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Towards India's New Fiscal Federalism

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I wish to thank Indian Econometric Society for giving me the high honour of delivering this year's Prof. Sukhamoy Chakravarty Memorial Lecture. Prof. Sukhamoy Chakravarty was one of the best economists of our country. His phenomenal scholarship encompassed wide range of subjects and not just economics alone. He was both an outstanding theorist and a mathematical economist of truly rare ability. However, what was very unique of Prof. Sukhamoy Chakravarty was him fully dedicating his astonishing scholarship to address our country's pressing development challenges. His superb Ph. D Thesis under Prof. Jan Tinbergen illuminated the important issues relating to investment planning in the newly emerging economies. In this, he explored deep analytical issues such as the nature of the objective function to be optimized, planning horizon, choice of the discount rates, etc. No wonder, his book "Capital and Development Planning" much admired by the great Prof. Paul Samuelson is an all-time classic.

He also deployed his huge intellectual prowess to study and improve India's development planning process and outcomes. He was the architect of the model on which our 5th Five-Year Plan was based and that work still remains unsurpassed. His thinking on planning and development evolved over time especially after his involvement with the policy making at highest level, whether as a Member of the Planning Commission or as the Chairman of the Economic Advisory Council to the Prime Minister. Perhaps one of the best places to find the distilled views of Prof. Sukhamoy Chakravarty on development would be his Radhakrishnan Memorial lecture delivered at Oxford University in the 80's.

My own association with Prof. Sukhamoy Chakravarty began in November 1973 when I joined as a Consultant to the Perspective Planning Division of the Planning Commission. I worked in that capacity for almost four years before I joined the Ministry of Commerce as its Economic Advisor. Prof Alagh was in- charge of the Perspective Planning Division and Prof. Sukhamoy Chakravarty supervised it as a Member. It is here I came to know Prof Sukhamoy Chakravarty not only as one of our greatest economists but also as one of the noblest persons that one can meet. To me his scholarship was awe inspiring. Planning Commission had then perhaps India's finest library on social sciences including economics. I remember its Chief Librarian telling me that Prof. Sukhamoy Chakravarty had perhaps read more books from the library than entire Planning Commission staff put

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together! In fact, my own private ambition was that I should be able to talk to Prof. Sukhamoy Chakravarty about a book which I had read but he had not. For the entire four years with the Planning Commission I could not succeed on this project. I distinctly recall that in 70's there was a recently published paper by Prof Paul Krugman on international trade and within a few weeks of its publication in the EJ, Prof. Sukhamoy Chakravarty asked me to read it telling me that this paper is of great significance to the theory of international trade. He was indeed very prescient as many years later this paper brought the Noble Prize to Prof Krugman. Incidentally, I would like to add here that in all fairness that the Noble Prize should have been shared with Prof. Avinash Dixit, one of my thesis supervisors at Berkeley. I do think that his original paper jointly written with Joseph Stiglitz provided the foundation for Prof. Krugman's paper.

Although Prof. Chakravarty was essentially a structuralist, he was rather orthodox on some important policy issues. For instance on fiscal policies he was completely against populist policies and very much supported strict fiscal discipline. Similarly, in his famous report on monetary policy, he advocated rule-based monetary policy and first time introduced the inflation rate of 4% as a monetary policy target. I think he would have been very comfortable with our present policy stance on inflation targeting. I recall his meeting with Shri Rajiv Gandhi, the then Prime Minister. Prof. Chakravarty gravely cautioned him against the then emerging revenue deficit in the Central Government finances and the Prime Minister promised him to take the corrective actions. Alas! This was not followed and the country had to seek the IMF Bailout in 1991.

When I reflect back, what are the important things I learnt from Prof. Sukhamoy Chakravarty? I think these will have to include (1) the importance of thinking analytically when dealing with policy issues, (2) keeping one's mind open to data and new analytical insights and (3) the commitment to continuously look for the policies that will ameliorate India's under development or poverty as fast pace as possible.

Yet another important insight he provided was that in designing the growth strategy, the importance of identifying empirically what is the most dominant structural constraint faced by the economy and devise policies to alleviating that constraint, as such an approach would continue to enlarge the growth possibility set.

