Fifteenth Finance Commission Award and the North-eastern States

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This paper deals with the expected fiscal transfers to north-eastern states under the Fifteenth Finance Commission award. The analysis reveals that the ratio of central transfers has been declining. However, the structural disabilities of these states necessitates that the union government supplements the finance commission transfers with other budgetary support.

The recommendations of the Fourteenth Finance Commission to raise the share of tax devolution from 32% to 42% of the divisible pool (Finance Commission 2015: 90), have made metamorphic changes in the system of federal transfers to the north-eastern states (NES).[1] Traditionally, the NES have an overwhelming dependence on central transfers, as they suffer from serious fiscal disabilities due to historical and structural reasons—a fact that has been widely acknowledged by the successive finance commissions. Insofar as the pattern of central transfers to NES is concerned, unlike other major states in the country, these states used to receive the bulk of the central resources through grants outside the finance commission transfers, but this got changed in the Fourteenth Finance Commission award period. For instance, grants other than finance commission transfers constituted 57.1% of the total central transfers to these states during the Thirteenth Finance Commission award period, and this sharply declined to 34.8% in the Fourteenth Finance Commission award period, with their share in shareable taxes of the union government increasing correspondingly (Table 1, p 70).

With the reduction in centrally sponsored schemes (CSSs) and modification of their funding pattern, along with statutory transfers prevailing over discretionary transfers in the Fourteenth Finance Commission award (Reserve Bank of India 2017; Bhattacharjee 2018), the finance commission transfers have become a significant source of revenue receipts of these states during the Fourteenth Finance Commission award period. This paper deals with the expected transfers to NES under the Fifteenth Finance Commission award. As a backdrop, we have discussed the salient features of state government finances of NES, using the data available in the Fifteenth Finance Commissions volume 4 covering the last four years of the Thirteenth Finance Commission award period (2011–12 to 2014–15, henceforth referred to as period one) and the first four years of the Fourteenth Finance Commission award period (2015–16 to 2018–19, henceforth referred to as period two).

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Table 1: Distribution of Central Transfers to NES by Type of Transfers

(%)

State	Thirteenth Finance Commission Award Period (2010-11 to 2014-15)					Fourteenth Finance Commission Award Period (2015-16 to 2019-20)				
	Share In Central Taxes and Duties[$]	Grants-In-Aid (Statutory Grants)[#]	Finance Commission Transfers (Col 1 + Col 2)	Other Grants from the Centre[#]	Total (Col 3 + Col 4)	Share In Central Taxes and Duties[$]	Grants-in-Aid (Statutory Grants)[#]	Finance Commission Transfers (Col 6 + Col 7)	Other Grants from the Centre[#]	Total (Col 8 + Col 9)
	1	2	3	4	5	6	7	8	9	10
Arunachal Pradesh	17.1	10.9	25.8	74.2	100	72.0	0.5	72.5	27.5	100
Assam	52.9	2.3	54.7	45.3	100	57.5	5.4	63.0	37.0	100
Manipur	21.4	25.3	41.6	58.4	100	42.5	23.5	66.0	34.0	100
Meghalaya	27.6	12.1	37.2	62.8	100	55.0	4.8	59.8	40.2	100
Mizoram	19.1	22.3	36.9	63.1	100	40.1	33.8	73.8	26.2	100
Nagaland	15.8	29.2	39.1	60.9	100	34.0	35.5	69.4	30.6	100
Sikkim	27.1	0.0	27.1	72.9	100	60.6	1.5	62.1	37.9	100
Tripura	24.5	19.0	39.7	60.3	100	46.0	13.2	59.1	40.9	100
Memo:										
All States	58.7	6.9	64.3	35.7	100	61.0	7.4	68.5	31.5	100
General States (GS)	63.3	5.8	68.0	32.0	100	62.9	6.0	68.9	31.1	100
North-eastern States	32.7	12.7	42.9	57.1	100	53.0	12.2	65.2	34.8	100

Note: a. All States refers to 28 states.

b. Data for 2019-20 relates to Revised Estimates and for all other years are actual accounts.

Source: [$] Ministry of Finance: Union Budget, Various Issues, Government of India, New Delhi.

[#] Extracted from *EPWRF India Time Series*, www.epwrfits.in

Constraints to Fiscal Capacity

In a federal set-up like India, it is of utmost importance for each constituent state to make significant strides in revenue collection. However, own revenue receipts of the NES are generally found low (Table 2, p 70). As percentage of the gross state domestic product (GSDP), own tax revenue (OTR) of all NES has remained lower than that of general states.[2] Though Assam and Meghalaya have generally performed better in the collection of OTR throughout, a majority of other states have also reported an increasingly good collection during period two. In non-tax revenue (NTR) collection, these states have done marginally better than general states. Notably, Sikkim had NTR more than OTR during period one and it declined sharply in the subsequent period. In fact, the state's NTR used to account for 9.4% of the GSDP in 2011–12 and this steadily declined to less than 2.5% in recent years—an intriguing phenomenon by itself. Arunachal Pradesh and Mizoram are the other two states that had a NTR of over 2% of GSDP throughout, without much fluctuations. It is clear that NES have not performed well in their own revenue collection compared to general states. There are several constraints and structural rigidities faced by NES on account of which they suffer from serious revenue disabilities as well as cost disabilities.

