

● FINANCE COMMISSION

THE FINANCE COMMISSION WILL HAVE TO WALK THE FISCAL TIGHTROPE BETWEEN ALLAYING THE FEARS OF THE STATES AND PROTECTING FEDERAL VALUES

Redefining the federal fiscal landscape?

THE PRESIDENTIAL ORDER detailing the Terms of Reference (TOR) of the Fifteenth Finance Commission (FFC) has raised considerable controversy. The directive to use the population figures of 2011 was not the only issue that prompted the finance ministers of southern states to come together on a platform on April 10 in Thiruvananthapuram; there were many more contentious issues impinging on the fiscal autonomy of the states and the federal landscape of the country.

Guidelines and even directives have been given in TORs of past Commissions as well. While the basic TOR relating to tax devolution, principles governing grants-in-aid of revenues and the measures to augment the consolidated funds of states to supplement the resources of urban and rural local bodies are specified in the Constitution itself, the guidelines are given under the clause 280(d): "Any other matter referred to the Commission in the interest of sound finance."

Considerable rubble was raised when the chief minister of Kerala took a serious objection in his letter to the Chairman of the Commission on the TOR of the Ninth Finance Commission and stated: "...the Commission shall follow the normative approach." The latter had to write to all CMs, allaying their fears, stating it is not bound by the directive but in view of the Presidential notification it would consider, *inter alia*, adopting a normative approach whenever appropriate in the interest of sound finance. But in doing so, the Commission "...would apply a uniform, just and equitable yardstick both to the Centre and the states."

The concern with the TOR of the FFC is they ask the Commission to be one-sided in applying norms, impinge on states' fiscal autonomy and raise questions of Constitutional propriety. The first issue of concern is the suggestion in Para 5 of TORs that "...the Commission may examine whether revenue deficit grants be provided at all." The basic

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methodology of the Commission—laid down by the first Commission chaired by KC Neogi and followed by succeeding ones—is to make assessments of revenue receipts and revenue expenditures of states, devolve taxes based on a formula and fill post-devolution gaps with revenue deficit grants under Article 275. Over the years, Commissions have been applying norms while making assessments to avoid laxity in revenue effort and profligacy in spending. The suggestion to avoid providing revenue deficit grants would mean abrogation of the basic task of the Commission of balancing resource requirements of states.

Secondly, asking the FFC to review the recommendations of the previous Commission, stating they were overly generous, is unprecedented, nor was there a plea to the Commission to provide more fiscal space for introducing additional developmental schemes under "New India 2022." If the government thought the 14th Finance Commission "substantially enhanced tax devolution," it shouldn't have accepted the recommendations. In fact, there is no material truth in the claim that there was substantial increase when it is considered that the 14th Finance Commission had to include plan requirements. Introducing development programmes in a federal set-up should be as much a state responsibility as it is the Centre's, and to ask the Commission to pre-empt funds for the Centre based on its subjective judgement that the schemes are imperative is to state that the Centre knows best what needs to be done even in the areas specified in the State List! In the process, it

wants to nullify the rebalancing attempted by the 14th Finance Commission to provide marginally higher fiscal space in terms of untied funds. The Commission did so based on its estimate that the Centre's spending on the state subjects had steadily increased from 14% to 20% from 2005 to 2012. The Centre should have used the opportunity to rationalise the central schemes. Not only did the Centre not reduce the number, but substantially negated the objective of providing untied funds to the states by increasing the states' contribution to the schemes.

Equally worrisome are the suggestions to propose measurable performance-based incentives on a number of matters detailed in Para 7 of the TOR. These include progress made towards achieving replacement rate of population growth, achievements in the implementation of flagship schemes, progress made in enhancing revenues through DBT, progress made in the ease of doing business and promoting labour-intensive growth, control of 'populist spending', efforts in expanding and deepening tax net under GST, and progress made in sanitation, solid waste management and effecting behavioural change in open defecation. Each of the schemes has multiple objectives and it is not clear how they can be measured and incorporated in the recommendations.

Asking the Commission to take into account the measurable performances

as stated above shows that those who drafted the TOR seem to be ignorant about the history and the Constitutional status. The Constitution assigns broad-based taxes to the Centre for reasons of comparative advantage and harmonised tax collection. To ensure that the states get adequate resources for carrying out their Constitutional mandate, the system of tax devolution under Article 270 and grants under 275 are to be recommended by an independent arbiter called the Finance Commission. As stated by the Sixth Finance Commission, "...It is misleading to speak in terms of redistribution of resources between the Centre and the states, it will be more appropriate to view the problem as one of distribution of available resources as between

subjects coming within the competence of the Centre and those coming within the purview of the states. In our scheme ... we have taken the view that the resources belong to the nation and they should be applied at points where they are needed the most."

The simple point is that the taxes collected by the

Centre do not belong to it in entirety; they have to be shared with states. The national development agenda is not the exclusive domain of the Centre; states are equal partners. Performance requirements, if they have to be used, should be applied uniformly. It is unclear what is meant by populist spending. How do we characterise large amounts of taxpayers' money spent on various types of subsidies and transfers by the Centre? How do we characterise the ₹80,000 crore given for recapitalising public sector banks?

In the coming days, states are likely to raise these contentious issues and the Finance Commission will have to tread the path carefully to allay the fears of the states and protect federal values. The task is challenging and, hopefully, the Commission will prove equal to the task.

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