His analytical work touched vast number of policy areas. I already mentioned policies towards structural reforms, fiscal policies, and monetary policies to promote accelerated growth with equity. He was also deeply involved with the formulation of mesoeconomic policies relating to energy sector, technology, etc. He was undoubtedly India's most complete economist! As an accomplished economist, he fully recognized the important role of prices but he used to say that "market is a good servant but a bad master."

For today's lecture, I have chosen to speak on the topic relating to "fiscal federalism," a subject which Prof. Sukhamoy Chakravarty would have also liked me to talk on, as my most recent preoccupations in the Government have been on these issues. On my return from the IMF in 2002, till I submitted my report as the Chairman of 13th Finance Commission, I have been fully engaged on the issues of India's fiscal federalism, whether for the devolution of resources or in designing Goods and Services Tax which fundamentally impacted both the Centre and States. Very recently I also worked on the sub-national issues such as Maharashtra's sub-regional inequalities.

By all accounts, Indian economy today is on a growth turnpike, not very different from the growth miracles experienced by Asian tigers as well as China in earlier decades. India has consistently accelerated its growth rate over the last three decades. Indian economy experienced an upward structural break in the mid- eighties due to the initial policy measures of Rajiv Gandhi which were followed up by Narashimha Rao - Manmohan Singh structural reforms of 1991. There have been further reforms by both the UPA and NDA governments. Consequently, our country has not looked back since 1991 and has, in fact, become one of the best growth performers in the world economy.

The deep determinants of this remarkable growth experience of ours have been institutions, demographic transition, modern technology and accumulation of both human and physical capital. In my view, the most important of these factors has been our democratic framework, a key foundational institution. Our democracy has proved to be *sine qua non* for effectively formulating key economic policies and conducting policy reforms in a country that is so diverse. It is also of fundamental importance for maintaining social harmony. I cannot overemphasize the need for maintaining continuous vigilance to safeguard social harmony in our highly diverse society. In this endeavour, the "majoritarianism" will need to be eschewed. As the proverb goes "United we stand and divided we fall."

In a country as beautifully diverse as ours, Federalism as an organising principle is clearly the only way to succeed. In the analytical literature, "coming together" and "holding together" are the recognized forms of federalism. United States is the classic illustration of the first whereas the erstwhile Pakistan or Yugoslavia perhaps could be seen as illustrating the second.

Our approach to federalism is idiosyncratic. Distinguished jurist Nariman calls it 'quasi federalism'. I think it is better described as "cooperative federalism", where governance has a multi-level form with evolving relations between different levels of government. As an aside, I may mention that some people also talk about competitive federalism. I have considerable hesitation in deploying this term as I fear that it can only lead to race to the bottom via competitive populism. I will come back to the importance of this issue when I discuss horizontal devolution amongst the States. Ours is essentially a union of States consequently a unitary State, but with clearly demarcated rights and responsibilities at different levels of the government. Our model of Co-operative Federalism also offers flexibility for creatively responding to evolving structural changes. An example perhaps is unique feature of concurrent list in our constitution.

I want to argue that fiscal federalism has been one of the most important pillars for the success of our enduring democracy. Fiscal Federalism has provided the oxygen for the unique cooperative federal model of ours. The fiscal federalism mainly comprises allocation of rights and duties related to taxation and expenditure responsibilities and system of transfers between the different jurisdictions/levels of government such as Centre, State and local governments.

In the framework of fiscal federalism, federations all over have tried to tackle two important issues i.e., vertical imbalance and horizontal imbalance.

Vertical imbalance essentially arises due to the fiscal asymmetry in powers of taxation vested with the different levels of government in relation to their expenditure responsibilities prescribed by the constitution. Our Federal Structure has three levels of Governments: Central Government, State Governments and the elected Local Bodies. In India the Central government has far greater or larger domain where it may tax e.g., income taxes personal or corporate, taxing consumption of goods and services (CGST), taxing foreign transactions (exports/imports) and capturing natural resources rents, e.g., Spectrum Auction. In contrast, post-GST, the State governments may only tax the consumption of goods and services (SGST) and agricultural incomes, while the local or the third tier has even more limited power to tax which is largely confined to property tax. Consequently, the Central Government collects around 60% while its expenditure responsibility for carrying out its constitutionally mandated responsibility such as defence, etc., is only to the tune of 40% of the total public expenditure. Thus arises the vertical imbalance. Such vertical imbalance is even sharper in the case of the Third Tier consisting of elected local bodies and Panchayats. This imbalance is having deleterious effect on India's urbanization, the quality of local public goods and thus further aggravating the negative externalities for the environment and climate change.