Table 2: Own Revenue Receipts of NES

(as % of GSDP)

State	Own Tax Revenue		Non Tax Revenue	
	2011-12 to 2014-15	2015-16 to 2018-19	2011-12 to 2014-15	2015-16 to 2018-19
Arunachal Pradesh	2.8	3.6	2.7	2.2
Assam	5.1	4.7	1.6	1.7
Manipur	2.8	3.1	1.7	0.7
Meghalaya	3.9	4.7	2.0	1.5
Mizoram	2.4	2.9	2.1	2.1
Nagaland	2.3	2.6	1.6	1.4
Sikkim	3.3	3.0	6.5	2.3
Tripura	4.3	3.5	0.9	0.8
Memo:				
All States	6.8	6.3	1.2	1.2
General States	6.9	6.4	1.2	1.1

Note: All states refers to 28 states.
Source: Extracted from Finance Commission (2020), *Volume-IV The States.*

The fiscal efficiency of the NES is acutely affected by the structure of the economy featured by the preponderance of primary sector (agriculture and mining), and public administration (Table 3).[3] Overall, about 30% of gross state value added (GSVA) in NES comes from primary sector as against 21% in general states. Primary sector accounts for about 40% of GSVA in Tripura and a sizeable portion in other states as well, and the sector's importance is on the rise in Manipur, Meghalaya, Mizoram and Tripura. The proportionate share of public administration in the state's income of NES is high at about 9% compared to about 4% of general states, and the sector's share witnessed a marginal increase over the years in Arunachal Pradesh, Assam, Meghalaya and Nagaland. Primary sector and public administration are, thus, the major sectors in NES, except in Sikkim, and these sectors are the ones with a limited scope for revenue generation. The industrial base in NES is weak due to a number of inhibiting factors; notable ones include high cost of production arising from the complex topography of the region (hilly terrain), severe infrastructural bottlenecks, small size of local markets, lack of entrepreneurship, long international borders, internal strife in some parts, restrictive land laws and even fears of foreign usurpation of scarce local resources. On account of these factors, NES suffer from a low level of industrialisation, employment opportunities, urbanisation and commercial activities. As a result, economic activities that have a potential for augmenting state's revenue are found wanting and their absence severely constrains fiscal capacity of state governments in the region.

Table 3: Major Sector's Contribution to Gross State Value Added

(%)

State	Primary Sector		Public Administration	
	2011-12 to 2014-15	2015-16 to 2018-19	2011-12 to 2014-15	2015-16 to 2018-19
Arunachal Pradesh	45.0	38.2	12.6	14.4
Assam	31.1	30.9	6.1	7.0
Manipur	21.5	23.3	17.0	16.4
Meghalaya	22.6	24.1	9.7	11.5
Mizoram	23.1	29.1	18.1	13.3
Nagaland	33.3	31.9	15.5	17.9
Sikkim	9.1	9.7	7.1	6.2
Tripura	35.2	41.6	12.1	11.5
Memo:				
All States	22.2	21.1	4.3	4.2
General States	22.2	21.0	4.1	4.0
North-eastern States	29.8	30.3	8.9	9.4

Source: The author's calculation based on data extracted from *EPWRF India Time Series* (www.epwrfits.in)

Dependence on Transfers

As a proportion of GSDP, the total revenue receipts (TRR) of NES are relatively high compared to that of general states, but the bulk of it comes from central transfers (Table 4, p 71). The TRR showed an appreciable rise in Arunachal Pradesh from being around 47% of GSDP in period one to nearly 61% in period two, whereas it remained around 19% in Assam and 43% in Nagaland throughout. The TRR had declined in some states, more prominently in Sikkim from 31% of GSDP in period one to 21% in period two. With own resources remaining low, these states have a high level of dependency on central transfers. In

Arunachal Pradesh, Manipur, Mizoram and Nagaland, nearly 90% of TRR comes from central transfers. In the remaining states, other than Assam, central transfers account for more than three-fourths of TRR. Though the vertical devolution has increased in the Fourteenth Finance Commission award to 42% from 32% of the divisible pool, the central transfers as a proportion of GSDP have noticeably increased only in Arunachal Pradesh and Meghalaya. The ratio remained nearly the same or has declined in other states, despite the continuing significance of central transfers. A comparison of the size of central transfers, as a proportion to GSDP, shows that, except Sikkim, those states reporting an increase or a decrease in the ratio of TRR to GSDP in period two also have the ratio of central transfers to GSDP increasing or decreasing, as the case may be, nearly by the same proportion over period one. In Sikkim, the reduction in TRR is on account of reduction in both central transfers and own NTR. The reduction in the number of CSS and other conditional transfers, subsequent to the increase in the share of tax devolution from the divisible pool in the Fourteenth Finance Commission award, thus had an adverse effect on the finances of a majority of the NES.

