FISCAL FEDERALISM IN INDIA

- Post 1991 reforms, India lived in a period of rules based fiscal control and the Finance Commission was the instrumentality for promoting observance of the fiscal rules amongst States.
- shrinking fiscal space with a proliferation of Centrally Sponsored Schemes and inter-governmental transfers outside Finance Commission purview.
- In the constitutional context, fiscal federalism mandated that the borrowing program of State Governments had to be approved by the Union, there was a prohibition on external borrowings by a State.
- Subsequent to the 73rd and 74th amendment of the Constitution and insertion of clause (3) to Article 280, the Commissions started giving additional grants for local bodies as a measure to augment the consolidated funds of the States to supplement the resources of local bodies.

CONSTITUTIONAL PROVISIONS

- The Articles of the Indian Constitution relevant to Finance Commission are the following:
- Article 268. Duties levied by the Union but collected and appropriated by the States
- Article 269. Taxes levied and collected by the Union but assigned to States
- Article 270. Taxes levied and distributed between the Union and the States
- Article 271. Surcharge on certain duties and taxes for purposes of the Union
- Article 275. Grants from the Union to certain States
- Article 279. Calculation of "Net Proceeds"

CONSTITUTIONAL PROVISIONS

- Article 280. Finance Commission
- Article 281. Recommendations of the Finance Commission
- Article 243, Article 243 A to Article 243 O deal with Panchayats and Article 243 P to Article 243 Z and Article 243 ZA to Article 243 ZG deal with Municipalities.
- **Dr. M.Govinda Rao** : "Notwithstanding the weaknesses, it must be noted that the system of inter-governmental fiscal arrangements in India has served well for over 50 years. It has achieved significant equalization over the years, instituted a workable system of resolving the outstanding issues between the Centre and the States and amongst the States, and adjusted to the changing requirements. It has thus contributed to achieving a degree of cohesiveness in a large and diverse country."

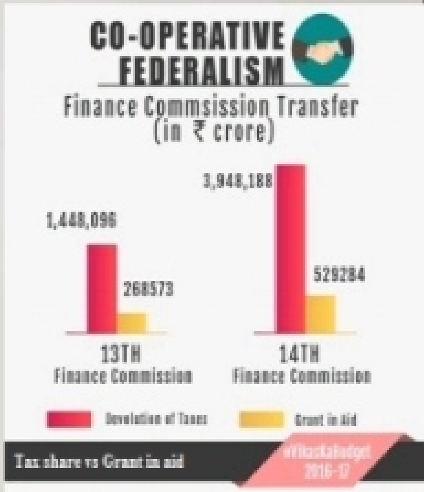
THE 14TH FINANCE COMMISSION

- DR. C.RANGARAJAN, CHAIRMAN 12TH FINANCE COMMISSION

"The setting up of a Finance Commission every five years is a constitutional mandate. The fiscal relations in this country have evolved over time through political, institutional and functional changes within the ambit of the provisions of the Constitution. The Finance Commission has had an important role to play in this evolving structure because resource sharing based on constitutional division of functions and finances between Centre and the States is a critical element of fiscal federalism."

THE 14TH FINANCE COMMISSION

- TERMS OF REFERENCE:
- (a) proceeds of taxes to be divided between the Union and the States, usually referred to as vertical balances,
- (b) the allocation of distribution of taxes among States, usually referred to as the horizontal balance,
- (c) the principles which should govern the grant-in-aid to the States by the Finance Commission, which are over and above the devolution of taxes as per the formula; and
- (d) measures to augment the consolidated fund of a State to supplement the transfer of resources to Panchayats and Municipalities, based on recommendations of the respective State Finance Commissions, usually referred to as Finance Commission Grants to Local Bodies.



THE 14TH FINANCE COMMISSION

The 14th Finance Commission adopted an approach beneficial for future Finance Commissions. The salient features of the approach was that they adhered to the letter and the spirit of the Constitution (balancing the Union and State's revenue powers with expenditure responsibilities listed in the 7th schedule of the Constitution), appreciated the problems raised by stakeholders, and attempted to address the troubling contemporary issues relevant to the Terms of Reference.

THE 14TH FINANCE COMMISSION

- The 14th Finance Commission assessed State Finances as (a) For States with above average tax-GSDP ratio the assumed tax buoyancy was 1.05 implying a moderate increase and (b) for other States a higher buoyancy of 1.5 was assumed.
- The 14th Finance Commission assumed an increase in aggregate tax-GSDP ratio from 8.26 of GSDP to 9 percent in the terminal year. On the expenditure side, the 14th Finance Commission included the expenditure incurred on the centrally sponsored schemes in revenue expenditure. The expenditure was projected as 11.12 percent of GDP against 13.57 percent projected by the States.

