



FINANCE COMMISSION AND CLIMATE CHALLENGES - GS II AND III MAINS

Q. As India stands at the crossroads of economic growth and environmental sustainability, the Finance Commission's role in fiscal federalism becomes crucial. Explain (10 marks, 150 words)

News: *To combat climate challenges, the Finance Commission needs to step up*

What's in the news?

- In recent years, India has emerged as a significant player in global efforts to combat climate change and enhance forest cover.
- This has not only contributed to environmental sustainability but also bolstered the resilience of communities and ecosystems.

Key takeaways:

- As India faces the challenges posed by climate change, fiscal federalism, particularly through the role of the Finance Commission (FC), has played a pivotal role in incentivising states to prioritise conservation efforts.

Finance Commission's Role in Fiscal Federalism and Forest Conservation

1. Incentivising Conservation Efforts:

- The FC's initiatives have been instrumental in providing concrete incentives for states to invest in forest conservation.
- By allocating specific funds dedicated to this cause, the FC acknowledges the intrinsic link between healthy forests, sustainable ecosystems and the overall well-being of the nation.
- This financial support acts as a catalyst, encouraging states to prioritize conservation efforts without compromising their economic interests.

2. Revenue Capacities and Expenditure Needs:

- Forest resources are not just a repository of biodiversity; they are also economic assets for states.
- The FC recognises that the conservation of standing forests and the augmentation of forest cover density have direct implications for the revenue capacities and expenditure needs of states.
- Striking a balance between the economic exploitation of forest resources and their conservation becomes imperative to ensure both environmental sustainability and economic prosperity.

Past Instances of FC Initiatives in Forest Conservation Efforts:

- The **12th FC (2005-10)** allocated Rs 1,000 crore for forest conservation, setting the stage for subsequent efforts.



- The **13th FC (2010-15)** increased this allocation to Rs 5,000 crore, emphasising the growing importance of environmental conservation.
- The **14th FC (2015-20)** introduced a significant shift by dedicating 7.5% of the divisible central tax pool to ecology and forests, reflecting a more comprehensive approach.
- The **15th FC (2021-26)** further increased this share to 10%, making it the largest payment for ecosystem services (PES) system globally.

Challenges in Navigating the Complexities of Fiscal Federalism and Environmental Conservation in the Current Scenario:

1. Balancing Conservation Costs with Economic Needs:

- The opportunity costs associated with conservation efforts can be substantial, particularly for states facing economic hardships.
- The financial burden of dedicating resources to forest preservation may strain state budgets, posing a challenge in garnering widespread commitment.

2. Innovative Financing Models for Conservation:

- The traditional models of financing conservation efforts may not be sufficient or sustainable in the long run.
- Relying solely on grants may create dependencies and hinder the development of self-sustaining mechanisms for conservation.

3. Climate-Induced Economic Vulnerabilities:

- The impacts of climate change pose significant threats to economic stability, especially for states reliant on sectors sensitive to climate variations.
- Unpredictable weather patterns, floods, and forest fires can exacerbate existing vulnerabilities.

4. Strategic Allocation of Resources:

- The FC faces the intricate task of allocating resources strategically to maximise both environmental and economic benefits.
- Ensuring that funds are directed toward key conservation initiatives while supporting state development goals requires a nuanced approach.

5. Integrating Environmental Goals with Fiscal Capacity:

- States may struggle to align their environmental goals with their fiscal capacity, leading to a potential disconnect between aspiration and implementation.

6. Ensuring Equitable Participation:

- There is a risk that states with greater fiscal capacities might disproportionately benefit from conservation incentives, widening existing economic disparities.

Potential Role of 16th Finance Commission:

1. Incorporating Climate Parameters into Tax Devolution Formula:

- The 16th FC can introduce a paradigm shift by incorporating climate vulnerability and emission intensity as key parameters in the tax devolution formula.
- By doing so, the commission aligns the fiscal incentives directly with India's Nationally Determined Contributions (NDCs) under the Paris Agreement, creating a powerful mechanism for states to actively contribute to the country's climate goals.



2. Performance-Based Grants for Crucial Sectors:

- Recognising that specific sectors play a pivotal role in achieving NDCs and Sustainable Development Goals (SDGs), the 16th FC can consider introducing performance-based grants.
- These grants can be tailored for sectors such as clean energy, sustainable land and forest management, and initiatives combating air pollution.
- This approach provides targeted financial support, ensuring that states actively engage in transformative actions.

3. Address Challenges in Emission Reduction:

- The commission can prioritise emission reduction by emphasising the decarbonisation of key sectors, such as energy and transport.
- This involves not only incentivizing states to adopt clean energy practices but also fostering innovation to address the seemingly intractable problem of crop burning.
- By allocating funds strategically, the 16th FC can drive tangible progress in mitigating the sources of emissions.

4. Fund Innovations for Ecological Challenges:

- The 16th FC can allocate funds to innovative solutions for ecological challenges induced by climate change.
- Whether it be mangrove restoration to counter weather vagaries or addressing the increasing incidents of forest fires, the commission can serve as a catalyst for research, development, and implementation of sustainable strategies.

5. Utilise Scientific Data for Informed Decision-Making:

- In an era of advanced technology, the 16th FC can leverage scientific data, pollution inventories, and remote sensing to ascertain the vulnerability of states and their mitigation efforts.
- This data-driven approach ensures that fiscal decisions are grounded in empirical evidence, enabling the commission to design a performance-based system for fund allocation that is both effective and equitable.

6. Transform into an Orchestrator of Climate Readiness:

- Beyond its conventional role as a fiscal arbitrator, the 16th FC can transform into an orchestrator of India's climate readiness.
- This transformation involves actively participating in the design and implementation of a fiscal blueprint that balances economic growth with environmental imperatives.
- The commission can become a guiding force in shaping policies that balance the needs of the present without compromising the ability of future generations to meet their own needs.

As India stands at the crossroads of economic growth and environmental sustainability, the Finance Commission's role in fiscal federalism becomes crucial. The 16th FC, with its potential to shape tax distribution principles and incentivise climate action, holds the key to a harmonious balance between economic development and environmental preservation. Through strategic initiatives and innovative approaches, the FC can transform into a formidable force in India's journey towards climate resilience.