

Fiscal equilibrium

Complex economic rules between state & Centre explained in simple terms

LEKHA CHAKRABORTY

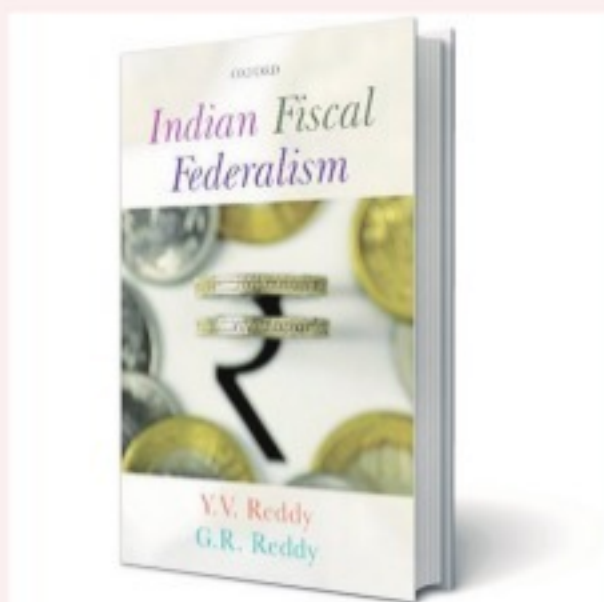
INDIAN FISCAL FEDERALISM, authored by YV Reddy and GR Reddy, is written from a practitioner's perspective. The simplicity of the book is appealing, especially when the content of the book is about a very complex set of rules and games between the Centre and the states.

I have identified a few 'empirical questions' in the book. One such question is about the 'hysteresis' or the reliance of an economy on history. The book delves deep into the significance of history of Indian fiscal federalism in understanding contemporary debates, something that is rare in India.

An aspect that received less adequate recognition in the context of "what holds India together" is the role of finance commissions. The book rightly highlights the significance of the existing institutional mechanisms for providing predictability in federal fiscal relations, along with the smooth transition of political regimes through peaceful elections, state reorganisation mechanisms and other institutions of economic management. The book throws light on these aspects of 'asymmetric' and 'cooperative' federalism in India.

There was continuity, there was change. The effectiveness of such processes in creating convergence is an empirical question. Has the goal of economic convergence been achieved, with poor states catching up in growth with the richer states in India? Existing empirical evidence is mixed.

There is a debate about the significance of conditional and unconditional transfers. The book highlights these questions and remains stoic about it, leaving a cue that researchers need to examine empirically the progressivity of tax transfers versus grants. In the chapter titled *Public Debt*, the book points out that fiscal rules determine the state's access to debt, subject to the approval of the central government. An empirical question I could gather here is whether access to debt, though 'not good' can be 'so bad'? Of course, the answer is, "it is context-specific". This also reminds me of the presidential address by Oliver Blanchard in the American Economic Association (AEA) 2019 meetings, where he highlighted that high public debt is not catastrophic if more debt can be justified



Indian Fiscal Federalism

YV Reddy & GR Reddy
Oxford University Press
Pp 304, ₹695

by clear benefits like public investment or output gap reduction. However, the output gap can be a difficult notion for financial commissions, which cannot incorrectly assume that an upturn in growth can eliminate the cyclical part of deficit, while such things cannot happen if there is no return of growth to prior trend.

The *Detail Matters* chapter provides us a rare empiric of projections and actuals of macro-fiscal variables used by various financial commissions and an analysis of any significant deviation between the two or not. This leads us to

empirically examine the fiscal marksmanship of various commissions.

The book has given importance to fiscal decentralisation. When it comes to third tier, the real issue is unfunded mandates. To analyse this empirically, we need reliable data at the third tier. The role of state finance commissions in making the devolution less arbitrary and less ad hoc at the third tier is emphasised.

The book talks about the growing prominence of economists in the commissions after the economic reforms, quite contrary to the initial financial commissions' composition of more lawyers to interpret constitutional clauses on federalism. This takes me to career theories, whether the personal characteristics of a financial commission chairperson influences the magnitude and criteria of tax transfers, and debt-deficit dynamics.

I noted the absence of a cross-country backdrop chapter on federalism experiences in the book. But I realise how different Indian fiscal federalism is from other country models. In other federations, inter-governmental fiscal transfers are predominantly grants, not tax transfers. So such fiscal equalisation models may be of different relevance to India.

This book is a must-read for the scholars and policy makers who are interested in federalism, to innovate financial commissions better.

Lekha S Chakraborty is associate professor, National Institute of Public Finance and Policy, New Delhi