Heed the federal framework

Most federations in the world have arrangements for the mobilisation and devolution of resources. In India, the Constitution provides for the appointment of a Finance Commission every five years to recommend methodology to share resources such that the fiscal space of the constituents, especially the States, is well protected.

The terms of reference of the 15th Finance Commission are thus a matter of utmost importance to the resources available to the States of India. The terms of reference of this Commission have created apprehension among States about principles of fairness and equity in the distribution of public resources for development. This article deals with some general matters of principle in this regard.

First, Article 1 of the Constitution of India recognises India as a Union of States. The unity of India can be preserved only if there is real fairness and equity in the matter of devolution of powers and resources to the States by the Central government. The foremost objective of the Finance Commission is an equitable distribution of financial resources between the two units of the Union.

Even a cursory glance at the State List in the Seventh Schedule of the Constitution shows that in the allocation of duties between the Centre and the States, fundamental tasks of enhancing human development, income growth, livelihoods, and protecting and sustaining the environment are entrusted to the States. However, although these major tasks of nation-building are the duty of the States, the resources to finance them are substantially controlled by the Centre.

I emphasise this point: the States in India today neither have the resources to fulfil their tasks as laid down in the Constitution, nor do they have the right to raise such resources. The present situation is not because of the action or inaction of the States but is directly the consequence of Central government policy.

There is thus a great asymmetry in India’s federal system. The Centre’s capacity to mobilise resources is far greater than that of the States, but the latter are required to undertake development expenditures that far exceed their revenue generating capabilities. The Constitution of India entrusts the Finance Commission with the responsibility of addressing this anomaly. So the basic mandate of the Finance Commission should be seen as that of deciding an appropriate quantum of unconditional devolution of resources from the Centre to the States, combined with more specific grants.

The devolution of resources by the 15th Finance Commission assumes further significance in the current environment, in which the finances of States have received a double blow in the form of demonetisation and the Goods and Services Tax (GST). The freedom of States to raise resources has been restricted by the introduction of the GST. They now have hardly any major tax left with them to make a difference to State resources.

Second, using the population data of 2011 as the base for tax devolution should not reduce the allocation of resources to States that have successfully reduced their rate of population growth. These States have incurred huge fiscal costs in order to achieve a lower population growth and healthy demographic indicators. They have made substantial investments on education, health and directly on family welfare programmes. Bringing down the rate of growth of population does not mean less expenditure for States. On the contrary, it creates new commitments by the States to those in the labour force and to senior citizens.

Many States of India today have achieved a replacement rate of growth of population or have

gone below that rate in a short span of time. An immediate effect of this is a sharp rise in the proportion of elderly in the population. The care of the elderly is the responsibility of State governments. The enhanced costs of such care must be considered by the Commission in making its awards and in deciding the population criterion to be used.

Third, the current terms of reference go far beyond the constitutional mandate of the Finance Commission. Indeed, they intensify efforts to use the Finance Commission as an instrument of fiscal consolidation and to impose the ideological and economic agenda of the Central government on the States. It is not the task of a Finance Commission to recommend “road maps for fiscal management” or to impose its perception of what policies are good for the people of the States. That is for democratically elected State governments to decide.

Fourth, this blatant interventionism finds further and dangerous expression in a statement that should not find a place in any list of terms of reference, that is: “the Commission may also examine whether revenue deficit grants be provided at all.” Revenue deficits are offshoots of the path of development followed by States and cannot be brought down in the short term. For instance, Kerala’s human development achievements are built on its investments in the people – in social sectors, health and education in particular. Public expenditure on them is a large part of the government spending and it has not been easy to bring down revenue deficits despite higher tax efforts. To discontinue post-tax devolution of revenue deficit grants would go against the principle of cooperative federalism.

Fifth, the terms of reference explicitly privilege the “committed expenditures” of the Centre. We should request the Commission to affirm its constitutional status and responsibility by upholding federalism and fiscal autonomy of the States. The Finance Commission should not take a “residual approach” to the question of vertical devolution. The approach should not be that of distributing what is left over after providing for the requirements of the Centre.

Sixth, the terms of reference are unprecedented in asking the 15th Finance Commission to consider proposing performance-based incentives beyond those relating to fiscal responsibility, population and devolution to local bodies. This reflects the viewpoint and ideological inclinations of the Central government and is an attempt to micro-manage the fiscal domain of the State governments. Let us not forget that in many spheres of activity, States have set the agenda for development. These sectors include health, education, forest management, public distribution of food, agricultural production — the list goes on. Such development was not because the concerned States received Central incentives. Best practices were created on their own initiative.

Thus, for the Finance Commission to propose “measurable performance-based-incentives” is nothing short of an attack on the federal structure mandated by the Constitution. It is not the duty of the Finance Commission to venture into the realm of day-to-day governance. The elected governments of States will decide what policies are appropriate for our people.

It is also not for the Finance Commission to declare this or that policy as “populist”. Any measure, from welfare pensions for the poor and weaker sections of the society to food assistance, can be termed as “populist” and recommended to be curtailed. This strikes at the root of a democratic polity in which State governments are free to implement welfare measures, albeit within conditions of fiscal responsibility.

Seventh, it is not correct that the fiscal space available to the Centre has shrunk following the 14th Finance Commission recommendations. The argument today that an increase in devolution from 32% to 42% led to a reduction of the fiscal space available to the Union government is not borne out by the evidence. In practice, when implementing the award of the 14th Finance Commission, the Union government cut allocations to several Centrally Sponsored Schemes in 2015-16. The

cutback was almost equal to the amount received by the States as a whole on account of the rise in share of taxes and duties. Thus, there was no squeeze of the fiscal space available to the Union government, because it had protected itself. In fact, the total resources devolved from the Union to all States put together has been declining as a share of GDP for some years now. There is no ground for reducing the share of States in the vertical devolution. The presumption now appears to be that the relative responsibility for development is shifting from the States to the Centre. Such a presumption, if accepted by the Commission, would shrink the fiscal space of the States and expand that of the Union government.

India’s great wealth rests in its diversity. To recognise this diversity is also to recognise that States will follow diverse paths of development. The Finance Commission must facilitate diversity and a democratic path of development by respecting principles of equity and fairness in allocating resources between the Centre and States in India.

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