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REIMAGINING THE NITI AAYOG

Relevant for: Indian Economy | Topic: Issues relating to Planning & Economic Reforms

India's Constitution-makers thought of India as a union of States with a centripetal bias, done, advisedly, to preserve the unity and integrity of a newly fledged nation. Since then, the Indian economy, polity, demography and society have undergone many changes. The new aspirational India is now firmly on a growth turnpike. It is in this context that we revisit India's fiscal federalism and propose redesigning it around its four pillars.

Typically, federations (including the Indian one) face vertical and horizontal imbalances. A vertical imbalance arises because the tax systems are designed in a manner that yields much greater tax revenues to the Central government when compared to the State or provincial governments; the Constitution mandates relatively greater responsibilities to the State governments. For example, in India, post the advent of Goods and Services Tax (GST), the share of States in the public expenditure is 60% while it is 40% for the Centre to perform their constitutionally mandated duties.

The horizontal imbalances arise because of differing levels of attainment by the States due to differential growth rates and their developmental status in terms of the state of social or infrastructure capital. Traditionally, Finance Commissions have dealt with these imbalances in a stellar manner, and they should continue to be the first pillar of the new fiscal federal structure of India.

However, in India, the phenomenon of horizontal imbalance needs to be understood in a more nuanced fashion. It involves two types of imbalances. Type I is to do with the adequate provision of basic public goods and services, while the second, Type II, is due to growth accelerating infrastructure or the transformational capital deficits. The latter are known to be historically conditioned or path dependent. Removing these two imbalances clearly comprises two distinct policy goals and calls for following the Tinbergen assignment principle, which are two different policy instruments. It is here that we believe that NITI Aayog 2.0 must create a niche, assume the role of another policy instrument and become the second pillar of the new fiscal federal structure.

In the past, the Planning Commission used to give grants to the States as conditional transfers using the Gadgil-Mukherjee formula. Now with the Planning Commission disbanded, there is a vacuum especially as the NITI Aayog is primarily a think tank with no resources to dispense, which renders it toothless to undertake a "transformational" intervention. On the other hand, it is too much to expect the Union Finance Commission to do the dual job. In other words, there is an urgent need for an optimal arrangement. It is best that the Union Finance Commission be confined to focussing on the removal of the horizontal imbalance across States of the Type I: i.e. the basic public goods imbalance. We need another institution to tackle the horizontal imbalance of the Type II; for this the NITI Aayog is the most appropriate institution. It can be argued that the Finance Ministry is the other alternative to deliver the goods in this regard but it is ill-suited to do this; its primary duty is to concern itself with the country's macro-economic stability and the proper functioning of the financial system rather than be an instrument of growth at the sub-national level.

Is NITI Aayog old wine in a new bottle?

Towards this task of cooperative federalism, NITI Aayog 2.0 should receive significant resources (say 1% to 2% of the GDP) to promote accelerated growth in States that are lagging, and

overcome their historically conditioned infrastructure deficit, thus reducing the developmental imbalance. In short, the NITI Aayog should be engaged with the allocation of “transformational” capital in a formulaic manner, complete with incentive-compatible conditionalities. The variables or parameters used in this formulaic transfer will be very different from those traditionally used by the Finance Commission.

NITI Aayog 2.0 should also be mandated to create an independent evaluation office which will monitor and evaluate the efficacy of the utilisation of such grants. In doing so, it should not commit the mistake of micro-management or conflicts with line departments. It must be also accorded a place at the high table of decision-making as it will need to objectively buy-in the cooperation of the richer States as their resources are transferred to the poorer ones.

The same perspective will have to be translated below the States to the third tier of government. This is crucial because intra-State regional imbalances are likely to be of even greater import than inter-State ones. Decentralisation, in letter and spirit, has to be the third pillar of the new fiscal federal architecture. De jure and de facto seriousness has to be accorded to the 73rd and 74th constitutional amendments. For this, the missing local public finance must be birthed. One of the ways for this is through the creation of an urban local body/panchayati raj institutions consolidated fund. This would mean that Articles 266/268/243H/243X of our Constitution will need to be amended to ensure that relevant monies directly flow into this consolidated fund of the third tier.

GST collections at 1.06 lakh cr. in March, clock the highest-ever

Through such constitutional amendments, the Centre and States should contribute an equal proportion of their Central GST (CGST) and State GST (SGST) collections and send the money to the consolidated fund of the third tier. For instance, one-sixth sharing of the CGST and SGST with the third tier can generate more than 1% of the GDP every year for the financing of public goods by urban-level bodies. Such an arrangement will be the third pillar of fiscal federalism. Further, the State Finance Commissions should be accorded the same status as the Finance Commission and the 3Fs of democratic decentralisation (funds, functions and functionaries) vigorously implemented. This will strengthen and deepen our foundational democratic framework.

The fourth pillar — and in a sense what is central and binding — is the “flawless” or model GST. It is to the credit of our democratic maturity that the GST Bill was passed unanimously by Parliament; but in its present form, it is far from flawless. It needs further simplification and extended coverage. We need to quickly achieve the goal of a single rate GST with suitable surcharges on “sin goods,” zero rating of exports and reforming the Integrated Goods and Services Tax (IGST) and the e-way bill. The GST Council should adopt transparency in its working, and create its own secretariat with independent experts also as its staff. This will enable it to undertake further reforms in an informed and transparent manner. Thus, India will be able to truly actualise the “grand bargain” and see the GST as an enduring glue holding the four pillars together by creating the new fiscal federal architecture and strengthening India’s unique cooperative federalism.

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