Table 4: Total Revenue Receipts of NES

(as % of GSDP)

State	Total Revenue Receipts		*Of which*: Central Transfers	
	2011-12 to 2014-15	2015-16 to 2018-19	2011-12 to 2014-15	2015-16 to 2018-19
Arunachal Pradesh	46.6	60.9	41.2	55.0
Assam	19.1	19.3	12.4	12.8
Manipur	45.6	40.9	41.2	37.0
Meghalaya	25.9	30.3	20.0	24.1
Mizoram	48.5	44.8	44.1	39.8
Nagaland	42.6	42.9	38.8	39.0
Sikkim	31.0	21.0	21.1	15.7
Tripura	31.9	24.4	26.6	20.1
Memo:				
All States	13.3	14.0	5.3	6.5
General States	12.7	13.4	4.6	5.9

Note and Source: Same as Table 2.

High Committed Expenditures

In a majority of NES, government spending is the lynchpin of their economic activities given its large size. As a proportion of GSDP, the total expenditure (combined revenue and capital expenditure) is higher amongst NES than general states (Table 5). Arunachal Pradesh has recorded a higher level of government spending than its peers at 62% of GSDP in period two, and up from 51.4% in period one. Mizoram and Nagaland also continue to have a high level of government expenditure—at around 45% of the GSDP. It is, however, instructive to note that government spending in these states largely depends upon central transfers. The rate of increase in the ratio of government expenditure to GSDP during period two in Arunachal Pradesh and Meghalaya is nearly the same as the rate of increase in the ratio of central transfers to GSDP. In a similar manner, the states where the size of central transfers has decreased also witnessed an equivalent decline in government spending. This highlights the centrality of the central transfers for undertaking additional government spending in these states. Moreover, the bulk of government expenditures are committed ones comprising salaries, pension and interest payments. More than half of the total expenditure is accounted by committed expenditure in Assam, Manipur, Nagaland and Tripura. A further comparison reveals that the own revenue receipts have remained higher than their committed expenditure in general states, whereas the committed expenditure exceeds own revenue receipts by a huge margin in NES. Thus, huge government spending in NES is featured side by side by their overwhelming dependence on central transfers even to meet their committed expenditure.

Table 5: Total Expenditure (Revenue + Capital)

(as % of GSDP)

State	Total Expenditure		*Of which*: Committed Expenditure	
	2011-12 to 2014-15	2015-16 to 2018-19	2011-12 to 2014-15	2015-16 to 2018-19
Arunachal Pradesh	51.4	62.0	21.6	23.7
Assam	20.9	20.8	12.3	12.1
Manipur	48.1	43.1	24.5	21.7
Meghalaya	29.3	33.2	11.5	13.3
Mizoram	56.0	44.8	26.1	20.3
Nagaland	45.8	45.5	26.0	26.0
Sikkim	32.2	22.7	11.4	10.4
Tripura	32.0	29.1	16.2	16.0
Memo:				
All States	15.8	17.1	6.2	6.2
General States	15.1	16.6	5.7	5.8

Note: Committed Expenditure includes Interest, Pension and Salary.
Source: Same as Table 2.

Fluctuating Fiscal Deficits

While general states generally have revenue deficit, all of the NES have revenue surplus (Table 6). The magnitude of revenue surplus varied across NES. In 2018–19, for instance, Arunachal Pradesh reported revenue surplus of 15.3% of GSDP, Mizoram 7.9% and Assam 2.1%. Tripura used to have a high level of revenue surplus of 7.5% in period one, but it shrunk to 1.5% in period two. During these periods, the average revenue surplus of Arunachal Pradesh stood at 7.3% and 13% of GSDP, respectively. Revenue surplus also went up in Mizoram, but declined in Manipur, Nagaland Sikkim and Tripura. With low level of own revenue receipts, the revenue surplus of these states is therefore on account of larger central transfers. On the other hand, the NES have fiscal deficits similar to that of the general states. The period average shows some improvement in the reduction of fiscal deficit across the NES, except in Tripura and Sikkim. A year-on-year comparison shows that fiscal deficit of some NES exceeded that of general states by a huge margin in some years. And also, there is no discernible trend in the magnitude of fiscal deficit or surplus across the states and over the years. To illustrate, Arunachal Pradesh had a fiscal deficit of 11% of GSDP in 2013–14 and this dropped to a surplus of 2.9% in the very next year. Similarly, the state's fiscal deficit was 1.4% of GSDP in 2017–18 and this went up to 8% in the following year. In a way, this suggests a lack of stability in capital expenditure, or for that matter in the management of state finances. Other than Tripura, the NES recorded fiscal deficit of less than 3% of GSDP in the Fourteenth Finance Commission award period; thus, they have more fiscal space despite suffering from deficiency in fiscal capacity.

