 have been taken from budget documents of respective State Governments. For GSDP in 2014-15 data have been taken from the Central Statistics Office (CSO).
Note: The ratios are not comparable across States as the GSDP figures provided in State budget documents of 2016-17 are with respect to the 2004-05 GSDP series for some States and 2011-12 GSDP series for others. Within States, the changes are measured with respect to the same base of GSDP series.

It is important to note that Central grants for the social sector account for a relatively small portion of social sector expenditures in States. Even in 2014-15, (i.e. prior to the implementation of FFC recommendations) Central grants for the social sector accounted for around a third of the total social sector expenditures in the eight relatively more centrally dependent States (Table 2).[18] For other States the contribution was even smaller. The changes in social sector expenditures are, therefore, determined to a large extent by States' own revenue and fiscal priorities. In a number of States, States' own revenues to GSDP ratio has also fallen between 2014-15 (R.E.) and 2015-16 (R.E.), and this is likely to have affected social sector expenditures as well.

Table 2: Central Transfers for social sector as a proportion of Social Sector Expenditures in States, 2014-15 and 2015-16 (per cent)

States	2014-15 (R.E.)	2015-16 (R.E.)
Bihar	36.1	28.0
Chhattisgarh	42.8	29.5
Gujarat	17.7	12.5
Haryana	11.1	11.5
Jharkhand	40.2	31.4
Karnataka	23.8	14.6
Kerala	20.5	17.8
Madhya Pradesh	34.0	24.1
Maharashtra	20.1	15.8
Odisha	35.0	31.2
Punjab	19.2	14.8
Rajasthan	24.9	20.6
Tamil Nadu	20.9	19.3
Uttar Pradesh	38.3	25.9
West Bengal	30.7	22.3

Source: State budget documents for the years 2015-16 and 2016-17

Importantly, in most States, expenditures on Social Services have received a lower priority than Economic Services in the first year of the FFC period. In a number of States where expenditures have declined in both Economic and Social Services (as per cent of GSDP), the decline has been more in Social Services than Economic Services (Table 3). These include States like Bihar, and Maharashtra. In other States like Karnataka, Madhya Pradesh, Haryana, Kerala and Punjab, while expenditure in Social Services has fallen, expenditure in Economic Services has risen. In Uttar Pradesh, Chhattisgarh, Odisha and Rajasthan, where expenditure in both Social and Economic Services has shown a rise, the increase in expenditure towards Economic Services has been higher than the expenditure in Social Services. On the whole, in 11 out of the 15 States under

[18] The eight relatively more centrally dependent States include Bihar, Uttar Pradesh, Jharkhand, Chhattisgarh, Madhya Pradesh, Rajasthan, Odisha and West Bengal. In these States, Central transfers constitute a relatively high proportion of total revenue receipts of States.

analysis here, expenditure in Economic Services has been relatively higher than Social Services. Even among the eight relatively more centrally dependent States[19], in six States expenditure towards Social Services has been lower than Economic Services.

Table 3: Changes in selected indicators of revenue receipts and expenditures in major States between 2014-15 and 2015-16 (per cent of GSDP)

