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State Government Finances

15th Finance Commission: sharp rise in conditional grants may nudge states to expedite reforms

February 2021

Highlights

Share of 10 states in divisible pool is lower during the 15th FC's period of FY2022-26 compared to the 14th FC's award period

Karnataka is the biggest loser, Maharashtra is the biggest gainer in terms of the share in the divisible pool of taxes in FY2022-26 over FY2016-20

57% of the total 15th FC grants are conditional compared to only ~17% during the 14th FC's award period

Eligibility condition to receive a large portion of local body grants, may nudge the states to set up SFCs by March 2024, undertake reforms related to timely availability of accounts and property tax

Sharp rise in unconditional revenue deficit grants during FY2022-26, to aid post-pandemic recovery for 17 recipient states

- The Fifteenth Finance Commission (15th FC) has recommended a vertical tax devolution of 41% of the divisible pool of taxes of the Government of India (GoI) to the state governments during FY2022-26. The vertical and horizontal devolution formulae recommended for FY2021 have been retained for FY2022-26.
- Despite this, there are mild changes in the individual states' shares in the divisible pool of taxes of the GoI (decline for 15, rise for 13) during FY2022-26, relative to FY2021. This reflects the use of updated data for calculating the income distance and tax effort for its award period of FY2022-26.
- Based on the vertical devolution and inter-se split recommended by the 15th FC, the share of 10 states in the divisible pool would decline during FY2022-26, relative to the 14th FC's award period of FY2016-20, with Karnataka being the biggest loser and Maharashtra being the biggest gainer.
- Total grants of Rs. 8,535 billion (~57% conditional) recommended by the 15th FC have been accepted by the GoI for FY2022-26, 58.8% higher than the Rs. 5,374 billion grants (including J&K; only 17% conditional) recommended by the 14th FC for FY2016-20. The step-up in conditional grants could act as an incentive for states to undertake associated reforms.
- The 15th FC has recommended Rs. 4,364 billion as grants for local bodies, 54.5% of which are conditional and tied and 29.3% are conditional and untied. Receipt of the conditional grants during FY2025-26 is based on the states setting up State Finance Commissions (SFCs) for the coming five-year period and acting on their recommendations by March 2024.
- Another entry level condition for availing grants by rural and urban local bodies (ULBs) pertains to timely availability of online Accounts from FY2022. Additionally, for receipt of grants by ULBs, states are required to notify a floor rate for property tax by FY2022 which should increase at a prescribed growth rate.

Highlights

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State governments have been allowed some extra fiscal space in FY2022 and FY2023 relative to the earlier target of restricting the fiscal deficit to 3.0% of GSDP

At this point, we can't be sure how much of the extra fiscal space will be funneled by the states toward growth-enhancing capital spending

Additional borrowing of 0.5% of GSDP for FY2022-FY2025 is contingent on completion of power sector reforms

Looming revenue concerns may push some state governments to complete the power sector and municipal reforms, and set up SFCs so that their borrowing space may be enhanced

- The fulfilment of the conditions by the state governments and local bodies remain a key risk for availing a substantial 84% of total local body grants. Out of the balance local body grants, a tied grant of Rs. 701 billion is for plugging gaps in the health care system. Though this amount is modest, it is unconditional.
- The GoI has accepted the 15th FC's recommendation of Rs. 2,945 billion revenue deficit grants (RDG) to 17 states during FY2022-26, 51.2% higher than the Rs. 1,948 billion recommended by the 14th FC to 11 states (including to Jammu and Kashmir or J&K) during FY2016-20.
- The RDG is unconditional, which is a positive for the recipients. Nearly 70% of the amount is to be disbursed during FY2022 and FY2023, making them front-ended. This would aid the recipient states in recovering from the damage caused to their tax revenue base by the Covid-19 pandemic.
- For disaster management, the 15th FC has recommended the share of the Union Government at Rs. 1,226 billion for FY2022-26, more than double the grant recommended during the 14th FC period. This tied grant is conditional, but unlike the front-loaded RDG, its amount would rise by 5% each year from FY2023.
- The 15th FC has recommended a normal net borrowing limit of states of 4.0% of Gross State Domestic Product (GSDP) for FY2022 (in line with the limit in F2021), 3.5% of GSDP for FY2023 and 3.0% of GSDP till FY2026, for which the GoI has given an in-principle approval. Additional borrowing of 0.5% of GSDP for FY2022-FY2025 is contingent on completion of power sector reforms.
- The tapering of RDG by FY2023 and the discontinuation of the GST compensation grants beyond June 2022 would materially alter the revenues of some state governments. This may push them to complete the power sector reforms, which have proven challenging in the past, as well as the municipal reforms related to local body grants, so that their borrowing space may be enhanced.

Key recommendations of the 15th FC on taxes

15th FC retains vertical and horizontal devolution criteria for FY2022-26, in line with its recommendations for FY2021

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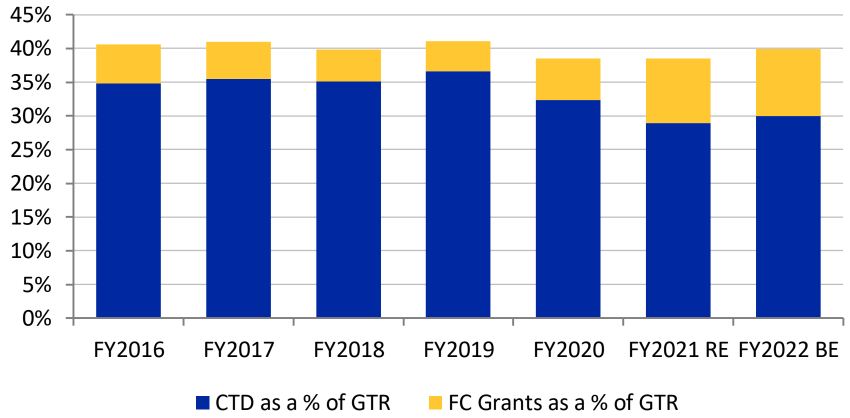
Exhibit 1: Horizontal devolution criteria for the 15th FC's award period

	14th FC (FY2016-20)	15th FC (FY2021)	15th FC (FY2022-26)
Population	17.5%	15.0%	15.0%
Demographic Performance		12.5%	12.5%
Demographic Change	10.0%		
Area	15.0%	15.0%	15.0%
Forest and Ecology	7.5%	10.0%	10.0%
Income Distance	50.0%	45.0%	45.0%
Tax Effort		2.5%	2.5%

Source: *FC reports; ICRA research*

- Vertical devolution for FY2022-26 is recommended at 41% of the net proceeds of Union taxes, unchanged from FY2021.
- Horizontal devolution criteria and weights for the award period FY2022-26, also unchanged from FY2021.