Table 6: Deficit Indicators of NES

(as % of GSDP)

State	Revenue Deficit		Fiscal Deficit	
	2011-12 to 2014-15	2015-16 to 2018-19	2011-12 to 2014-15	2015-16 to 2018-19
Arunachal Pradesh	-7.3	-13.0	4.7	1.1
Assam	-0.3	-1.0	1.8	1.5
Manipur	-7.4	-4.0	2.4	2.2
Meghalaya	-1.4	-1.6	3.3	2.8
Mizoram	0.1	-7.8	7.1	-0.2
Nagaland	-4.9	-2.8	3.1	2.6
Sikkim	-5.3	-2.8	1.1	1.6
Tripura	-7.5	-1.5	0.1	4.6
Memo:				
All States	0.0	0.1	2.3	3.0
General States	0.1	0.2	2.3	3.0

Note: Negative (-) sign indicates surplus and Positive (+) sign indicates deficit.
Source: Same as Table 2.

The state finances of NES are also featured by their high level of debt to GSDP ratio compared to general states (Table 7). Indeed, the debt to GSDP ratio of these states, other than of Assam and Sikkim, is far ahead from the norm of 25%. Nevertheless, this ratio, except Meghalaya, is on a declining trend in period two as compared to period one.

Table 7: Outstanding Debt of NES

(as % of GSDP)

State	2011–12	2014–15	2018–19
Arunachal Pradesh	36.5	34.1	34.9
Assam	22.0	18.1	18.8
Manipur	49.4	40.6	37.5
Meghalaya	25.6	29.1	31.7
Mizoram	62.7	48.5	37.5
Nagaland	55.5	43.2	42.7
Sikkim	22.9	22.6	22.1
Tripura	35.7	31.6	29.7
Memo:			
All States	23.9	23.3	25.3
General States	23.4	23.0	25.0

Source: Same as Table 2.

Fifteenth Finance Commission Formula

For the formulation of criteria and their respective weights for horizontal devolution, the Fifteenth Finance Commission was guided by three principles, namely need and cost disability, equity, and efficiency (performance). The issue of the states' need was addressed by considering the criteria of population, area and forest cover, and ecology. Each of them deserves some discussion, as they are of considerable importance to NES (Table 8). First, population has been used as a need criterion, as it is related to expenditure that states have to incur for providing comparable services to their residents. The Fifteenth Finance Commission used Population Census 2011 and assigned it a weight of 15%. A close examination of the *inter se* shares of NES in the 2011 population reveals that only Assam has a noticeable share of 2.649% and all other states have a share of less than 0.3% each, with Sikkim accounting for 0.052%. Overall, the combined *inter se* share of NES in 2011 population stood at 3.885% marginally up from 3.676% as per 1971 population. Second, the need-based criterion of area was assigned a weight of 15%, and NES invariably benefited by it. Just like its predecessor, the Fifteenth Finance Commission also followed the idea of adjusted area, that is, for 12 small states with less than 2% of share in actual area, a minimum of 2% of *inter se* share in total adjusted area were assigned. Considering the floor limit of 2%, Arunachal Pradesh and Assam are large states, accounting for 2.742% and 2.568%, respectively, of the actual area, and other NES are small states. However, by the idea of adjusted area, the six small NES gained by a good margin, though Arunachal Pradesh and Assam lost by a fraction. The combined *inter se* share of these states stands at 8.583% in the actual area and this doubles to 16.551% in the adjusted area.

Table 8: *Inter se* Shares of NES in Criteria of Horizontal Devolution in the Fifteenth Finance Commission

State	Population		Demographic Performance		Area		Forest and Ecology	Income Distance			Tax Effort	
	(Share-Population 1971) (%)	*Inter se* Share-Population 2011 (%)	Total Fertility Rate (Census 2011)	*Inter se* Share (%)	Area-*Inter se* Share (%)	Adjusted Area *Inter se* Share (%)	*Inter se* Share (%)	Average (₹)	Rank	*Inter se* Share (%)	Tax/GSDP (%)	*Inter se* Share (%)
Arunachal Pradesh	0.087	0.117	2.240	0.080	2.742	2.350	13.302	140197	15	0.100	3.890	0.073
Assam	2.716	2.649	2.160	2.596	2.568	2.201	3.367	83552	24	3.752	4.860	2.042
Manipur	0.199	0.242	1.860	0.221	0.731	2.000	1.878	77379	25	0.358	3.160	0.121
Meghalaya	0.188	0.252	3.630	0.107	0.734	2.000	2.513	84717	23	0.354	5.090	0.203
Mizoram	0.062	0.093	2.560	0.050	0.690	2.000	1.534	165119	12	0.056	2.910	0.043
Nagaland	0.096	0.168	2.080	0.095	0.543	2.000	1.496	118976	16	0.179	2.680	0.071
Sikkim	0.039	0.052	1.440	0.056	0.232	2.000	0.683	388736	2	0.011	2.930	0.024
Tripura	0.289	0.312	1.730	0.345	0.343	2.000	1.517	109834	18	0.360	3.550	0.176
Memo:												
All States	100.000	100.000	2.170	100.000	100.000	100.000	100.000	125242		100.000	6.300	100.000
North-eastern States	3.676	3.885		3.550	8.583	16.551	26.290			5.170		2.753