	Bihar			***Chhattisgarh***		
	2014-15 (R.E.)	**2015-16 (R.E.)**	**Change**	**2014-15 R.E.)**	**2015-16 R.E.)**	**Change**
Total Revenue Receipts	23.8	20.6	-3.2	20.8	23.4	2.7
Total Central Transfers	16.7	14.9	-1.8	10.4	11.4	1.0
Total Expenditure	31.8	26.3	-5.5	23.1	26.1	3.0
Expenditure on Social Services (incl. RD)	16.5	13.1	-3.4	11.3	12.3	1.0
Expenditure on Economic Services	7.1	6.0	-1.1	7.6	8.9	1.3
	Jharkhand			**Madhya Pradesh**		
	2014-15 (R.E.)	**2015-16 (R.E.)**	**Change**	**2014-15 R.E.)**	**2015-16 (R.E.)**	**Change**
Total Revenue Receipts	22.2	21.5	-0.7	20.6	18.3	-2.3
Total Central Transfers	12.6	12.2	-0.4	11.0	10.0	-1.0
Total Expenditure	24.2	23.0	-1.1	22.1	21.1	-1.0
Expenditure on Social Services (incl. RD)	12.4	12.0	-0.4	10.8	9.9	-0.9
Expenditure on Economic Services	5.6	4.9	-0.7	5.7	5.7	0.01
	Odisha			**Rajasthan**		
	2014-15 (R.E.)	**2015-16 (R.E.)**	**Change**	**2014-15 R.E.)**	**2015-16 (R.E.)**	**Change**
Total Revenue Receipts	20.5	21.5	1.0	15.8	15.8	0.05
Total Central Transfers	11.9	12.3	0.4	7.1	7.3	0.2
Total Expenditure	23.4	24.5	1.1	19.6	20.1	0.5
Expenditure on Social Services (incl. RD)	10.7	11.0	0.3	9.7	10.0	0.2
Expenditure on Economic Services	6.5	7.5	0.9	5.1	5.4	0.3
	Uttar Pradesh			**West Bengal**		
	2014-15 (R.E.)	**2015-16 (R.E.)**	**Change**	**2014-15 R.E.)**	**2015-16 (R.E.)**	**Change**
Total Revenue Receipts	22.9	23.2	0.3	12.0	11.9	-0.1
Total Central Transfers	12.8	13.0	0.2	6.8	7.0	0.3
Total Expenditure	25.7	28.4	2.7	15.0	14.7	-0.3
Expenditure on Social Services (incl. RD)	10.3	11.4	1.1	7.3	7.4	0.04
Expenditure on Economic Services	6.8	8.4	1.6	2.1	2.1	0.03
	Gujarat			**Haryana**		
	2014-15 (R.E.)	**2015-16 (R.E.)**	**Change**	**2014-15 (R.E.)**	**2015-16 (R.E.)**	**Change**
Total Revenue Receipts	11.1	10.6	-0.5	10.3	10.7	0.4
Total Central Transfers	3.1	3.0	-0.1	2.3	2.7	0.4
Total Expenditure	13.3	12.8	-0.5	13.7	14.0	0.4
Expenditure on Social Services (incl. RD)	5.8	5.8	-0.005	6.0	5.8	-0.2
Expenditure on Economic Services	3.9	3.5	-0.4	3.5	4.4	0.9
	Karnataka			**Kerala**		
	2014-15 (R.E.)	**2015-16 (R.E.)**	**Change**	**2014-15 (R.E.)**	**2015-16 (R.E.)**	**Change**
Total Revenue Receipts	15.9	16.0	0.1	12.2	12.1	-0.1
Total Central Transfers	5.2	5.0	-0.2	3.4	3.8	0.4
Total Expenditure	18.6	18.7	0.1	15.2	15.0	-0.1
Expenditure on Social Services (incl. RD)	7.8	7.7	-0.1	5.8	5.3	-0.5
Expenditure on Economic Services	5.6	5.9	0.3	2.3	2.4	0.1

[19] These include Bihar, Uttar Pradesh, Jharkhand, Chhattisgarh, Madhya Pradesh, Rajasthan, Odisha and West Bengal.

	Maharashtra			Punjab		
	2014-15 (R.E.)	**2015-16 (R.E.)**	**Change**	**2014-15 (R.E.)**	**2015-16 (R.E.)**	**Change**
Total Revenue Receipts	10.1	10.1	-0.02	11.6	11.2	-0.5
Total Central Transfers	2.7	2.7	0.01	3.0	3.2	0.1
Total Expenditure	12.2	12.0	-0.2	14.4	14.1	-0.3
Expenditure on Social Services (incl. RD)	5.5	5.3	-0.2	4.8	4.6	-0.2
Expenditure on Economic Services	2.9	2.8	-0.1	3.1	3.2	0.1
	Tamil Nadu					
	2014-15 (R.E.)	**2015-16 (R.E.)**	**Change**			
Total Revenue Receipts	12.2	11.4	-0.8			
Total Central Transfers	3.5	3.5	0.004			
Total Expenditure	14.4	13.9	-0.5			
Expenditure on Social Services (incl. RD)	6.1	6.0	-0.1			
Expenditure on Economic Services	3.0	2.9	-0.1			