Horizontal imbalance arises because of the differential capacity to tax amongst the States as against the expenditures required for providing pubic goods of comparable quantity and quality to those residing in their States. This in turn arises because of the vast regional imbalances in terms of per-capita incomes, stage of demographic transition, physical infrastructure levels, social capital endowment, natural resources availability such as water, mineral resources and geographical features such as hilly terrain or desert area. The unevenness of developmental outcomes of course gets further compounded by the differences in the levels of effective governance.

In our county, unlike the other developed federal or quasi-federal economies such as the USA, Canada, Australia, and EU the regional disparities in terms of per-capita incomes is much sharper leading to yet another imbalance i.e. "development imbalance". For instance, in developed countries the ratio of per capita incomes between the most and least developed regions seldom exceeds 2, whereas in our case it is more than 6. This is accounted by differences in growth rates between States over a period of time, i.e., due to "development imbalance". These differential growth rates could be due to several reasons as I have mentioned earlier but there is yet an additional important reason. Increased level or availability of both physical and social infrastructure is one of the major sources for differential levels of development. A recent paper of Prof. N. R. Bhanumurthy, my NIPFP colleague, has brought this issue in a great detail[1]. The stock of infrastructure gets accumulated over a period of time and lends a character of path dependency to this differential development process. This in turn affects the growth going forward via the economics of agglomeration. This underlines the fact that when it comes to accelerating growth, it's not just geography and physical and natural resources but indeed, history matters! India has vigorous internal migration and if these development imbalances persist the rate of internal migration will get accelerated. If this is sudden and excessive, it will lead to considerable political tensions. Hence, the issue of "development imbalance," if kept unresolved can lead to a serious threat to social and economic stability. Such 'development imbalance' phenomenon exists also within our States and not just between the States. That is why this is a fit case for a serious fiscal policy intervention.

These three imbalances if not satisfactorily resolved will provide the seeds for political discontent and thus threaten the very democratic fabric and the national security. For successfully, meeting the challenges posed by the three imbalances requires us to move to what I call "New Fiscal Federalism."

Our constitution and creative democratic politics had addressed such issues by creating two institutions viz., Finance Commission and Planning Commission for promoting fiscal federalism. The Finance Commission derives its *raison de etre* from Articles 275, 280 and their sub-clauses to meet horizontal and vertical imbalance, whereas our political process leveraged Article 282 to create the Planning Commission. These institutions were used to carry out systemic fiscal transfers in the nature of devolution or conditional ones. This arrangement or framework of fiscal federalism in India served well in maintaining the general wellbeing and integrity of our country. I may add that many thoughtful analysts have argued that lack of such instrumentalities have led to break ups in many other federations.

Over the years, successive Finance Commissions played important role towards strengthening fiscal federalism. Let me take the example of the more recent ones. The 10th FC chaired by Shri K.C. Pant combined all the taxes into one combined pool for the purpose of devolution rather than doing it based on tax sources. This paved the way for important tariff reforms. Earlier to this, the Central government had no incentive to undertake such reforms since as import duties were not shareable. The 12th FC under the Chairmanship of Dr. Rangarajan enhanced the fiscal stability of the States by linking grants conditional upon observable fiscal discipline by the States. These conditional grants were in addition to the statutory unconditional/untied devolution of funds. This was very effective in improving the fiscal health of the States. The 13th FC opened up the possibility of formulaic tax devolution to the third tier in order to strengthen and empower democratic decentralization process, through an interesting/innovative mechanism. This provided much needed "revenue buoyancy" to the local governments. The 14th FC gave a sharp increase in the percentage share of taxes devolved to the States whilst virtually in effect eliminating conditional transfers via the Planning Commission grants or grants under Central Sector/Sponsored Schemes. This along with the replacement of Planning Commission by NITI Aayog is considered by some to be a major reform for our cooperative federalism. I have a somewhat different perspective in this regard to which I will now turn.