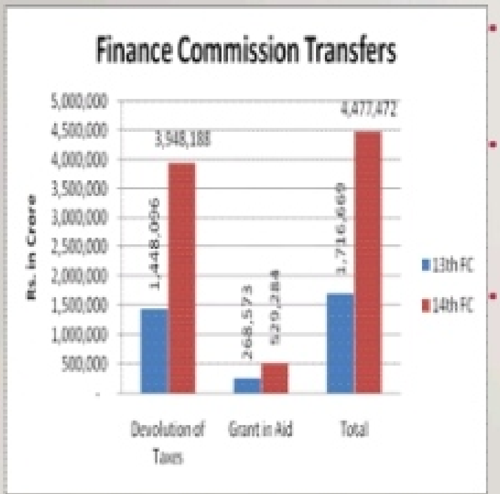
The fiscal road map for the next five years:

	FY15*	FY16	FY17	FY18	FY19	FY20
GDP rate of growth (current prices)		13.5%	13.5%	13.5%	13.5%	13.5%
As a % of GDP						
Gross revenue receipts	12.14	12.25	12.39	12.55	12.73	12.92
Gross tax revenues	10.6	10.72	10.87	11.03	11.2	11.39
Tax share to states	2.97	3.96	4.03	4.1	4.18	4.27
Net revenues to Centre	9.13	8.25	8.32	8.41	8.51	8.62
Revenue expenditure	12.18	10.81	10.57	10.2	9.87	9.55
Subsidy	2.02	1.7	1.6	1.4	1.2	1
Capital expenditure	1.76	1.64	1.4	1.9	2.4	2.9
Fiscal deficit	4.24	3.6	3	3	3	3
Revenue deficit	3.05	2.56	2.25	1.79	1.36	0.93

*Reassessed by the 14th Finance Commission

Source: 14th Finance Commission report

THE 14TH FINANCE COMMISSION



- The 14th Finance Commission recommended increasing the share of tax devolution to 42 percent of the divisible pool as against 32 percent recommended by the 13th Finance Commission.
- The 14th Finance Commission did not adopt a fiscal performance criterion on the grounds that rules based fiscal regime under the Fiscal Responsibility Act was already in place and it was not necessary to introduce separate fiscal discipline indicator in the devolution formula.
- Dr. Y. Venugopal Reddy says : "There has been a compositional shift in transfers from grants from the Union to the States in favor of tax devolution, thus enhancing the share of unconditional transfers to the latter. The balance in fiscal space thus remains broadly the same in quantitative terms, but tilts in favor of States in qualitative terms through compositional shift in favor of devolution and hence fiscal autonomy."

NITI AAYOG

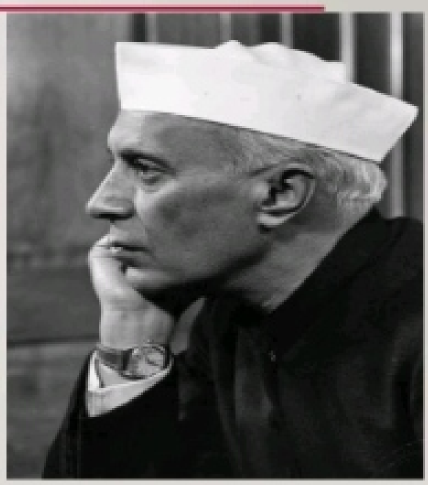
The NITI Aayog, established in 2015, is one of Indian democracy's youngest institutions.

Mandate:

- re-imagining the development agenda by dismantling old-style central planning,
- foster cooperative federalism, evolve a national consensus on developmental goals,
- redefine the reforms agenda,
- act as a platform for resolution of cross-sectoral issues between Center and State Governments, capacity building and
- to act as a Knowledge and Innovation hub.

PLANNING COMMISSION

- Established in 1950
- Mandate: The initial mandate was to establish heavy industries through public investment as a means for achieving rapid industrialization. The functions assigned to the Planning Commission were to assess and allocate plan resources, formulate plans and programs for area development, determine implementation methodology, identify resource constraints and appraise & adjust implementation.
- An internal evaluation in Government revealed that Planning Commission was witnessing policy fatigue necessitating structural changes in central planning process.