Source: Figures of receipts, transfers and expenditures have been taken from the State budget documents for the years 2015-16 and 2016-17. Figures of GSDP in 2015-16 have been taken from budget documents of respective State Governments. For GSDP in 2014-15 data have been taken from the Central Statistics Office (CSO).

***Note**:* The ratios are not comparable across States as the GSDP figures provided in State budget documents of 2016-17 are with respect to the 2004-05 GSDP series for some States and 2011-12 GSDP series for others. Within States, the changes are measured with respect to the same base of GSDP series.

5. Summary

Emerging evidence on the impact of the recommendations of the Fourteenth Finance Commission (FFC) suggests that there has been an increase in Central transfers and social sector expenditures in a number of States in 2015-16, the first year of the FFC award period. This evidence is based on a year to year comparison between 2014-15 (the last year of the TFC award period) and 2015-16 (the first year of the FFC award period). As the base year for comparison is a single year 2014-15, the inferences are affected by the level of transfers and expenditures in that year vis-à-vis other years of the TFC period. The existing evidence is also likely to be biased upwards as these are based on comparisons between *Actuals* and *Revised Estimates* or *Revised Estimates and Budget Estimates* between 2014-15 and 2015-16.

This paper makes two contributions. First, using Union budgets we provide a comparison of aggregate share of resources devolved to States by the Union Government in 2014-15 with respect to the other years of the TFC period. This enables us to put into perspective the existing evidence on State-level changes in the first year of the FFC award period (which has been measured with respect to a single year 2014-15) *vis-a-vis* the average of the TFC period. Secondly, we attempt to correct for the upward bias in existing evidence that has been induced because of systematic differences between *Actuals*, *Revised Estimates* and *Budget Estimates* by providing a comparison of *Revised Estimates* for 2014-15 with *Revised Estimates* for 2015-16 in States. Using this approach, we revisit questions on the net gain in Central transfers in States and how has social sector expenditures fared in States following the FFC recommendations. We also compare the changes in expenditures on Social Services *vis-a-vis* Economic Services in States to examine the relative priorities of States in the two services in the first year of the FFC award period.

Our analysis suggests that the magnitude of gains from Central transfers at the State-level is likely to be much lower than the extent documented in existing studies. Despite significant increase in tax devolution, share of States in Gross Tax Revenues of the Union Government was likely to be lower in the first two years of the FFC period than the average of the Thirteenth Finance Commission period because of contraction in grants. Even while providing a comparison with respect to a low base year, we find that Central transfers to GSDP ratio is also likely to fall in a number of major States. Although receipt of grants from the Union Government for social sectors is likely to fall in most States, States have compensated for this fall and social sector expenditures are likely to increase in most of States. As proportion of GSDP however, it is likely that social sector expenditures will fall in most major States. Also, expenditures on Social services have received a lower priority over expenditures on Economic Services in the first year of the FFC award period.

The observations made in this paper may at best be considered a preliminary exploration of the changes in Central transfers and social sector expenditures in the first year following the recommendations of the FFC. The analysis is preliminary in nature as it is based on *Revised Estimates* and not *Actual* figures of transfers, expenditures and Gross State Domestic Product (GSDP). Also, State-wise analysis is based on a year to year comparison of 2014-15 and 2015-16. If the figures for any of these years are affected by unusually high or low values in any State, the relative loss or gain in States may be different from what is indicated here. Also, it is likely that 2015-16, the first year of the FFC period was a year of transition to a new regime of Centre-State fiscal relations after the recommendations of the FFC. Over the medium term, the direction of change following the FFC recommendations may play out differently, and from that perspective, trends in the first year only provide an early glimpse of the emerging scenario.

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