Exhibit 2: Central tax devolution (CTD) and FC grants as a proportion of gross tax revenues (GTR) during FY2016 to FY2021 BE

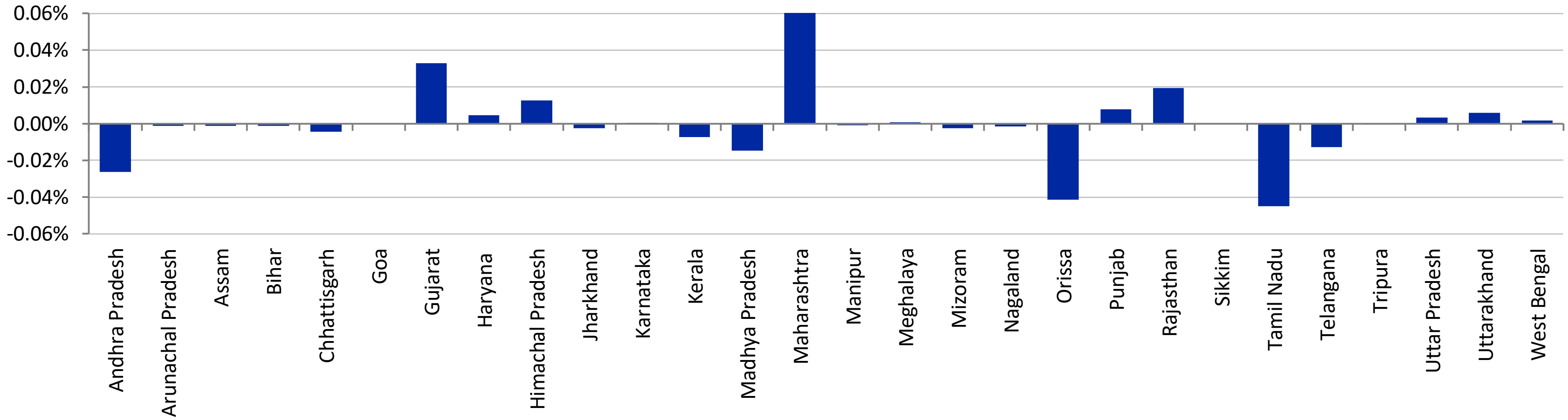


Source: *Union Budgets; ICRA research*

- Share of CTD in the GoI's GTR is budgeted to decline to ~30% in FY2022 from ~35% in FY2016, given the higher proportion of cesses and surcharges that are not shareable with the states.
- However, the share of FC grants relative to GTR is forecast to rise to ~10% in FY2022 BE from ~6% in FY2016, led by substantially higher grants recommended by the 15th FC.

Mild changes in state-wise share in divisible pool for the award period FY2022-26 relative to FY2021

Exhibit 3: Changes in share in divisible pool during FY2022-26 from FY2021



Source: *FC reports; ICRA research*

- This is led by the changes in computation of the income distance and tax effort criteria, even though their weights have not changed.
- For the award period FY2022-26, income distance and tax effort have been calculated based on data for FY2017-19 as compared to FY2016-18 for FY2021.

Share of 10 states in divisible pool set to decline in FY2022-26 from FY2016-20, following change in criteria

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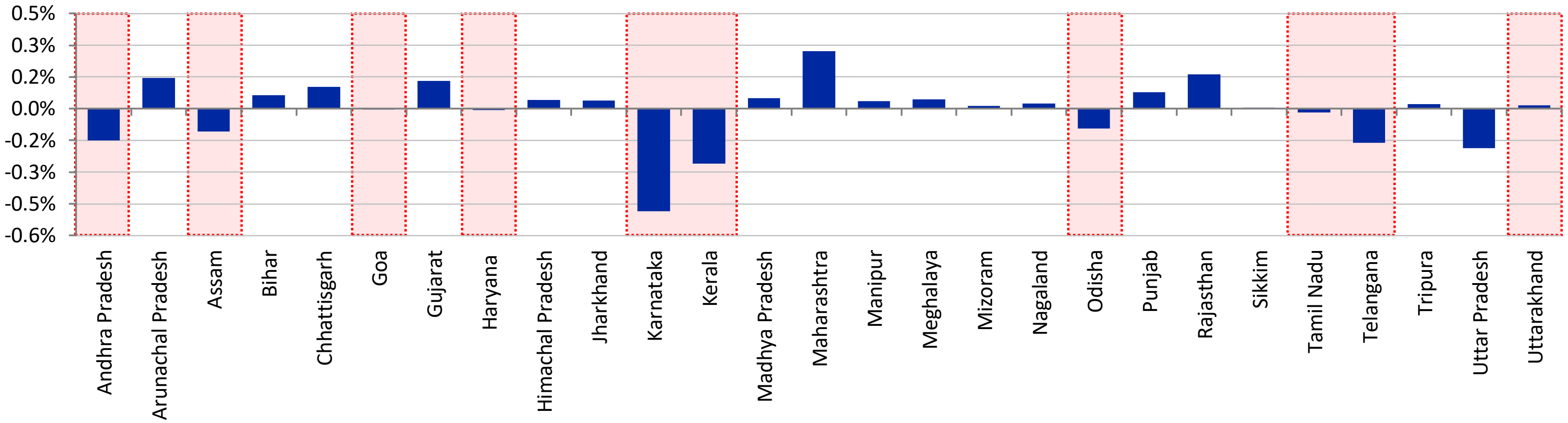
Exhibit 4: Changes in divisible pool share for FY2022-26 from FY2016-20



Source: *FC reports; ICRA research*

- The 15th FC was required to use population as per the 2011 Census; it has also used demographic performance (with a weight of 12.5%) to reward those states, which have performed well on demographic management.
- The 14th FC was mandated to use population based on the 1971 Census, although it was allowed to take into account any demographic changes since 1971. Therefore, it had introduced the demographic change criterion, giving 10% weightage to 2011 population.
- The 15th FC It has introduced a new criterion (tax effort), measurable by the ratio of three-year average of per-capita own tax revenues and per-capita GSDP.
- Karnataka is the biggest loser, Maharashtra is the biggest gainer in terms of share in divisible pool of taxes in FY2022-26, relative to FY2016-20.

Key recommendations of the 15th FC on grants

GoI has so far accepted some of the 15th FC's recommendations on grants

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Exhibit 5: The 15th FC's recommendations for grants for its award period

Rs. Billion	14th FC* (FY2016-20)	15th FC (FY2022-26)						
		FY2022	FY2023	FY2024	FY2025	FY2026	FY2022-26	Growth over 14th FC
Revenue Deficit Grants (RDG)	**1,948**	1,185	862	517	245	137	**2,945**	**51.2%**
Local Bodies	**2,874**	803	847	872	921	921	**4,364**	**51.8%**
Disaster Management	**551**	222	233	245	257	270	**1,226**	**122.5%**
Sector-specific Grants	-	123	237	248	331	361	**1,300**	-
State-specific Grants	-	-	99	99	149	149	**496**	-
Grand Total	**5,373**	**2,333**	**2,278**	**1,980**	**1,902**	**1,837**	**10,331**	**92.3%**

- So far, the GoI has accepted the 15th FC's recommendations for revenue deficit grants, grants for local bodies and disaster management and mitigation, and has included the same in its FY2022 Union Budget.
- However, the GoI is yet to accept the recommendations of the 15th FC on state-specific and sector-specific grants.