In the present scheme of things, the collapsing of two different sources of transfers, aimed at differing objectives, is deeply problematic. Let me step back here for a bit and recall the two different types of horizontal imbalances that I talked about. Each of these imbalances is important and needs to be rectified. One has to do with the differing levels of per-capita consumption of basic public goods and services. The other has to do with the differing levels of stock of infrastructure leading the differential growth accelerating potential development. These are two distinct policy goals and following Tinbergen Principle warrants two distinct policy instruments. Eliminating the Planning Commission and replacing this with NITI Aayog merely as a think tank leaves us with only one instrument; namely Finance Commission. This approach if not reviewed can lead to a serious problem of increasing regional and sub-regional inequities.

I would argue that replacing the Planning Commission, which was promoting regionally balanced growth in India, by NITI Aayog, a Think Tank, has reduced the Government's Policy reach. This means that currently India's Fiscal Federalism stands only on one pillar, viz., Union Finance Commission. This is a serious weakness of our present Fiscal Federalism and needs to be quickly corrected.

There are not many studies in India which have looked at regional growth patterns. The Paper by Prof. Arvind Panagariya published in 2010 argued that the relatively poorer regions are experiencing faster rate of growth and higher rate of poverty reduction.[2] A recent Paper by Prof. Pinaki Chakraborty, my colleague at NIPFP, gives a more nuanced answer[3]. He argues that India has been experiencing the process of "Conditional Convergence" amongst the different States. Even this qualified result suggests that our policy approach of using an additional Policy Instrument such as the Planning Commission for resource transfers to the States through Plan Grants has been useful in reducing "development imbalance." The challenge, of course, is how to make it more effective.

I would, therefore, argue strongly that there is deep analytical foundation for a case where the NITI Aayog gets significant levels of resources for allocating to the different States. These resource transfers will be aimed at mitigating the development imbalances by promoting accelerated growth of lagging States and sub-regions. Given our political economy, these grants need to be conditional and formulaic. The purpose of these grants would be to enable the lagging States to build capacities in infrastructure sectors such as roads, ports, railways and digital connectivity, supply of power, access to credit and improving governance. This will serve the objective of helping the lagging States and regions to attain growth acceleration and the reduction in developmental gap. Planning commission, as is well known, has been using the various forms of the famous Gadgil formula and later the Gadgil-Mukherjea formula for allocating plan grants. Although they did serve the needs of the time, given the acuteness of challenges posed by continued inequalities between and within the States, I believe that we need to reinvent the central grants by using somewhat different variables and formulae, while being mindful of macro-economic conjuncture and structural needs. These grants can be Capital or Revenue. Equally, these can be either conditional or unconditional transfers.

It is possible to suggest that such allocation of transfer grants be administered by the ministry of Finance. But, by nature of its mandate the Ministry of Finance is primarily concerned not with structural transformation but rather with the issues related to short/medium term macroeconomic stability including managing balance of payments, inflation and business cycle. Invoking the Tinbergen's assignment principle viz., number of objectives matching the number of instruments, it is desirable that a functionally distinct entity such as the new NITI Aayog or NITI Aayog 2.0 be put to use to do the job at hand related to the structural issues including removal of regional imbalances in the economy as I have outlined above.

This would mean that the new NITI Aayog or NITI Aayog 2.0 will be responsible for allocating development or transformational capital or revenue grants to the States. Given the overall resource constraints what this would mean is that the future Finance Commissions, as against what has been done by the 14th FC, will have to revert to the modest percentages in their devolution formula as was indeed the historical trend. This of course does not mean an overall reduction in the overall transfers but only in their composition and their source. Needless to say the overall levels of such transfers will be determined by the Ministry of Finance keeping in mind the FRBM regime in place. I dare say that such an approach will help in strengthening the cooperative federalism as an acceleration of lagging regions will lead to higher growth in all the regions.

