

● THE FIFTEENTH FINANCE COMMISSION

THE CENTRE WOULD DO WELL TO REMEMBER THAT OFFSETTING THE FISCAL DISABILITIES OF THE STATES IS CRITICAL TO ACHIEVING AND REALISING THE GOALS UNDER NEW INDIA 2022

Redefining the Commission's mandate?

THE APPOINTMENT OF the Fifteenth Finance Commission (15th FC) has not come a day sooner. The Commission will require two years to make recommendations on tax devolution and grants for the period 2020-25 and many other issues referred to it in the terms of reference (TOR). Besides the chairman, it has two full-time members and two part-time members, and given their competence, experience and specialised knowledge, it is well-equipped to deal with the challenging TOR within the specified period.

Most governments tend to be a little uneasy around the Finance Commission as the latter act independently, and the Union government has no control over what they recommend. The problem gets complicated as there is a tradition of accepting the core recommendations of the Commissions, making them awards. Although it is the Union government which issues the TOR through the president and tries to nudge the Commissions to make recommendation in its favour through various directives, most Commissions have taken the view that India is a Union of States and resources raised by the Union government belong to the nation to be deployed between the Union and states to meet their needs arising from Constitutional assignments. Indeed, the Constitutional provision under Article 270 for sharing of Union taxes is the recognition of the fact that for reasons of comparative advantage, centralised collection of the tax is necessary but the proceeds do not entirely belong to the Union and must be shared with the states to enable them to fulfil their Constitutional mandate. The transfers recommended by the Commissions through tax devolution under Article 270 and grant under Article 275 are not charities; they are meant to enable the states to provide comparable levels of services at comparable tax rates while ensuring a budget balance in the revenue account.

Over the years, the presidential TORs have mandated the Commissions to deal with a number of matters other than the core tasks listed under Article 280 namely, devolution of taxes, grants in aid to be given to states and measures to supple-

ment the consolidated funds of the states to supplement the resources of rural and urban local bodies. Under 280 (d) – “Any Other Matter in the Interests of Sound Finance”, they have been asked to make recommendations on a number of issues. The provision has also been used to give directives to the Commissions—and some of these have been controversial.

There are some important differences in the presidential TOR to the 15th FC. Unlike the past Commissions which were specifically asked to take into account the 1971 population when used in the devolution formula, the 15th FC has been asked to use the 2011 population. This is important for, public services have to be provided to the current population and not the population of any earlier date. The stipulation to use 1971 population for allocating resources arose from a parliamentary resolution. The Fourteenth Finance Commission (14th FC) was asked to take account of 1971 population and also subsequent demographic changes.

Since the 12th Finance Commission, an important mandate given to the commission is to prescribe fiscal targets and recommend a roadmap for consolidation. While the states, by and large, have complied with the targets, the Union government has been flouting them on one pretext or another. In fact, after the 14th FC submitted a roadmap, the Fiscal Review Committee with NK Singh as the Chairman was asked to revisit the road map for the period until 2023, and the committee recommended more stringent targets. It will be interesting to see whether there will be any departure from this.

While the TOR nudges the commission to adopt a more incentivised approach to making transfers to states, there is no such attempt to influence the behaviour of the Union government. Tax ef-

**M GOVINDA
RAO**

Emeritus professor, NIPFP, and chief economic adviser, Brickwork Ratings



fort is an issue relevant to both the Union and the state governments and now that the power to levy GST rests with the GST Council, states have limited manoeuvrability. Populism is a bane arising from electoral politics, and both the Union and State governments are equally guilty. At least as far as the states are concerned, their resource assessment is done by taking taxable capacity rather than actual tax revenues in the assessments whereas Central taxes are simply projected for the period of the award.

The two most important differences in the TOR of the 15th FC relate to (i) the issue of whether the revenue deficit grants to be provided at all and (ii) impact of substantially enhanced tax devolution to states following the recommendations of the 14th FC on the fiscal situation of the Union government, and to take into account the imperative of the national development programme, including New India 2022. Both raise issues of Constitutional propriety and will be questioned by the state governments.

The Constitution makes specific provision for giving “grants in aid of revenues” to the states under Article 275 (1), and to suggest that revenue deficit grants may not be provided is tantamount to asking the Commission to ignore Articles 275 and 280 3 (b). In fact, constitutional experts have questioned the legitimacy of giving grants under 282 for central schemes and consider Article 275 as the only legitimate channel. As a matter of fact, tax devolution

is made on the basis of criteria representing revenue and cost disabilities and these still leave some states with uncovered expenditure needs over their revenue capacity and the commissions have used the grants under 275 (1) to target the transfers to bridge them. Is it the intention of the TOR to nudge the commission to act in violation of the Constitutional provisions?

Similarly, to suggest that the 15th FC should review the impact of the “overly generous” devolution by the 14th FC and take into account the impending commitments arising from New India 2022 is to nudge the 15th FC to reduce the devolution to the states to meet the requirements of the central schemes. There are two issues with this. First, the 14th FC’s recom-

mendation on increasing devolution from 32% to 42% is not as generous as it looks. It must be noted that unlike the previous Commissions, the 14th FC was asked to cover the requirements under both Plan and Non-Plan accounts which required it to subsume Gadgil formula grants, amounting to 5.5% of the divisible pool in their recommendation. In addition, the 14th FC avoided giving discretionary sectoral grants including environmental grants amounting to 1.5% of the divisible pool. Thus, the legitimate comparison should be between 39% and 42%. Furthermore, the 14th FC’s analysis showed that Union government’s spending on the State List increased from

14% during 2002-05 to 20% during 2005-11, and the increase in spending on Concurrent List was from 13% to 17%. The increase of three percentage points was only to give the states greater flexibility.

The 15th FC has an important role at this juncture in strengthening the fabric of fiscal federalism and intergovernmental finance. Offsetting the fiscal disabilities of the states is critical to achieving and realising the goals under “New India 2022”.

To suggest that the 15th FC should review the impact of the “overly generous” devolution by the 14th FC and take into account the commitments of New India 2022 is to nudge the 15th FC to reduce the devolution to the states to meet the requirements of the central schemes