Note: ** Including J&K*
Source: *Union Budget; FC report; ICRA research*

FC grants set to increase sharply during the 15th FC's award period

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Exhibit 6: Growth of the 15th FC's accepted grants over 14th FC grants (including Jammu & Kashmir)

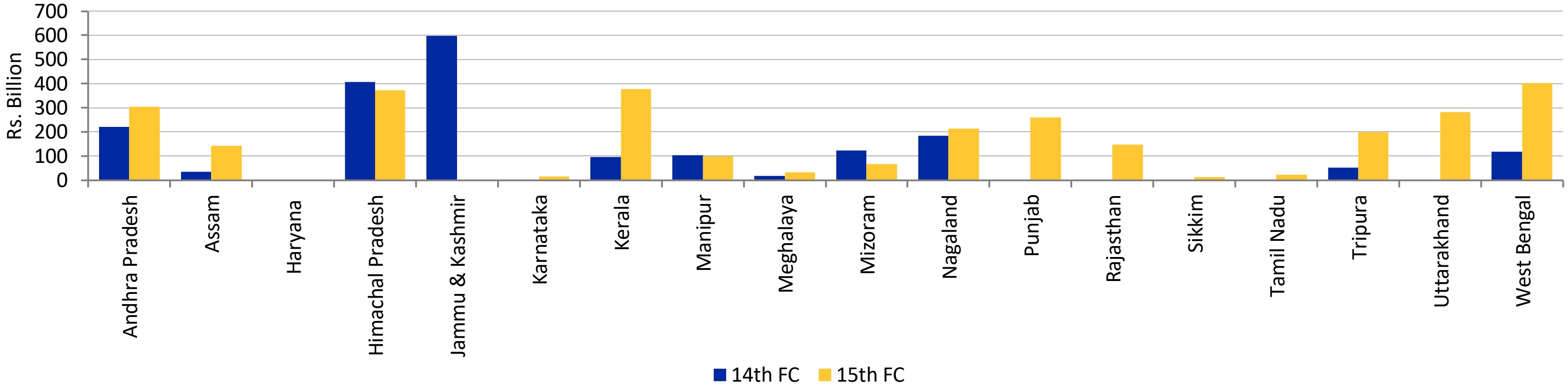
Rs. Billion	14th FC	15th FC	Growth
Revenue Deficit Grants	1,948	2,945	51.2%
Local Bodies Grants	2,874	4,364	51.8%
Disaster Management Grants	551	1,226	122.5%
Total Grants	**5,374**	**8,535**	**58.8%**

Exhibit 7: Growth of the 15th FC's accepted grants over 14th FC grants (excluding Jammu & Kashmir)

Rs. Billion	14th FC	15th FC	Growth
Revenue Deficit Grants	1,352	2,945	117.9%
Local Bodies Grants	2,827	4,364	54.4%
Disaster Management Grants	538	1,226	127.8%
Total Grants	**4,716**	**8,535**	**81.0%**

Substantial rise in RDG during the 15th FC's award period

Exhibit 8: State-wise RDGs in the 14th FC's and the 15th FC's award periods



Source: *FC reports; ICRA research*

- Haryana, Karnataka, Punjab, Rajasthan, Sikkim, Tamil Nadu and Uttarakhand, which didn't receive RDG during the 14th FC's award period, are set to receive such grants during the 15th FC's award period.
- Largest increase in RDG is for West Bengal (by Rs. 284 billion), followed by Kerala (by Rs. 283 billion) and Uttarakhand (Rs. 281 billion) in the 15th FC's award period over the 14th FC's award period.
- These grants are unconditional and untied, and comprise nearly 35% of the total accepted grants of the 15th FC.

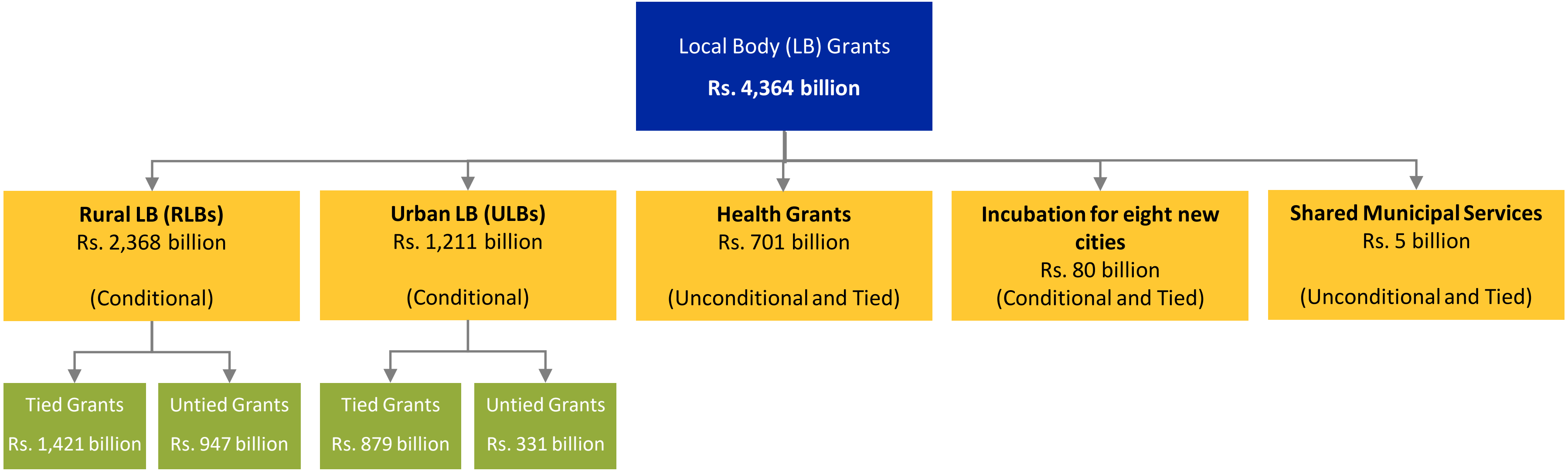
RDG highly front-ended, in line with past practice; may soften post-pandemic stress

Exhibit 9: RDG in the 15th FC's award period for top 10 states

Rs. Billion	FY2022	FY2023	FY2024	FY2025	FY2026	FY2022-26
Andhra Pradesh	173	105	27	-	-	305
Assam	64	49	29	-	-	142
Himachal Pradesh	102	94	81	63	33	372
Kerala	199	132	47	-	-	378
Nagaland	46	45	44	41	36	212
Punjab	101	83	56	20	-	260
Rajasthan	99	49	-	-	-	147
Tripura	45	44	42	38	30	199
Uttarakhand	78	71	62	49	21	281
West Bengal	176	136	84	6	-	401
Sum Total	**1,082**	**808**	**472**	**216**	**120**	**2,698**
Total RDG Grants	**1,185**	**862**	**517**	**245**	**137**	**2,945**

Source: *FC reports; ICRA research*

More than 80% of the total Local Body Grants are conditional in nature



- For RLBs, distribution of grants amongst the states is based on 90% weightage to population and 10% to area. For ULBs, nearly 68% of the grants are provided for cities with less than million population and the balance to million-plus cities.
- For the Rs. 80 billion challenge fund for the incubation of eight new cities and Rs. 5 billion grants for shared municipal services, the Ministry of Housing and Urban Affairs in consultation with the states, will draw up the modalities for the administration and flow of these grants.

Source: *FC report; ICRA research*

Entry level conditions imposed for availing Local Body grants

- The 15th FC noted that only 15 states have set up their fifth or sixth SFCs, whereas several states have not moved beyond their second or third SFC. Therefore, the 15th FC recommended that the states would have to set up SFCs and act on their recommendations on or before March 2024 to be eligible for grants.

- For availing the grants for local bodies, the states to ensure timely availability of accounts of the local bodies.

- For the first two years (FY2022-23), the states should ensure at least 25% of the LBs have both their provisional accounts for the previous year and audited accounts for the year before the previous available online. From FY2024 onwards, states will receive total grants due to the LBs having both provisional accounts of the previous year and audited accounts for the year before previous and making these available online.

