

Federalism that's not cooperative

A reliable system of intergovernmental fiscal transfers is the key to a viable and stable federal polity. In India, the design of a sound intergovernmental transfer system that will balance the mismatches in resources and expenditure responsibilities of the various levels of government has been statutorily left to the Union Finance Commission (UFC). After the abolition in 2014 of the Planning Commission, which played a critical role in the Indian transfer system, the UFC has emerged as the principal agency to handle this delicate task. Article 280(3) and its first three clauses clearly spell out the core duties of the UFC: tax devolution, grants-in-aid, and augmenting the resources of panchayats and municipalities. Over the years, the open-ended subclause, 280(3)(d), that provides for “any other matter... in the interests of sound finance”, has been exemplified in the Terms of Reference of recent UFCs. The Terms of Reference of the 15th FC have attracted considerable public debate. Some States even held ‘conclaves’, and six of them submitted a memorandum to the President to alter clauses which allegedly violate constitutional propriety, long-standing precedents, and the “fiscal rights” of States.

The Terms of Reference controversy could have been averted under the dispensation of a truly cooperative federalism. The rationale of Article 280, which establishes the UFC, is derived from the acknowledged mismatches between the resources of the Centre and the expenditure responsibilities of the States. Although the Constitution borrowed heavily from the Government of India Act, 1935, it was not for a continuation of the past but for building a ‘holding together’ federation where joint action is avowedly the binding ethos. The Constitution-makers never asked pertinent questions like who should do what and who should tax where and used the principle of subsidiarity (what can be done best at a particular level should be done at that level and not at a higher level) or other criteria in functional and revenue assignments. Given this historical reality, the Terms of Reference of a UFC should have been a joint exercise rather than a Union diktat.

In preparing the Terms of Reference for a quasi-judicial body like the UFC, it is important not to use it as a platform to impose the Union government’s agenda on the States. The Union governments up to the 10th FC were generally circumspect. The fiscal consolidation roadmaps that entail expenditure compression which ultimately reduce vital public spending on health, education, food security entitlements, drinking water, and so on disturb the finer fabric of India’s cooperative federalism — especially in the context of India’s lowest share of direct taxes in total taxes in the world, disreputable tax-GDP ratio, imprudent transgression into States’ autonomy, alarming growth of economic inequality, and so on. The litany of “fostering higher inclusive growth” guided by “the principles of equity, efficiency and transparency”, which was echoed by earlier Commissions too, has no operational significance when you go through the entire clause, particularly the requirement to “examine whether revenue deficit grants be provided at all.”

Another important issue that has been deliberately omitted in the ongoing debate, as also in the memorandum to the President, relates to transfers to local governments. That, following the 73rd and 74th Constitutional Amendments, Article 280(3) was amended to incorporate the clauses relating to panchayats and municipalities underscores the organic link in Indian federal public finance. It is instructive to recall that Item No.6 of the Terms of Reference of the 11th FC wanted that commission to take into account constitutional mandates such as creation of institutions of self-government, planning for economic development and social justice, and so on. Later on, such clauses were discontinued. The Terms of Reference of the 15th FC introduces “performance-based incentives” which inter-alia want, “Provision of grants in aid to local bodies for basic services, including quality human resources, and implementation of performance grant system in improving delivery of services.” This subclause is not constitutionally neat because grants to local governments constitute a separate core mandate. Further, while including this among the “performance-based incentives”, the strategic efforts made by the 13th FC in this regard and the

efforts to link local grants to the divisible pool via Article 275 are apparently ignored. Performance-based incentive clauses are valid only as a result-oriented accountability mechanism and also for ensuring constitutional mandates. Padding the Terms of Reference with questionable clauses under this rubric naturally invites resistance from subnational entities.

The need for an integrated federal public finance that takes local governments into account in macro policymaking and in formulating strategies to ensure regional equity and for evaluating the revenue potential and fiscal capacity does not seem to have occurred to the decision-makers of the country. This omission is tantamount to tearing the web of a 'holding together' federation which seeks "inclusiveness" as a national goal. The Terms of Reference debate and the memorandum of the State Finance Ministers are silent on this vital issue. While we have a credible budgeting and financial reporting system at the Union and State levels, it is inexplicable why the financial accounting and accountability mechanisms at the local government level are left to fend for themselves.

In the Terms of Reference debate, population was the overarching concern. But the real issues are: (i) that there was a unilateral abrogation of an unwritten covenant or guarantee given to the States in June 1977 in Parliament (and endorsed by the National Development Council in 1979) that the 1971 Census population data will be used in computing devolution shares to the States; and (ii) in mandating the 2011 population, no alternate compensatory device has been envisaged. Interestingly, there was no strong protest when all the previous four commissions violated the 1971 population criterion in arriving at local government share. Actually, from a larger cooperative federalism perspective, the issue of population should refer to demographic dividend, inter-State migration, ageing population, and the like. For example, Kerala reaped its demographic dividend long back in 2001 and now accommodates nearly three million migrants from places like Odisha, West Bengal and Bihar. This takes a heavy toll on the State and local government resources. The whole issue of balanced regional development cannot be taken in a casual and illogical manner.

The drawing up of a Terms of Reference of a constitutional body is a serious exercise to be handled with sagacity and skill, based on proper consultations in the true spirit of cooperative federalism.

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