

An open letter to Finance Ministers

My fellow Finance Ministers in the States, I hope you will agree that the award of the Finance Commission is vital to State finances. Some of us who met initially at Thiruvananthapuram, Kerala, and later at Amaravati, Andhra Pradesh, are worried about the implications of the terms of reference (ToR) of the Finance Commission determined by the Union government. The issues related to *inter se* distribution of resources are what have drawn attention and made headlines. But the issues at stake are much larger.

The Hindu explains: why the 15th Finance Commission has riled some States

What the ToR challenge are the federal values enshrined in the Constitution and the modicum of fiscal autonomy State governments enjoy. I am writing this open letter just in case you have misunderstood that our concerns are limited to a change in the population base year, from 1971 to 2011, which would in fact affect not only the southern States in general but also other States where population growth has declined. We will certainly be making our legitimate claim not to be penalised for implementation of the national population policy. As has always been the case, in the memorandum we are to submit to the Finance Commission, we can agree to disagree as to what the best criteria for horizontal distribution are. But all of us in the Union of India have a common stake in the vertical distribution of resources between the Union government and the States as a whole.

I am afraid that for political reasons many of us are failing to undertake this national duty to defend the rights of States on the one hand and the fiscal federalism of the country on the other. I want to raise before you, in public, some of the issues in the ToR which are going to adversely affect the financial resources and fiscal autonomy of States. If any of my fellow Finance Ministers has a different opinion, please join me in a public debate. I fervently hope that at least some of you will do so.

GST's complicated

First, is there any Finance Minister who will welcome a reduction in the share of taxes of the States from the 42% that was awarded by the 14th Finance Commission? This is precisely what the ToR propose to do. What else is the meaning of item 6(iv) in the ToR? Never before in India's history has the Finance Commission been asked to review the award of its predecessor. A reminder of certain facts: 32% of the 13th Finance Commission and 42% of the 14th Finance Commission are not comparable. The first refers to non-plan revenue expenditure and the second to total revenue expenditure. Plan grants have been terminated. Further, the Government of India has increased our share of Centrally sponsored schemes so that the overall devolution as a share of GDP has remained more or less the same. The goods and services tax (GST) has further worsened vertical devolution due to the 50:50 sharing of taxes. You just read the ToR with respect to the GST where it is made out that the GST is going to adversely affect Central resources. The whole argument of an asymmetric GST burden is a joke.

Second, the idea of federalism ensures that every citizen of India is provided comparable public services and taxation. It is for this purpose that the Constitution has provided for the provision of revenue deficit grant. No Finance Commission can review this. How is it then that item 5 in the ToR says, "The Commission may also examine whether revenue deficit grants be provided at all"? Don't you agree that this is an infringement on the constitutional rights given to States?

Borrowing rights

Third, the ToR want to curtail borrowing by States from the present 3% of Gross State Domestic Product (GSDP) to 1.7% if the Fiscal Responsibility and Budget Management Review Committee has its way with its recommendation.

We have just started exercising borrowing rights as recommended by the 14th Finance Commission. If this is reversed, this will severely curtail capital expenditure of States. Further, there is a mischievous angle to the ToR which has asked the Finance Commission to explore the conditions to be imposed on borrowing by States. So far, there has been no condition on the 3% of GSDP fiscal deficit ceiling. We have to reject outright this incursion into the fiscal freedom of States.

Taxing times for the States

Fourth, the 14th Finance Commission directed its efforts to ensure that the discretionary element in the grant given by the Commission is totally eliminated. It is loud and clear from the ToR that the Union government is using the Finance Commission route to impose conditionalities through a plethora of conditional grants. Item 7 in the ToR talks about incentivising nine items and I am not against many of them. But the choice should be left to States. Equally unacceptable is the reference to populist schemes which are in the exclusive jurisdiction of elected State governments. Is this not undemocratic?

My appeal to everyone is to join hands to uphold the Constitution and the right of States and block the sinister move to undermine the basic tenets of fiscal federalism in India. On our differences over the criteria of *inter se* distribution we shall agree to disagree and approach the Fifteenth Finance Commission individually in our memorandum. I appeal to those who are in agreement to join us in this effort to protect the constitutional rights of States. Let political alignments not stand in the way of defending the rights of States.

T.M. Thomas Isaac is the Finance Minister of Kerala

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Syed Ata Hasnain For a developing country that is

END

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