- In addition to the above, for receipt of grants for the ULBs, the state governments should notify floor rates of property tax, and demonstrate year-wise consistent improvement in these collections in tandem with the simple average growth rate of the state's own GSDP from FY2023 onwards.

Source: *FC report; ICRA research*

Ten state governments to receive three-fourth of the total local body grants

Exhibit 10: Allocation for RLB and ULB grants for top 10 states

Rs. Billion	FY2022	FY2023	FY2024	FY2025	FY2026	FY2022-26
Andhra Pradesh	29	30	31	33	32	155
Bihar	55	57	59	62	62	296
Gujarat	35	37	37	40	39	188
Karnataka	35	37	38	40	40	189
Madhya Pradesh	44	46	47	49	49	235
Maharashtra	64	67	68	72	72	343
Rajasthan	43	44	45	48	48	227
Tamil Nadu	40	41	42	45	44	212
Uttar Pradesh	108	111	114	121	120	574
West Bengal	49	50	52	55	54	260
Sum Total	**502**	**520**	**534**	**565**	**560**	**2,680**
Total RLB and ULB grants	**670**	**694**	**712**	**755**	**747**	**3,579**

Source: *FC report; ICRA research*

Health grants of Rs. 701 billion recommended in aggregate for 28 states

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Exhibit 11: Allocation for health grants to be routed through LBs for top ten states

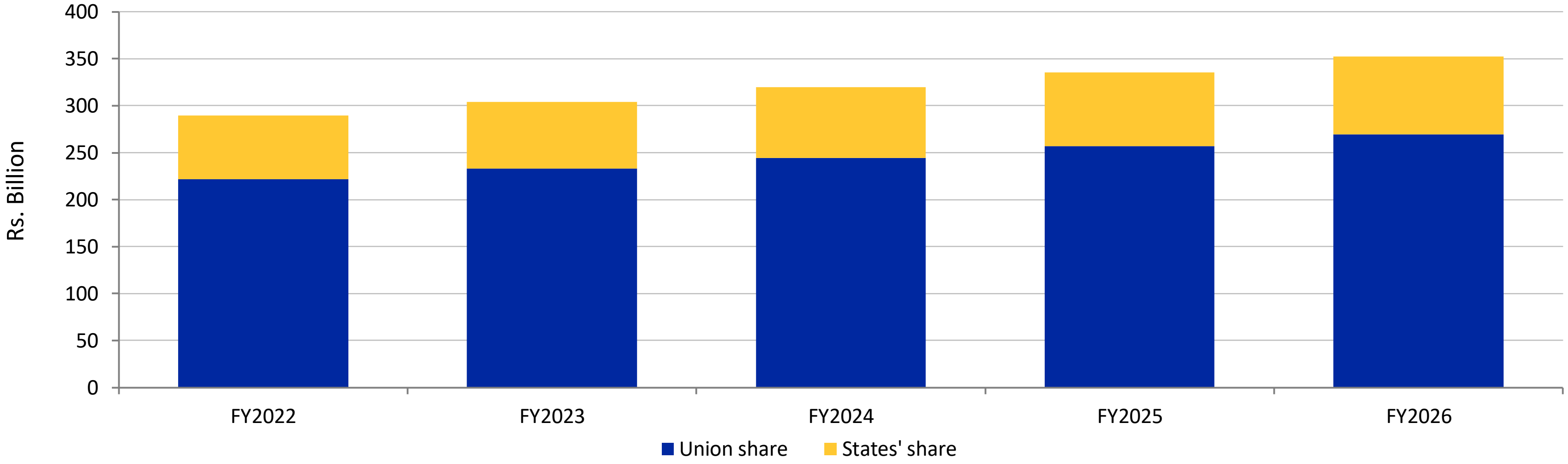
Amount in Rs. Billion	FY2022	FY2023	FY2024	FY2025	FY2026	FY2022-26
Bihar	11	11	12	12	13	60
Gujarat	6	6	7	7	7	33
Karnataka	6	6	6	6	6	29
Kerala	6	6	6	6	6	30
Madhya Pradesh	9	9	10	10	11	49
Maharashtra	13	13	14	15	15	71
Rajasthan	8	8	9	9	10	44
Tamil Nadu	8	8	8	9	9	43
Uttar Pradesh	18	18	19	20	21	97
West Bengal	8	8	9	9	10	44
Sum Total	**94**	**94**	**99**	**104**	**109**	**500**
Total Health Grants	**132**	**132**	**139**	**145**	**153**	**701**

- Health grants are unconditional, but tied towards supporting diagnostic infrastructure, block level public health units, Urban Health and Wellness centres, building-less sub-centres and Conversion of Rural PHCs and sub-centres into Health and Wellness Centre.
- As per the 15th FC, a Committee needs to be set up under the Ministry of Health and Family Welfare, GoI for deciding the mechanism for flow and utilization of health grants by Apr 2021 so that funds can start flowing from July 2021. Similar committees need to be set up at the State and district level.
- The 15th FC has recommended that health spending by the states should be increased to more than 8% of their budgets by FY2022, and that the combined public health expenditure of the Central and state governments should be increased in a progressive manner to reach 2.5% of GDP by FY2025.

Note*: State-wise allocation for grants for Incubation for eight new cities and shared municipal services is not available*
Source*: FC report; ICRA research*

Receipt of disaster management grants is conditional and tied

Exhibit 12: Allocation for State Disaster Response Management Fund (SDRMF)



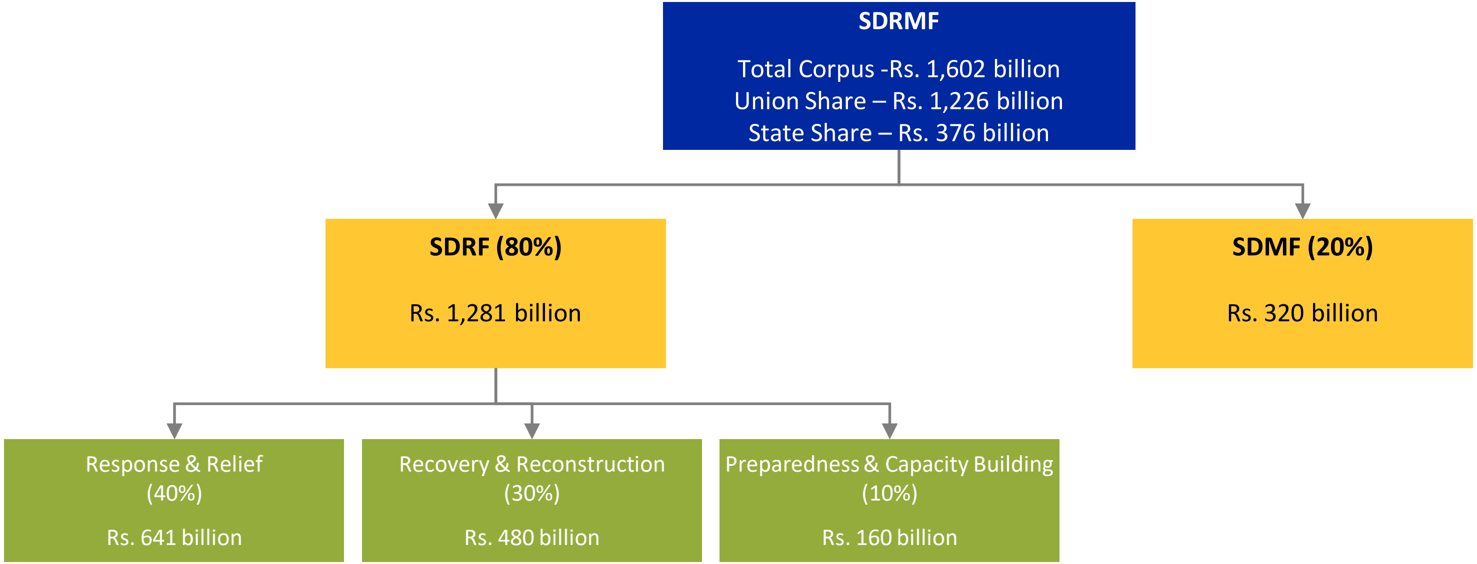
- The release of Disaster Management grants is conditional on the states experiencing any disasters covered under State Disaster Relief Fund (SDRF) constituted under the Disaster Management Act, 2005; moreover, their end-use is tied.
- For disaster management, the 15th FC has recommended the share of the Union Government at Rs. 1,226 billion for FY2022-26, more than double the grant recommended during the 14th FC period.
- Notably, during FY2016-20, the GoI had transferred Rs. 471 billion as grants for SDRF, which was lower than the Rs. 551 billion (including J&K) recommended by the 14th FC.