Source: Extracted from Finance Commission (2020), *Volume II Annexures.*

And, finally, with regard to forest cover and ecology criteria, the Fifteenth Finance Commission felt that states with forest cover provide ecological benefits, but at the same time, they face fiscal disabilities due to the significant opportunity cost of forest cover, which needed to be compensated. Forest being a concurrent list subject, most of its expenditure falls on the states. The Fifteenth Finance Commission assigned an increased weight of 10% to forest and ecology criteria that included very dense and moderately dense forest, compared to 7.5% in the Fourteenth Finance Commission formula. Amongst all states, Arunachal Pradesh has the largest forest cover accounting for a whopping *inter se* share of 13.302%. Assam is the next NES with a large *inter se* share of 3.367%. In forest cover and ecology criterion, the combined *inter se* share of NES stands at 26.290%; perhaps, the only criterion in which these states had relatively more advantage.

Insofar as equity-based criteria are concerned, like earlier finance commissions, the Fifteenth Finance Commission also used per capita income distance with a weight of 45%. It has been maintained that income distance is more equitable and progressive, as it provides a higher share to those states with lower income. Of the NES, only Arunachal Pradesh, Mizoram and Sikkim have higher per capita income than of all states. Sikkim is a state with the second highest per capita income—nearly three times more than that of all states. The average per capita income of Assam, Manipur and Meghalaya is about two-thirds of all states. The combined *inter se* share of these states in income distance stands at 5.170%, which is 1.33 times higher than their *inter se* share in population. Because income is also a major determinant of revenue capacity of a state, per capita income is used; low-income implies low revenue capacity. This does not, however, hold good for all the NES, as those states with higher incomes, such as Arunachal Pradesh, Mizoram and Sikkim are also the ones with low tax to GSDP ratio.

The Fifteenth Finance Commission used demographic performance and tax effort for performance-based criteria. The demographic performance has been used for the first time to reward those states that have done well in controlling their population growth and also in achieving better human capital outcomes in education and health. It may be recalled that there were some apprehensions when the terms of reference (ToR) of the Fifteenth Finance Commission mandated it to use population Census 2011 in lieu of the 1971 Census, belying the expectation of the states which took serious measures towards population control since the 1970s (Bhaskar 2018). To dispel these apprehensions, the Fifteenth Finance Commission has used demographic performance using the reciprocal of total fertility rate (TFR) scaled by the population of the 1971 Census and assigned a weight of 12.5%. States such as Arunachal Pradesh, Meghalaya and Mizoram had a TFR higher than 2.17 of all states. Sikkim is the state with the least TFR of 1.44. These states together had *inter se* share of 3.55% in demographic performance.

Another performance indicator was tax effort; it basically sought to reward states with a better tax collection effort and, at the same time, motivate others to become more tax efficient. The Fifteenth Finance Commission used the ratio of tax to GSDP (average for 2016–17, 2017–18 and 2018–19) and assigned it a weight of 2.5%. Considering the fact that the tax to GSDP ratio of all of the NES remained too low compared to 6.3% of all states, the total *inter se* share of NES stood at 2.753%—the lowest of all criteria. On a balanced consideration, it can be said that the need-based criteria have favoured the NES and equity-based criteria only to a limited extent.

Suggestions by the NES

As part of consultative process, the finance commission encourages states to propose criteria and weights for horizontal devolution reflecting their aspirations and expectations. It is instructive to examine how far the final criteria adopted by the Fifteenth Finance Commission have represented various suggestions given by the state governments in the region (Table 9). In this context, the following observations are made.

Table 9: Criteria and Weights Proposed by NES

State	Vertical Devolution	Horizontal Devolution				
		Population	Forest Area	Area	Income Distance	Other
Arunachal Pradesh	50	20	10	20	30	Performance based criteria : 5% Infrastructure deficit: 5% Deficit in Human Development: 10%
Assam	50	20	10	5	50	Socio Economic Infrastructure Gap: 15%
Manipur	50	15	15	15	55	
Meghalaya	48	25	10	15	50	
Mizoram	50	25	10	10	40	Fiscal Discipline: 7.5% Historical infrastructure gap: 7.5%
Sikkim	50	20	10	20	30	Population Control: 20%
Tripura	50	10	5	10	50	Demographic change: 10% Accessibility and availability of infrastructure: 5% International border: 10%
Recommended by the 15th FC	*41*	*15*	*10*	*15*	*45*	*Demographic performance: 12.5%* *Tax effort: 2.5%*

Note: Government of Nagaland did not have proposal with regard to horizontal devolution.
Source: Same as Table 2.