Let me hasten to add that I am not suggesting for a moment that NITI Aayog 2.0 should take the form of the old Planning Commission. In the age of globalization and open economy, macro-economic framework has to be different in terms of analytical framework and approach. It should take care to eschew yesteryears micro-management vis-à-vis Central Ministries and the State Governments via excessive bureaucratization. Similarly, NITI Aayog 2.0 need not be involved with the approval of the States' annual expenditure programs. It should rather strive to be a think tank with "praxis" possessing considerable financial muscle and devote its energies to outline coherent medium and long term strategy and corresponding investment resources for transforming India. Towards this, my preliminary study suggests that the NITI Aayog 2.0 will annually need the resources of around 1.5% to 2% of the GDP to provide suitable grants to the States for mitigating the development imbalance. These formulaic annual grants, whether capital grants or revenue grants for the relevant CSS will need to be conditional to ensure that (1) outcomes are commensurate and (2) it discourages an individual State to adopt policies that have negative policy externalities, e.g., creation of populist subsidies and thus avoid race to the bottom. Such presence of "negative policy externalities" we notice often, e.g., the provision of free "electricity," irrigation water subsidies, etc. "Gresham's Law" seems to be relevant not only for the currency markets alone! I hope that such a perspective for the resource needs of the NITI Aayog 2.0 will be kept in view by the 15th Finance Commission in making their recommendations.

There is yet another important reason for having such conditional transfers. These grants essentially imply transfers from relatively rich States to the other States. In order to maintain political support for such transfers, there is a need to demonstrate that these are purposeful, effective and bring long run positive gains to all the States. After all, all indirect taxes are somewhat regressive and consequently relatively poorer sections of the richer States are transferring resources. The benefits of their sacrifice will need to be effective and equitable.

In order to make the new NITI Aayog more effective, it is essential to ensure that the institution is at the "High Table" of decision making of the Government. This means the Vice Chairman of the new NITI Aayog will need to be a permanent invitee of the Cabinet Committee on Economic Affairs. Thus, the new NITI Aayog will make available to the highest level of policy making the knowledge-based advice and provide the national and long term perspective on the policy proposals. Today, there is no such advice available to our cabinet. I cannot overemphasize the need for such a perspective as every ministry tends to take a sectional or sectoral view. Equally, individual ministries cannot fully take into account the inter-sectoral implications or the long term implications for the different regions of India.

I should also mention that in this task an establishment of Independent Evaluation Office in the new NITI Aayog will be sine qua non as it will be a needed instrument to improve the development outcomes, expenditure efficiency and accountability. Finance Commission being the First Pillar, NITI Aayog 2.0 will be the Second Pillar of the New Fiscal Federalism.

As I said earlier, "development imbalance" issues exist at the State level too due to the intra state / regional disparities.[4] Hence, the State Finance Commissions and the State Planning Boards will also need to keep the above perspective. This means that the State Finance Commissions will also need to be strengthened in terms of their mandate, and their recommendations should receive acceptance similar to the Central Finance Commission. This can be achieved by amending (i) Article 266 of the Constitution to include a consolidated fund for Municipalities and Panchayats and (ii) Articles 243H and 243X to ensure that revenue allocated by the Central and State Finance Commissions to Municipalities and Panchayats do not form part of the consolidated fund of the State and instead the funds flow directly to the consolidated fund thus created.

To deepen further our cooperative federalism would be the objective of "New Fiscal Federalism." Towards this, it is necessary to vigorously implement the 73rd and 74th Amendments. This will promote democratic decentralization by empowering the Third Tier of our federalism, viz., elected local bodies. To give content to such empowerment involves transferring functions and functionaries from the Second Tier to the Third Tier and strengthening the fiscal base of the Third Tier. This is what is called as the "3-F" strategy for effective democratic decentralization. India's new fiscal federalism will have to make arrangements to provide the fiscal base and financial resources to the Third Tier Government. Towards empowering of the Third Tier, reformed NITI Aayog will also need to play an important role.