Source: *FC report; ICRA research*

Mitigation funds recommended to be set-up at the state and national level

- Disaster Risk Management Fund (DRMF) to include Disaster Relief Fund (DRF) and Disaster Mitigation Fund (DMF), at both the national and state level.
- Mitigation Fund should be used for local level and community-based interventions, which reduce risk and promote environment friendly practices.
- Sharing arrangement recommended by the 13th FC (25% contribution by all states, except North-Eastern and Himalayan or NEH states, which will contribute 10%) to continue for the 15th FC's award period for SDRMF, with the balance to be contributed by the Union Government.
- Total allocation for SDRMF for the 15th FC's award period is Rs. 1,602 billion, of which the Union Government's share is Rs. 1,226 billion.
- 80% of the total SDRMF is recommended to be allocated to the SDRF for response and relief (40%), recovery and reconstruction (30%), and preparedness and capacity-building (10%), with flexibility for re-allocation within these three heads.
- The balance 20% of SDRMF is recommended for State DMF (SDMF).

A fifth of disaster management grants have been earmarked for mitigation efforts

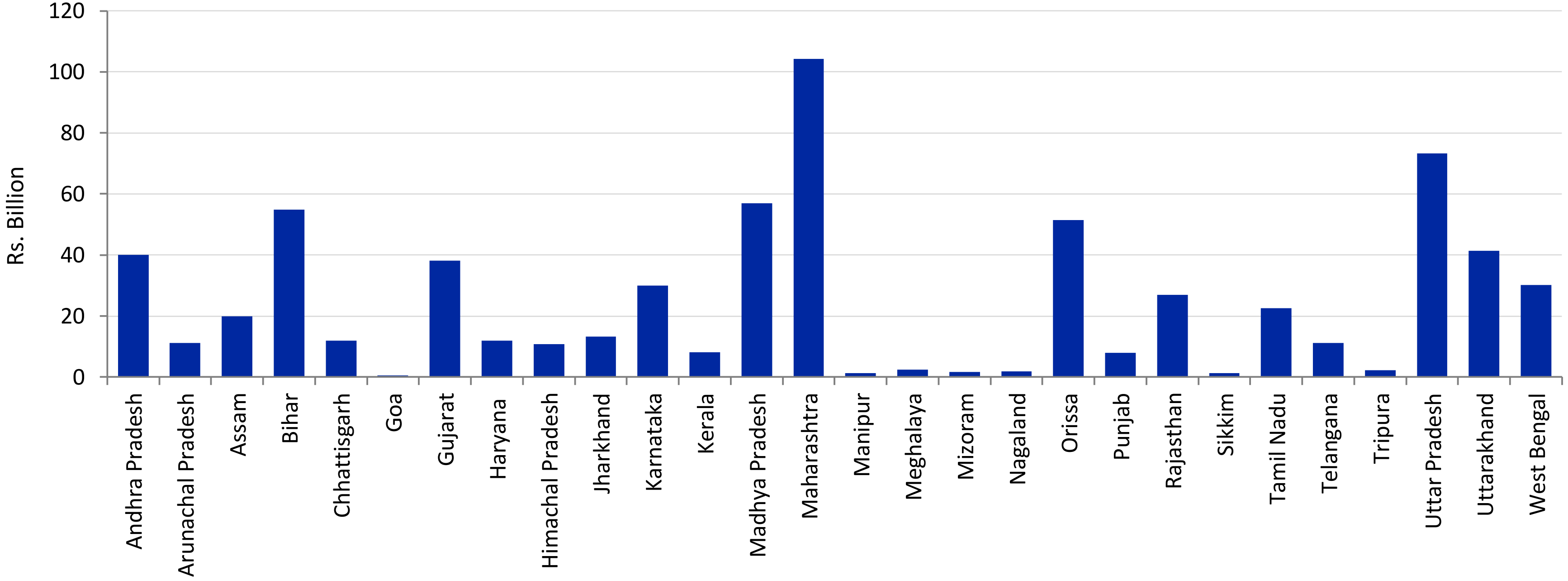


- For state-wise allocations for SDRMF, the 15th FC has formulated a new methodology, which replaced the expenditure-driven methodology used by the earlier FC's.
- The new methodology uses a combination of capacity (reflected through expenditure), risk exposure (area and population) and hazard and vulnerability (risk index).

Source: *FC report; ICRA research*

Maharashtra is the biggest gainer based on the new methodology for disaster management grants followed by 15th FC

Exhibit 13: Absolute increase in state-wise SDRMF grants recommended by the 15th FC relative to the 14th FC



Source: *FC report; ICRA research*

Disaster management grants to increase by 5% each year from FY2023

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Exhibit 14: Allocation for SDRMF grants (Union share) for top ten states

Rs. Billion	FY2022	FY2023	FY2024	FY2025	FY2026	FY2022-26
Andhra Pradesh	11	12	12	13	14	62
Bihar	14	15	16	16	17	78
Gujarat	13	14	15	15	16	73
Madhya Pradesh	18	19	20	21	22	101
Maharashtra	32	34	36	37	39	178
Orissa	16	17	18	19	20	89
Rajasthan	15	16	16	17	18	82
Tamil Nadu	10	11	11	12	12	56
Uttar Pradesh	19	20	21	22	24	107
West Bengal	10	11	11	12	12	56
Sum Total	**160**	**168**	**176**	**185**	**194**	**881**
Total SDRMF grants	**222**	**233**	**245**	**257**	**270**	**1,226**

Source: *FC report; ICRA research*

- The 15th FC has recommended that the allocation for State and National DRMF for FY2022 be retained at the level of FY2021, and thereafter to increase by 5% each year.
- Nearly a third of the disaster management grants are recommended for Maharashtra, Uttar Pradesh and Madhya Pradesh during FY2022-26.