One, a majority of the NES recommended that the vertical devolution be raised to 50% of shareable resources from 42% under the Fourteenth Finance Commission. Meghalaya recommended 48%. The Government of Tripura proposed 50% in light of rising shares of cesses and surcharges and discontinuation of central grants such as normal, special, and special plan assistance. However, the Fifteenth Finance Commission fixed vertical devolution at 41% reasoning that the states in general receive additional financial resources through the finance commissions' recommended grants and by means of other grants and transfers from the union government. Two, Arunachal Pradesh recommended that 10% of the total shareable resources be set aside for NES. Nagaland suggested that 25% of the total devolution to the states be set aside for special category states, and of this, 3% each could be allocated to states like Nagaland. However, no such exercise was undertaken by the Fifteenth Finance Commission. Three, all state governments of NES, other than Nagaland, recommended a number of criteria for horizontal devolution. Arunachal Pradesh and Tripura recommended seven criteria each, Mizoram six criteria, Assam and Sikkim five criteria each, and Manipur and Meghalaya four each. Of these, four criteria are found common across the states. They include population (use of 2011 Census), income distance, area and forest cover, which also their found place in the ultimate formula of the Fifteenth Finance Commission. Four, Tripura recommended a weight of 5% to the criteria of forest, whereas all other six states recommended 10% which is in conformity with the formula of the Fifteenth Finance Commission. Five, with regard to weight to area criteria, suggestions varied between 5% (by Assam) and 20% (by Arunachal Pradesh and Sikkim). Meghalaya recommended a floor limit of 2% to small states and the use of the three dimension (3D) area for hill states. The final weight of 15% to the criteria of area in the Fifteenth Finance Commission formula compares well with the proposal made by the NES.

Six, there appears to be no disagreement amongst the NES for adopting the population of the 2011 Census. Arunachal Pradesh, Assam and Sikkim favoured giving 20% weight to population criteria. While Meghalaya favoured 17.5%, it additionally recommended 7.5% to the composition of the Scheduled Tribe (ST) population, thus making it a total of 25%. Sikkim and Tripura also recommended separate weights for population control or demographic changes. The Fifteenth Finance Commission assigned a weight of 15% to population criteria. Seven, all of the NES favoured income distance to a considerable extent. As many as four state governments were in favour of assigning weights of more than 50% to income distance. Arunachal Pradesh and Sikkim recommended a lesser weight of 30% and Mizoram 40%—these are the three NES with per capita income exceeding all states' average. More so, Arunachal Pradesh suggested the exclusion of agricultural GSVA while computing per capita income. Thus, income distance has the maximum weight in the proposals of the NES governments, and the Fifteenth Finance Commission has also assigned a maximum weight of 45% to income distance. And, finally, several states suggested a few other criteria, which are mostly centred on infrastructure deficit and performance. Tripura wanted to include international border as a criterion. Taken together, it is observed that the Fifteenth Finance Commission's formula for horizontal devolution among states by and large resonated the suggestions of the governments of NES; as many as four criteria, with a total weight of 85%, are nearly consistent with the recommendations of a majority of these states.

A Favourable Award

The *inter se* shares of the NES in the divisible pool of shareable tax resources showed an increase to 8.533% under the Fifteenth Finance Commission award from 7.907% under the Fourteenth Finance Commission award (Table 10). Although the total *inter se* share of these states has steadily increased in the last four finance commission awards, a sharp rise is noticed under the Fourteenth Finance Commission award by 1.759 percentage points over the Thirteenth Finance Commission award. Such a scale of increase was attributed to the inclusion of forest cover with a weight of 7.5% and enhancing the weight to area criteria to 15% from the erstwhile 10%. One state that benefited the most on account of this is Arunachal Pradesh, which continues to have attained a higher and an increased *inter se* share in the Fifteenth Finance Commission award as well. While the combined *inter se* share of NES went up, that of Assam went down further to 3.128% from 3.311% in the Fourteenth Finance Commission award. As noted above, the criteria of area, and forest cover and ecology have favoured these NES, thus enhancing their *inter se* share in the horizontal devolution.

Table 10: *Inter Se* Share of North-eastern States in All Shareable Union Taxes

(%)

Finance Commission Award Period	Twelfth Finance Commission 2005-2010	Thirteenth Finance Commission 2010-2015	Fourteenth Finance Commission 2015-2020	Fifteenth Finance Commission 2021-2026	Share (expected) in Central Taxes & Duties under Fifteenth Finance Commission Award (₹Crore)	
Arunachal Pradesh	0.288	0.328	1.370	1.757	74,227	*(93.4)*
Assam	3.235	3.628	3.311	3.128	132,152	*(77.8)*
Manipur	0.362	0.451	0.617	0.716	30,251	*(68.7)*
Meghalaya	0.371	0.408	0.642	0.767	32,403	*(83.1)*
Mizoram	0.239	0.269	0.460	0.500	21,124	*(70.0)*
Nagaland	0.263	0.314	0.498	0.569	24,039	*(50.3)*
Sikkim	0.227	0.239	0.367	0.388	16,393	*(84.1)*
Tripura	0.428	0.511	0.642	0.708	29,912	*(55.6)*
Memo:						
All States	100	100	100	100	4,224,760	*(80.6)*
North-eastern States	5.413	6.148	7.907	8.533	360,501	*(74.6)*

Note: 1. Shareable union taxes are excluding service tax until the Fourteenth Finance Commission.
2. Figures in brackets are share (expected) in central taxes and duties as % of the total finance commission transfers to respective states.