To provide the necessary fiscal base for the 3rd Tier, I would strongly urge to make Constitutional Amendment to enable both States and the Centre to share an equal percentage of their GST, i.e., of SGST and CGST with the 3rd Tier. This will provide a buoyant fiscal base to the 3rd Tier and more importantly align interests of the elected officials with their citizens as GST is essentially a consumption-based tax. Towards this, I would propose the following rates: A single GST rate of 12% with CGST and SGST of 6% each and both Centre and State would share 1/6th of this with the 3rd Tier. This would enable providing a fiscal base of not less than 1% of GDP to the 3rd Tier in a predictable manner. Given growing urbanization and the increasing role of the cities in maintaining the country's growth momentum, an adequate fiscal base for the cities can alone ensure the supply of required public goods such as urban mobility, solid waste management, public health, etc. Such a measure will also generate considerable amount of fiscal resources with high buoyancy. For instance, this year alone it can generate more than rupees two lakh crores and growing by more than 10% every year. These large resources would be additional to the resources from the property taxes that will continue to be levied by the local bodies.

There is, of course, need to reform the Property Tax System on the lines suggested by the 13th Finance Commission.

Such strengthening of the fiscal base can give a major boost for improving greatly the urban infrastructure and strengthen our cities as powerful engine of growth. With a predictable fiscal base, the well run local governments can also raise additional resources via issuance of long term bonds.

Such an approach for sharing taxes with the 3rd Tier has one additional important feature. The proposed sharing procedure is fully "incentive-compatible." You would recall that what I am proposing is the sharing of the GST with the 3rd Tier. GST is a consumption tax and sharing this with the 3rd Tier will align the incentives for the "governed" as well as "governors" thus promoting efficient deployment of these resources. Cities with better local public goods would increase automatically the tax base of the cities as better public goods will promote growth of economic activities and the resident citizens' incomes and consumption which, in turn, will provide high fiscal resources to the cities' governments. Equally, every citizen will be contributing to the fiscal base as the GST is a consumption tax. Consequently, every citizen will demand high accountability of the governance. In other words, both demand for and supply of good governance will improve quality of life on a sustained basis.

The effective "democratic decentralization" means autonomy of the third tier governments in terms of funds, functions and functionaries. It is my belief that strengthening the fiscal base of the 3rd Tier through sharing of the GST, i.e., giving the greater autonomy for funds will incentivize the State Governments, i.e., the 2nd Tier of the Government to hand over the control of relevant functions and functionaries to the 3rd Tier and thus truly empowering the 3rd Tier. Hence, I have no doubt that the proposed constitutional arrangements for sharing of the GST with the 3rd Tier along with strengthening of the state finance commissions, will provide the Third Pillar of India's new Fiscal Federalism in addition to the two Pillars, i.e., Finance Commission and the NITI Aayog 2.0. This will usher the era of democratic decentralization envisaged by the 73rd and 74th Amendments and provide new strength to India's Cooperative Federalism.

Let me now turn to the Fourth Pillar of India's new fiscal federalism, viz., the Constitutional Amendment that adopted the GST. I must say that the passage of the GST Constitutional Amendment with unanimity in the Parliament, the notification, the ratification by 17 States and the Presidential nod all of this must surely gladden the heart of every right thinking citizen. This has demonstrated the Statesman like ability of our political parties to be bi-partisan and to come together when fundamental national interests are involved.

In effect, GST is a "grand bargain" with the Centre undertaking to implement a commonly agreed GST which would be done through a joint GST council. The GST Council so created by the constitutional amendment is a land mark event in the history of India's fiscal federalism. The Centre and the States from being good "fiscal neighbours" now will become equal fiscal partners in sharing a common indirect tax base. To enable a successful and a smoother implementation of GST, the Centre has also agreed to compensate the States for any loss of revenue for a period of five years. Ruefully, the current GST arrangement is rather a weak pillar, and more reforms are necessary to ensure that the GST becomes a firm and lasting Fourth pillar of our fiscal federalism Architecture.