Nearly all state governments set to gain from the 15th FC-recommended grants, provided all conditions are met

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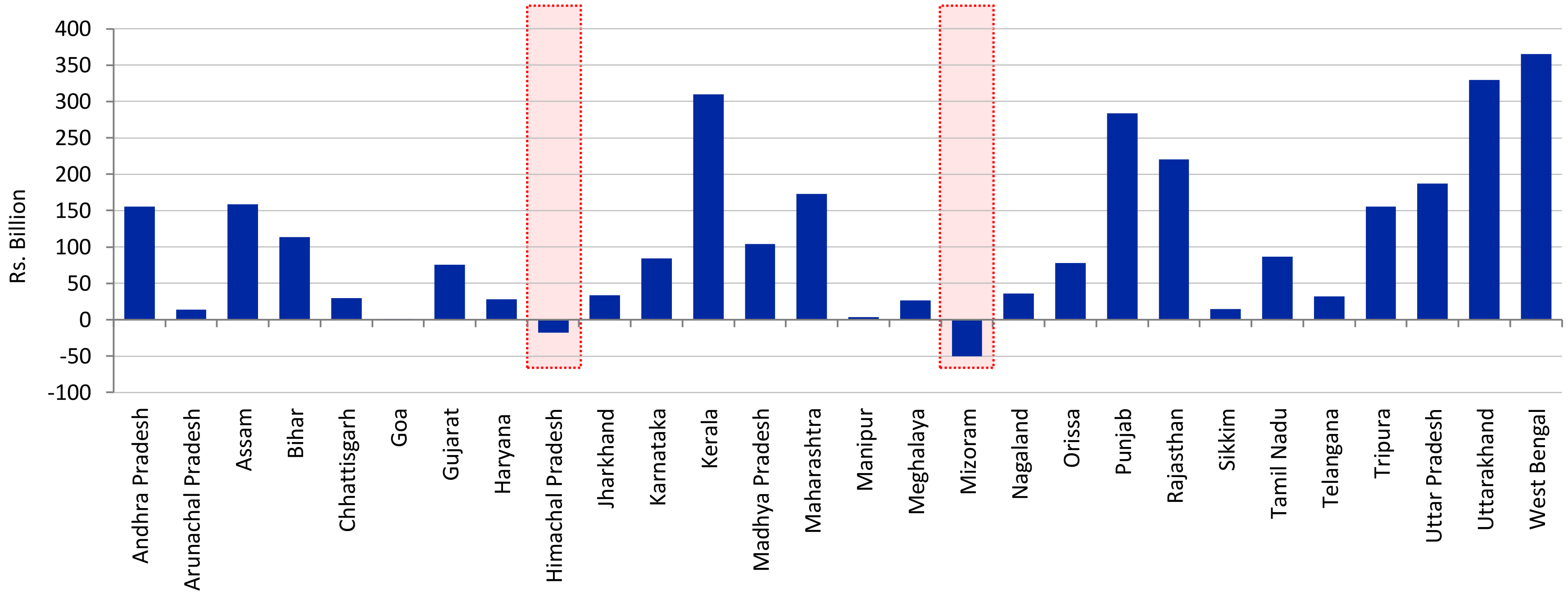
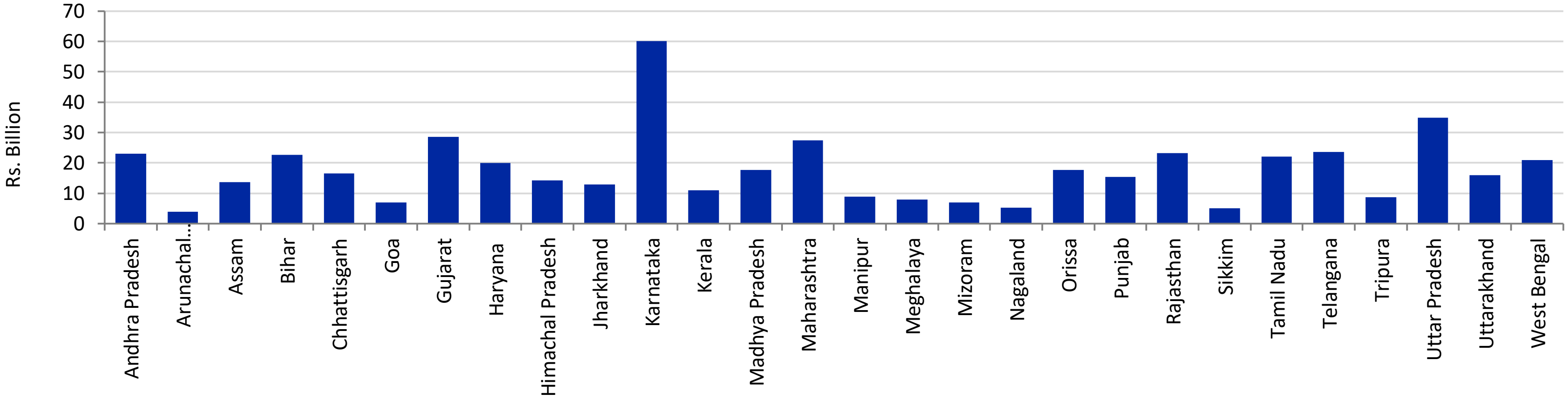
Exhibit 15: State-wise increase(+) and decrease(-) in grants recommended by the 15th FC (accepted), relative to the 14th FC



Source: *FC report; ICRA research*

State-specific grants for addressing special needs and cost disabilities

Exhibit 16: State-wise break-up of state-specific grants



Source: *Union Budget; FC report; ICRA research*

- The 15th FC has recommended a total of Rs. 496 billion for state-specific grants to states for building infrastructure related to water supply, road network etc.
- In its action taken report (ATR) on the 15th FC's recommendations, the GoI indicated that it will give due consideration to this recommendation, keeping in view the untied resources available for the state governments and fiscal commitments of the Centre.
- Karnataka, Uttar Pradesh, Maharashtra and Gujarat comprise nearly 30% of the total state-specific grants.

Performance-driven incentives and grants for state governments

Exhibit 17: Break-up of sector-specific grants

Rs. Billion	FY2022	FY2023	FY2024	FY2025	FY2026	FY2022-26	Purpose/Nature of grants
Sector-specific Grants	**123**	**237**	**248**	**331**	**361**	**1,300**	
Health	48	62	64	65	79	318	▪ Unconditional but tied towards critical care hospitals, public health labs, training for healthcare workers and Diplomate of National Board courses.
School Education	-	12	12	12	12	48	▪ Grants to be released based on the Performance Grading Index of the Ministry of Education and to be tied to improving educational outcomes.
Higher Education	11	12	13	13	13	61	▪ Unconditional but tied towards development of online education and professional courses in regional languages.
Implementation of agricultural reforms	-	75	75	150	150	450	▪ Conditional on achieving targets for land lease reforms, water use in agriculture, export promotion and improving production and tied to development of agriculture and allied sectors.
Maintenance of PMGSY roads	37	42	56	61	78	275	▪ Unconditional but tied to the maintenance of Pradhan Mantri Gram Sadak Yojana (PMGSY) roads.
Judiciary	21	21	21	21	21	104	▪ Unconditional but tied to certain courts and cases.
Statistics	-	7	2	2	2	12	▪ Combination of conditional and unconditional grants and tied to the improvement of statistical systems.
Aspirational districts and blocks	6	6	6	6	6	32	▪ Conditional basis key performance indicators formulated by the Niti Aayog.