Source: Based on data extracted from Fifteenth Finance Commission (2020), *Main Report* and related previous issues.

Grants-in-Aid

Another major route used for resource transfers from the union government is grants-in-aid. The Fifteenth Finance Commission took a positive view on this issue reasoning that "the grants-in-aid can make corrections for cost disabilities and other redistributive requirements which can be addressed only to a limited extent in any devolution formula" (Finance Commission 2020: 291). In accordance with this, the Fifteenth Finance Commission has increased the proportionate share of grants-in-aid in the total union government transfers to 19.65% during its award period, compared to 11.97% in the Fourteenth Finance Commission award. The NES generally suffer from both fiscal and cost disabilities, and considering this, a favourable view on the usefulness of grants-in-aid is a welcome step.

Of the total grants-in-aid to all states, the NES are expected to receive 12.1% (Table 11). Of these states, Assam's share is high at 3.7% of the total. The relative share of Nagaland and Tripura stands at 2.3% each, whereas of Arunachal Pradesh, Meghalaya, Mizoram and Sikkim is less than 1% each. The Fifteenth Finance Commission recommended distribution of grants-in-aid to states under five major heads, of which grants to local governments has the largest share of 42.1% of the total, followed by post-devolution revenue deficit grant (29%). The disaster relief grants and sector-specific grants account for about 12% each and state-specific grants for 4.9% of the total grants-in-aid.

Table 11: Grants-in-Aid (Expected) to North-eastern States in the Fifteenth Finance Commission Award

(₹ Crore)

State	Post -devolution Revenue Deficit Grants to States	Disaster Relief Grants to States	Grants to Local Governments to States#	State-specific Grants	Sector-specific Grants $	Total Grants-in-Aid	
Arunachal Pradesh	-	1,382	1,618	400	1,865	5,265	*(6.6)*
Assam	14,184	4,268	10,934	1,375	6,850	37,611	*(22.2)*
Manipur	9,796	234	1,277	900	1,597	13,804	*(31.3)*
Meghalaya	3,137	363	1,385	800	924	6,609	*(16.9)*
Mizoram	6,544	259	713	700	824	9,040	*(30.0)*
Nagaland	21,249	228	1,038	525	733	23,773	*(49.7)*
Sikkim	1,267	279	360	500	682	3,088	*(15.9)*
Tripura	19,890	378	1,580	875	1,152	23,875	*(44.4)*
Memo:							
All States	294,514	122,601	427,911	49,599	122,037	1,016,662	*(19.4)*
General States	153,101	107,774	401,776	40,504	100,918	804,073	*(17.5)*
North-eastern States	76,067	7,391	18,905	6,075	14,627	123,065	*(25.4)*

Note: 1. Figures in brackets are percentage of grants-in-aid to the total finance commission transfers to respective states.

2. # excludes ₹8,000 crore earmarked for incubation of new cities, and ₹450 crore for facilitating shared municipal services.

3. $ excludes ₹4,800 crore for enhancing school outcomes and ₹500 crore for aspirational districts and blocks.

Source: Extracted from Fifteenth Finance Commission (2020), *Main Report*, Table 10.13, p. 328.

An interesting pattern observed in the distribution of grants-in-aid across the NES is that while revenue deficit grant is nil for Arunachal Pradesh, it is the largest grant to all other NES; more than 80% of the total grants-in-aid to Nagaland and Tripura is accounted by it. Although a few states were of an opinion that the revenue deficit grant was a disincentive for tax effort and prudent expenditure management, the NES were generally in favour of its continuance arguing that their need for social sector expenditure and maintenance of capital assets were relatively higher than other states due to topographical conditions (Finance Commission 2020: 293). In grants-in-aid to Assam, local governments grants is the second largest followed by sector-specific grants. For the NES as a whole, grants-in-aid constitute about 25% of the finance commission transfers compared to 17.5% of general states. It accounts for nearly half of the total finance commission transfers to Nagaland, 44.4% to Tripura, and a little over 30% to Manipur and Mizoram. Arunachal Pradesh has the least share of grants-in-aid at 6.6% of the finance commission transfers.

Though the Fifteenth Finance Commission awarded a significant portion of grants-in-aid in the form of grants to local government, it also noted the lack of progress made in the appointment of state finance commissions (SFCs), whose recommendations mattered for transferring grants to the local bodies. And so, it mandated that no grants are to be released to states if they have not complied with the constitutional provisions in respect of SFCs before March 2024. A lot needs to be done in the appointment of SFCs in all NES, except in Assam and Sikkim (Finance Commission 2020: 177). This requires the utmost attention of the state governments in the region.