THE PLANNING COMMISSION

Table 6.1: Timing of the Five Year Plans

First Plan	1951-56
Second Plan	1956-61
Third Plan	1961-66
Three Annual plans	1966-69
Fourth Plan	1969-74
Fifth Plan	1974-78*
Annual Plan	1979-80
Sixth Plan	1980-85
Seventh Plan	1985-90
Annual Plan	1990-92
Eighth Plan	1992-97
Ninth Plan	1997-2002
Tenth Plan	2002-2007
Eleventh Plan	2007-2112

The Planning Commission from 1950 to 2014 formulated twelve five year plans.

The 1st and 2nd plans aimed at raising public resources for investments in public sector,

the 3rd plan focused on increased emphasis on exports and the 4th Plan formulated at a difficult period of balance of payments crisis focused on agricultural development.

The 5th Plan provided enhanced allocations for social sector spending.

The 6th and 7th Plans were infrastructure plans focusing on raising plan resources for infrastructure spending.

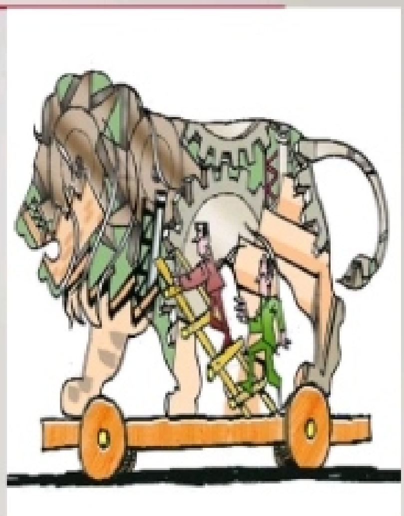
The 8th Plan formulated in the midst of economic reforms achieved 6.7 percent growth.

The 9th Plan period witnessed a sharp decline in economic growth to 2.4 percent.

The 10th and 11th Plans implemented in the 2004-2014 period witnessed economic growth trajectory of above 9 percent.

NITI AAYOG

- The NITI Aayog has done enormous amount of work in a short period of 3 years.
- The NITI Aayog formulated the
  - Make in India Strategy for Electronics Industry, a Model Land Leasing Law, laid down a National Energy Policy, prepared a Roadmap for Revitalizing Agriculture, designed a Developmental Strategy for North East and Hilly areas and undertook an appraisal of the 12th Five Year Plan. Further the NITI Aayog recommended closure of sick PSUs, strategic disinvestment of other CPSUs and pushed for reforms in Medical Council of India and the University Grants Commission.
- The two-standout initiatives of the NITI Aayog were the model law on land leasing and the framework of priorities for disinvestment.



NITI AAYOG

- An over-arching theme of the NITI Aayog was the change in focus from central planning to cooperative federalism. The Prime Minister said that "Through the NITI Aayog, India will move away from the one size fits all approach and forge a better match between schemes and needs of States".
- The Governing Council of NITI Aayog met very often, 3 sub-groups of Chief Ministers were worked on centrally sponsored schemes (CSS), skill development and Swach Bharat. Based on their recommendations, the new CSS sharing system was notified and a transparent formula based allocation of resources was reached.
- The Swach Bharat cess was levied on all services. To promote skill development initiatives, the involvement of States in the Pradhan Mantri Kaushal Vikas Yojana was ensured. The Atal Innovation Mission was launched to seed innovations to teach young minds new skills.

NITI AAYOG

- The NITI Aayog made serious efforts for Transforming India's developmental agenda.: sought proposals from all Central Ministries for Accelerated Growth and Inclusion Strategy, Employment Generation, Energy Conservation and Efficiency, Good Governance and Swach Bharat.
- In April 2017, the NITI Aayog Governing Council approved the 3 Year Action Plan agenda
- An agricultural transformation was envisaged with the objective of doubling farmer's income by 2022
- Further the NITI Aayog, monitored the implementation of the Sustainable Developmental Goals.

THE GOODS AND SERVICES TAX

- The Act of 2016 envisages constitution of Goods and Services Tax Council (GSTC) comprising of the Union Finance Minister, the Minister of State (Revenue) and the State Finance Ministers to recommend on the GST rate, exemption thresholds, taxes to be subsumed and other features. This mechanism seeks to ensure some degree of harmonization on different aspects of GST between the Centre and the States as well as across States.