Source: *FC report; ICRA research*

Key recommendations of the 15th FC on deficits and borrowings

In-principle acceptance for 15th FC's recommendation on state borrowings

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Exhibit 18: Fiscal deficit glide path for state governments during FY2022-26

As a % of GSDP	FY2022	FY2023	FY2024	FY2025	FY2026
Upper Limit	4.5	4.0	3.5	3.5	3.0
o/w for borrowing linked to power sector reforms (Conditional)	*0.5*	*0.5*	*0.5*	*0.5*	
Normal Borrowing Limit	**4.0**	**3.5**	**3.0**	**3.0**	**3.0**
Lower Limit	3.0	3.0	3.0	3.0	3.0

Note: *negative values indicate surplus and positive values indicate deficit*
Source: *FC report; Union Budget; ICRA research*

- The 15th FC has recommended that the normal limit for net borrowings of state governments be fixed at 4.0% of GSDP in FY2022 (in line with the enhanced borrowing baseline limit for FY2021), 3.5% of GSDP in FY2023 and thereafter at 3.0% of GSDP till FY2026.
- It has recommended an additional borrowing space of 0.5% of GSDP for the states, during the four-year period FY2022 to FY2025, on a conditional basis linked to power sector reforms:
  - These include timely submission of audited results of the power distribution utilities, sustained increase in electricity consumption, improvement in operational efficiency and reduction in subsidy dependence.
  - The magnitude of reform-linked borrowing is lower than the level of 1.0% of GSDP that was allowed by the GoI to the state governments in FY2021.
- The Commission has allowed for carrying forward any unutilised borrowing limit in a financial year to the next financing year, within in its award period.
- As per the ATR on the 15th FC's recommendations, the GoI has given in-principle acceptance to the net borrowing limit of the states and has fixed the net borrowing limit of the state governments at 4.0% of GSDP for FY2022.

Liabilities of the state governments to remain elevated at around 33% of GSDP during the 15th FC's award period

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Exhibit 19: Indicative debt path for state governments during FY2022-26

As a % of GSDP	FY2022	FY2023	FY2024	FY2025	FY2026
Revenue Deficit	-0.5	-0.8	-1.2	-1.7	-2.5
Fiscal Deficit	4.0	3.5	3.0	3.0	3.0
Total Liabilities	32.6	33.3	33.1	32.8	32.5

Note: *negative values indicate surplus and positive values indicate deficit*
Source: *FC report; Union Budget; ICRA research*

- The 15th FC has recommended the setting-up of a High-powered Inter-governmental Group for defining and achieving debt sustainability over a time period. The group may craft the new Fiscal Responsibility and Budget Management Framework and oversee its implementation.
- The Commission has suggested that the state governments may form independent public debt management cells, which will manage their borrowing programmes.
- It has remarked that the Union and state governments should disclose contingent liabilities in a transparent manner and should assess the associated risks.
- The Commission has opined that the states should have access to more facilities for short-term borrowings other than the ways and means/overdraft facility provided by the Reserve Bank of India.
- **The 15th FC has remarked that disclosure of the financial positions of the states and their credit ratings will help in broadening the investor base. Moreover, it has opined that credit ratings will reinforce self-discipline on the fiscal front and lead to better pricing of SDLs.**

Other key recommendations of the 15th FC

15th FC has recommended that the Consolidated Fund of India should be a major source for funding the Defence Fund

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Exhibit 20: The 15th FC's recommendation for sources of revenues and quantum of the Defence Fund (Rs. Billion)

Sources of revenue	Purpose	FY2022	FY2023	FY2024	FY2025	FY2026	FY2022-26
Transfers from Consolidated Fund of India	Defence & Internal Security	243	268	300	338	384	1,534
Disinvestment Proceeds from Defense Public Sector Enterprises	Defence	70	70	80	90	90	400
Monetisation of Defence Lands	Defence	60	70	80	90	100	400
Payments for Defence lands likely to be transferred to state governments and for public projects in future	Defence	4	6	9	13	18	50
Total		**377**	**414**	**469**	**531**	**592**	**2,384**

- The 15th FC has recommended that the GoI may set-up a non-lapsable Fund (Modernisation Fund for Defence and Internal Security) to be maintained in the Public Account of the Union Government.
- It has recommended funding of Rs. 243 billion from the Consolidated Fund of India for FY2022, which is around 1% of the budgeted GTR of the GoI for that year.
- Based on the scheme of funding the Defence Fund recommended by the 15th FC during FY2022-26, the share of the GoI out of the Consolidated Fund of India, is estimated at around 64% of each year's corpus.
- The GoI has given in-principle acceptance to this recommendation and said that it will examine the sources of funding and modalities of this Fund. **However, it has not budgeted for the same in the Union Budget for FY2022.**

Source: *Union Budget; FC report; ICRA research*

Takeaways for state governments from FY2022 Union Budget

GoI's GTR revised down by Rs. 5.2 trillion in FY2021 RE

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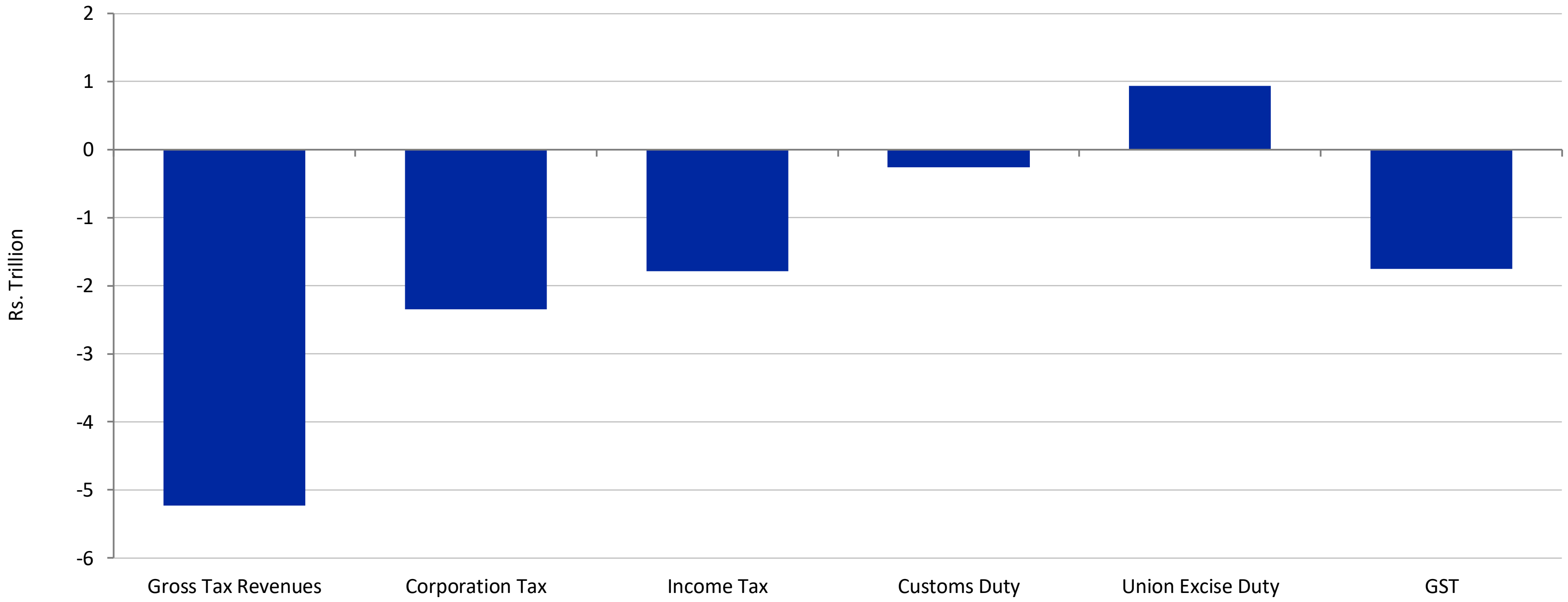
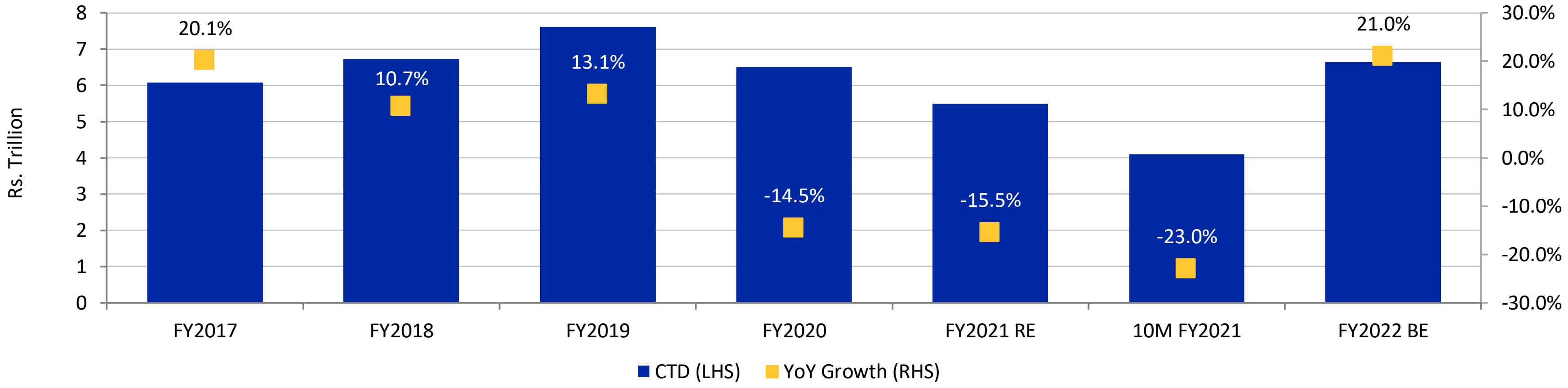
Exhibit 21: Variation in GoI's GTR in FY2021 Revised Estimates (RE) relative to FY2021 Budget Estimates (BE)



