Mandate and allocations

The terms of reference of the 15th Finance Commission raise questions about constitutional propriety

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It is not without reason that the presidential terms of reference (ToR) of the Fifteenth Finance Commission have raised questions, and the recent conclave of Finance Ministers of the southern States to discuss contentious issues in the ToR is only the beginning. In the months ahead more debate on this is likely. But the line by the media that this conclave was about concerns over the directive to use population data in the ToR from the 2011 Census, and not the 1971 Census that was used earlier, is an exaggeration.

To be fair, the meeting was called to discuss all contentious issues. Of course, for the southern States the issue of population was a point of concern and provided a common meeting point for the Ministers. But this was not the only area.

Using population data

Conceptually, general purpose transfers to States by way of tax devolution and grants are meant to enable them to provide comparable levels of public services at comparable tax effort. Public services have to be provided to the current population and not just the population of either the 1971 Census or the 2011 Census. The earlier Finance Commissions were issued the directive to use population data of 1971 based on a parliamentary resolution.

In fact, the Thirteenth Finance Commission expressed its frustration when it said: "We are bound by our ToR to take into account population figures for the States based on the 1971 Census" and assigned 25% weight to the factor. The Fourteenth Commission, after examining various factors to represent demographic changes, chose population figures of 2011 and assigned 10% weightage in addition to the 17.5% weightage given to the 1971 population data. The ToR for the present Commission could have been silent on which population figures should be used and avoided a controversy. In any case, from the perspective of economic objectives, there is no justification in using 1971 population data as a factor in the horizontal distribution of funds. From a political perspective, the use of 1971 population data will result in losers and gainers.

Fiscal federalism

States need to debate a number of contentious issues in the ToR which affect the very structure of fiscal federalism. These include: asking the Commission "to examine whether revenue deficit grants be provided at all"; considering "the impact of [the] fiscal situation of the Union government of substantially enhanced devolution by the Fourteenth Finance Commission, coupled with continuing imperative of the national development programme including New India 2022"; looking at the conditions that may be imposed by the Central government while providing consent to States when they borrow under Article 293(3); asking the Commission to propose measurable performance-based incentives to States in respect of a number of areas such as the implementation of flagship schemes, progress towards replacement rate of population growth, a control or lack of it in incurring expenditure on populist measures; and finally, promoting ease of doing business.

It must be noted that issuing directives and guidelines to the Finance Commissions has been done even in the past and there are cases of States taking serious objection to such directives. Although the basic ToRs of the Commission are laid down in Article 280 of the Constitution, guidelines and directives are given by the Union government under clause: "any other matter referred to the Commission by the President in the interests of sound finance". However, the ToR of the Fifteenth Commission raise questions about constitutional propriety and has implications for the federal fabric of the nation itself.

Take, for example, the suggestion that the Commission may examine whether the revenue deficit grants should be given at all. The very objective of Article 275 is to enable the Commission to give grants to offset post-devolution gaps between normatively assessed revenues and expenditures. If the Commission takes this suggestion seriously, it will have serious ramifications for States with genuinely large resource gaps.

National plans

Never before in the history of the country has a Finance Commission been asked to review the recommendations of the previous Commission on the grounds that it gave "substantially enhanced devolution". It has been clarified several times that the Commission had to include the grants for State Plan Schemes in its devolution. Furthermore, it desisted from giving discretionary and sector-specific grants including those for the environment.

Analysis shows that the increase was just about 2-3% of the divisible pool. Nudging the Commission to leave larger fiscal space for implementing national development programmes under New India 2022 is to ask it to leave more funds for making further intrusions into State subjects. The ToR seek to reduce the role of Article 275, which is a legitimate channel for grants, and asks the Commission to leave it more fiscal space to expand grants under Article 282, which is questionable.

Asking the Commission to take into account the performances in implementation of various Central schemes is equally contentious. The Seventh Schedule of the Constitution assigns the respective functions in terms of Union, State and Concurrent subjects. It is ironical that the Union government has been intruding into State subjects through Central schemes by forcibly using fiscal space. Performances must be built into the implementation of schemes and not into the tax devolution formula. It must be noted that devolution of taxes to States is not a charity; it is their right. As pointed out by the Sixth Finance Commission, "It is misleading to speak in terms of redistribution of resources between the Centre and States. It will be more appropriate to view the problem as one of distribution of resources as between the subjects coming constitutionally within the competence of the Centre and those coming within the purview of States. The resources belong to the nation and they should be applied at points where they are needed most."

Although it has by now become customary to issue guidelines, those issued this time raise questions of constitutional propriety. The ToR of the Ninth Finance Commission had raised considerable disquiet among States when it was asked to adopt a normative approach. The Chairman of the Commission had to allay their apprehensions in his letter to all the Chief Ministers saying: "It is the Commission's prerogative to adopt such approach and method as it considered fit and appropriate on subjects covered by (a) and (b) of Article 280(3) of the Constitution. In view of the Presidential notification, however, the Commission would consider, inter alia, adopting a 'normative approach' wherever appropriate in the interest of sound finance. But by doing so, the Commission would apply a uniform, just and equitable yardstick both to the Centre and States."

The ToR of the present Commission raise even more serious issues of constitutional propriety and, hopefully, States will safeguard their turf to preserve the federal fabric of the country.

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