NCAER (National Council of Applied Economic Research) study based on CG model done for the 13th Finance Commission has estimated that the lasting impact of "flawless" GST would be to increase the GDP by 1.5% to 2% accruing year after year. In my view, the potential benefits can be even larger as the model did not estimate the well-known dynamic effects of the GST. Unfortunately, the present implementation of the GST Regime is far removed from both the best international practices and the "flawless" GST model proposed by the Finance Commission. The flawless GST meant comprehensive coverage, one single rate for both goods and services, and a single market with single documentation for the seamless inter-regional and regional trade. I would urge the GST Council and the Government to move towards the "flawless" GST model as early as possible. The "flawless GST" will provide the Fourth enduring Pillar for India's new Fiscal Federalism. Hence, to achieve this, the government and the GST Council will have to undertake the following important GST Reforms. These proposals are based upon the joint papers with my colleague Dr. V. Bhaskar[5,6].

i. Firstly, GST should include real estate, electricity, liquor, tobacco and the petroleum products. Some of these products can be considered as "sin" goods and a single rate of GST may not be adequate to discourage the consumption of these products. Towards this, one can envisage "non-vattable" levy on these sin goods. Such a surcharge can be imposed by both Centre and State equally or by Centre alone or States alone. For instance, on tobacco, it can be only by the Centre and on liquor, it can be only by the States and on petroleum products both Centre and

States. Such a flexible approach towards tax jurisdiction for "non-vattable" surcharges will meet the concerns of the State Governments.

ii. Second important part of the reform is to put Exports at "zero rate" which is not yet done. One cannot tax exports as the foreign importers will go to other suppliers even if the Indian exporters are efficient. Such a policy already exists all over the world and it is also WTO compatible. I cannot overemphasize the urgency of this measure as expanding exports will be an important source for increasing growth and employment opportunities.

iii. Thirdly, bringing real estate in the GST will have an additional advantage of imparting transparency in the land and real estate markets and thus substantially reduce generation of black money in our economy. Frankly, to my mind, this measure will yield better results on controlling Black money than a measure like demonetization.

iv. Similarly, for reducing transaction cost, we need to reform IGST and completely do away with the system of e-way bills. All these measures will allow us to adopt a single rate of 12% of GST where 10% is equally shared as CGST and SGST and 2% to local bodies. A single GST rate is in line with best international practice. Such a single rate will improve compliance, completely do away with distortion and promote growth and employment. Of course while exports will be zero rated, the rate for food, lifesaving drugs, vaccines and lifesaving medical devices will need to be nil.

Such single rate of 12% will be a Revenue Neutral Rate for both Centre and States. This is based on the detailed estimates done by the Task Force appointed by the 13th Finance Commission.

v. Regarding the GST reforms, there is an additional point. This relates to the strengthening the Secretariat of the GST Council and also taking measures for promoting capabilities and transparency in the working of the GST Council. It is important to create an independent Secretariat manned by experts to assist the GST Council through their analysis, research papers, etc. This will lead the GST Council debates and decisions to be knowledge- based and thus better informed. It is also necessary to have at least some of the sessions of the GST Council open like our Parliamentary sessions. This would enhance transparency and accountability of the GST Council.

Finally, we need to recalibrate the GST administrative structure so that a tax payer is required to be audited only by a single tax authority, i.e., for a larger taxpayer by the Central authority and for smaller taxpayer by the State authority. The current practice of every taxpayer facing multiple audit agencies for the GST should be eschewed.

vi. In conclusion, I have discussed the issue of the need to revisit the fiscal federal architecture in contemporary India. Briefly tracing the origin of arrangement in contemporary history, I have attempted to point out the changing political- economic parametric environment calling for commensurate change in the way our fiscal federal setup ought to be conceptualised, here and now. In doing this, I have identified some of the important issues that arise as we move forward. I have also suggested innovative reform proposals towards creating Four Pillars- based architecture for India's new Fiscal Federalism. While the final resolution of these matters will be attained through a dialectic that will play out in the domain of real politik, it is important that such a process be helped along by evidence based analysis and debate. It is my strongest possible hope that this lecture will contribute to such a debate on the issues which are so vital to our country. I should say that in these debates, this society and its members should play a fulsome role.

vii. May I once again thank the organizers and, in particular, Prof. V. R. Panchamukhi, for inviting me here today. It has indeed been a pleasure and an honour to deliver this lecture. I thank you for your time and patience!

Endnotes

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