Note: *GST: Goods and Services Tax*
Source: *Union Budgets; Controller General of Accounts (CGA); ICRA research*

CTD in FY2021 RE is 30% lower than budgeted

Exhibit 22: CTD to state governments



Source: *Union Budgets; Ministry of Finance (MoF) CGA; ICRA research*

- CTD revised downwards by nearly 30% to Rs. 5.5 trillion in FY2021 RE from Rs. 7.8 trillion in the BE of that year.
- On a YoY basis, the CTD is set to contract for the second consecutive year, by 15.5% to Rs. 5.5 trillion in FY2021 RE from Rs. 6.5 trillion in FY2020.
- During 10M FY2021, the CTD to the state governments stood at Rs. 4.1 trillion, 23.0% lower than Rs. 5.3 trillion in 10M FY2020.
- Accordingly, the balance central taxes to be devolved in Feb-March FY2021 are pegged at Rs. 1.4 trillion, 17.6% higher than Rs. 1.2 trillion in Feb-March FY2020.

Subsequently, CTD is budgeted to expand by 21.0% in FY2022

Exhibit 23: Trend of the GoI's GTR in FY2021 RE and FY2022 BE

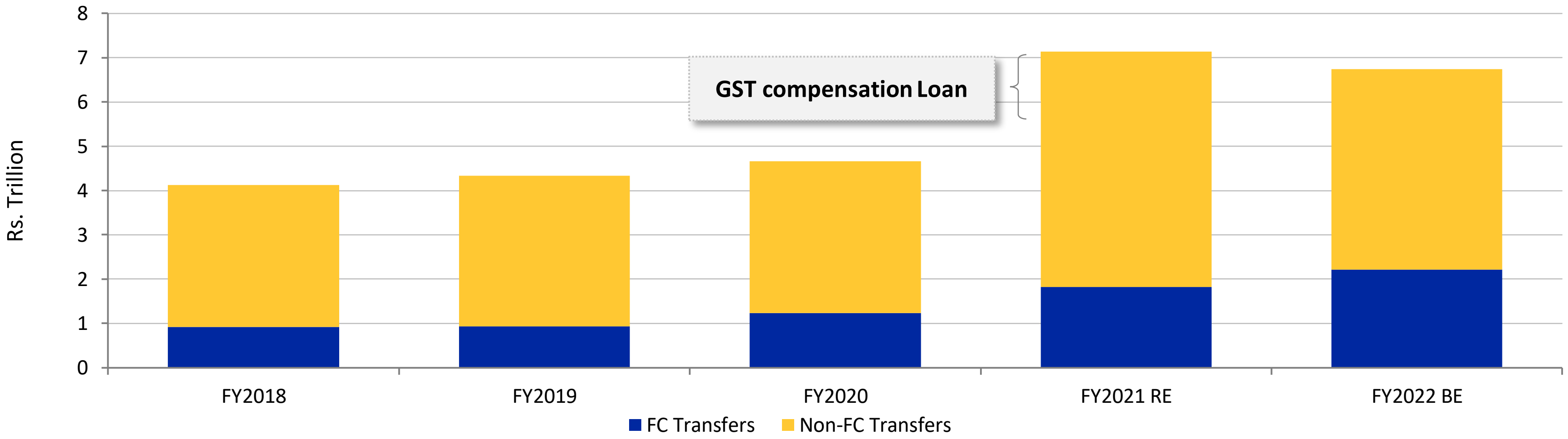
Amount in Rs. Trillion	FY2021 RE	FY2022 BE	Growth in FY2022 BE
GoI's GTR	19.0	22.2	**16.7%**
- Corporation Tax	4.5	5.5	22.6%
- Income Tax	4.6	5.6	22.2%
- Customs Duty	1.1	1.4	21.4%
- Union Excise Duty	3.6	3.4	-7.2%
- Services Tax	0.0	0.0	-28.6%
- GST	5.2	6.3	22.3%
CTD	5.5	6.7	**21.0%**

Source: *Union Budgets; CGA; ICRA research*

- Growth of the GoI's GTR is projected at 16.7% in FY2022 BE, somewhat higher than the 14.4% growth expected in nominal GDP in FY2022.
- Following two consecutive years of contraction, the CTD is forecast to expand by 21.0% to Rs. 6.66 trillion in FY2022 BE.
- Despite this, the absolute CTD in FY2022 would be lower than the level in FY2018 (Rs. 6.73 trillion) and FY2019 (Rs. 7.61 trillion).

Transfers to states (excluding CTD) budgeted to contract in FY2022

Exhibit 24: Transfers to states (excluding CTD) from the Centre



- Transfers to states (excluding CTD) are expected to rise by a sharp 27.5% in FY2021 RE to Rs. 7.1 trillion from Rs. 5.6 trillion in FY2021 BE, led by inclusion of Rs. 1.1 trillion GST compensation loan and increase in FC grants by Rs. 0.3 trillion.
- In FY2022 BE, transfers to states are forecast to contract by 5.4% to Rs. 6.7 trillion; transfers excluding FC grants (which comprise nearly two-thirds of total transfers) are budgeted to contract by 14.6% in FY2022 BE.
- Moreover, growth of FC grants is budgeted to ease to 21.1% in FY2022 from 47.4% in FY2021 RE.

Source: *Union Budgets; ICRA research*

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