THE GOODS AND SERVICES TAX

- The Goods and Services Tax Council has taken a number of important decisions in the past 2 years when it met 23 times.
- The GSTC decided that there would be 4 tax rates namely 5 percent, 12 percent, 18 percent and 28 percent. The tax rates for different goods and services have been finalized and notified. A cess over the peak rate of 28 percent on certain luxury and demerit goods has been imposed to compensate States for any revenue loss on account of implementation of GST.
- The GSTC also recommended enactment of 5 laws, the Central GST law, the Union Territories GST law, the Integrated GST law (to be levied on inter-State supply of Goods and Services), the State GST law and the GST compensation law. The CGST, SGST/ UTGST and IGST would be levied at rates mutually agreed upon by the Centre and the States under the aegis of the GSTC.

15TH FINANCE COMMISSION

- The Terms of Reference say that the Commission shall make recommendations on:
  - The distribution between Union and the States
  - The principles which should govern the grants-in-aid of the revenues of the States
  - The measures to augment the consolidated fund of State to supplement the resources of Panchayats and Municipalities

THE GOODS AND SERVICES TAX

- The Goods and Services Tax was introduced on July 1, 2017 following the passage of the 122nd Constitution Amendment Act 2016. The GST represents a very significant step in the field of indirect tax reforms in India, amalgamating a large number of Central and State taxes into a single tax, with the objective of mitigating cascading or double taxation in a major way and pave the way for a common national market.

15TH FINANCE COMMISSION

- The gazette notification further states that the Commission shall have regard to
- (iv) the impact on the fiscal situation of the Union Government of substantially enhanced tax devolution to States following the recommendations of the 14th Finance Commission, coupled with the continuing imperative of the national development program including New India-2022 and
- (v) the impact of the GST, including payment of compensation for possible loss of revenues for 5 years and abolition of a number of cesses, earmarking thereof for compensation and other structural reforms program, on the finances of Centre and States.

15^TH^ FINANCE COMMISSION

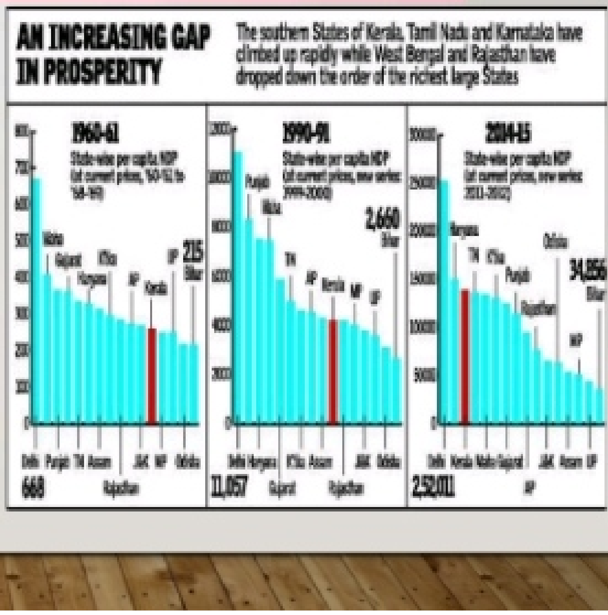
- The 15th Finance Commission will have to contend with the slowdown in the Indian economy.
- There is an upward trend in the fiscal deficits of States.
- The vertical balances to the States relative to Centre's gross revenue receipts have shown trend increases in every Finance Commission and it would not be possible to reduce the devolution without a corresponding increase in fiscal and revenue deficits of States.

15TH FINANCE COMMISSION

- The higher devolutions under the 14th Finance Commission are yet to result in significant increases in social sector allocations.
- There are pressures to increase allocations to the CSS schemes for higher expenditures on Health and Education.
- The tax buoyancies have been affected by the transition to the GST and the GST compensation to States will continue till 2022. The GST is expected to augment the Centre's fiscal efforts with higher tax collection.

15TH FINANCE COMMISSION

- On the Horizontal balances, the 15th Finance Commission has the responsibility of equalizing the widening gap between richer States and low income States. The inequalities in fiscal capacities between States have resulted in widely differing social and capital expenditures between States. A large part of the equalization effort by the 15th Finance Commission would have to be through grant-in-aid rather than devolution.



15^{TH} FINANCE COMMISSION

- The best way forward would be
  - adhere to the letter and the spirit of the Constitution (balancing the Union and State's revenue powers with expenditure responsibilities listed in the 7^{th} schedule of the Constitution),
  - appreciate the problems raised by stakeholders, and
  - attempt to address the contemporary issues relevant to the Terms of Reference.


Thank you