Finance Commission Transfers

The size of the finance commission transfers to NES as a whole is expected to remain at about 13.2% of GSDP under the Fifteenth Finance Commission award, which is similar to the level observed under the Fourteenth Finance Commission award period (Table 12, p 74). This is in conformity with the commission's "considered view" of ensuring "broad continuity in the availability of resources through the divisible pool" (Finance Commission 2020: 12). It is important to note that in spite of the marginal increase in the *inter se* shares of these states in the formula-based horizontal devolution, the assessed finance commission transfers on acc-ount of this as a proportion of GSDP show some decline, which is compensated by an almost equivalent increase in the grants. Some variations are noticed across the states. The size of the finance commission transfers, as a proportion of GSDP, is expected to go up marginally in the case of Arunachal Pradesh, Meghalaya and Tripura; these are the states that also recorded some increase in the finance commission transfers under the Fourteenth Finance

Commission award. The finance commission award as a proportion of GSDP also increased in the case of Mizoram under the Fourteenth Finance Commission but is expected to decrease under the Fifteenth Finance Commission award; for instance, the state received finance commission transfers to the tune of 27.4% of its GSDP under the Fourteenth Finance Commission award period and the expected ratio in the Fifteenth Finance Commission award is 16.7%—a reduction by 10.7 percentage points. Similarly, finance commission transfers to Nagaland are expected to go down by 4.8 percentage points of GSDP to 21.3% in the Fifteenth Finance Commission award, from 26.1% it received under the Fourteenth Finance Commission award. The finance commission transfers to Assam, the largest NES, is likely to remain unchanged at about 8.3% of GSDP. If the assessed own revenue receipts of these states are not going to improve much, the lack of additional budgetary support outside finance commission transfers could worsen their fiscal imbalances, thus forcing them to rely more on borrowing.

Table 12: Expected Finance Commission Transfers to NES during the Fifteenth Finance Commission Award Period

(as % of GSDP)

State	Thirteenth Finance Commission Award Period#*			Fourteenth Finance Commission Award Period#			Fifteenth Finance Commission Award Period$		
	Share in Central Taxes and Duties	Grants-in-Aid	Finance Commission Transfers	Share in Central Taxes and Duties	Grants-in-Aid	Finance Commission Transfers	Share in Central Taxes and Duties	Grants-in-Aid	Finance Commissi on Transfers
Arunachal Pradesh	7.1	3.9	10.0	39.1	0.2	39.4	38.6	2.7	41.3
Assam	6.4	0.3	6.6	7.4	0.7	8.2	6.4	1.8	8.3
Manipur	8.9	10.1	16.4	15.8	8.8	24.6	15.0	6.9	21.9
Meghalaya	5.5	2.5	7.4	13.5	1.2	14.7	15.0	3.1	18.0
Mizoram	8.4	9.3	15.4	14.9	12.5	27.4	11.7	5.0	16.7
Nagaland	6.2	10.5	14.1	12.8	13.3	26.1	10.7	10.6	21.3
Sikkim	5.4	0.0	5.4	9.5	0.2	9.7	7.1	1.3	8.4
Tripura	6.4	4.5	9.8	9.2	2.6	11.8	8.0	6.4	14.4
Memo:									
All States	3.0	0.4	3.3	3.9	0.5	4.4	3.4	0.8	4.2
General States	2.9	0.3	3.1	3.7	0.4	4.0	3.2	0.7	3.9
North Eastern States	6.5	2.4	8.3	10.6	2.5	13.1	9.8	3.3	13.2

Note: * Pertains to the last four years of the award period, that is, 2011-12 to 2014-15

Source: # Same as Table 1 $ Based on data extracted from Fifteenth Finance Commission (2020), *Main Report Volume*

Concluding Remarks

As time and again recognised by the finance commissions, the fiscal efficiency of NES is adversely affected by a combination of factors which are unique to the region—structure of the economy, topographical characteristics, infrastructural bottlenecks and poor human development. The analysis of state finances of NES reveals that although the central transfers continue to remain a dominant source of revenue receipts, they are as a proportion of GSDP on the declining trend in the Fourteenth Finance Commission award period (with exception of Arunachal Pradesh and Meghalaya), largely because a number of CSS and other conditional transfers have been restructured. There have been some improvements in the reduction of fiscal deficit relative to the GSDP during the Fourteenth Finance Commission award period, when the average fiscal deficit stood less than 3% of GSDP. Governments in the region should therefore utilise the fiscal space available to them by prudent expenditure management, especially of capital expenditure. That said, these states alone cannot address the serious challenges arising from the structural disabilities they suffer from. It is desirable that the union government supplement the finance commission transfers with other budgetary support, particularly for social and economic infrastructure development.

NOTES

[1] The NES comprises Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura.

[2] The Fifteenth Finance Commission grouped 28 states into two categories, namely the 10 north-eastern and Himalayan states (NE&HS) consisting of all of the eight NES, Himachal Pradesh and Uttarakhand, and 18 general states.

[3] For more details, see EPWRF (2018).

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