The Finance Commission and the Thiruvananthapuram conclave

Three southern states and Union Territory Puducherry came out **against the Terms of Reference(ToR)**stipulated by the Centre in the **15th Finance Commission** for devolution of funds to states. They were of the view that there was an attempt to reduce the Centre's share to states through the 15th Finance Commission, "If this is allowed to succeed, states would become a glorified municipalities".

Concerns by Southern States:

South Indian states have raised concerns over **a new population-based formula for tax** sharing between the Centre and states. The 15th Finance Commission, constituted in November 2017, has recognised population as an important criteria for distribution of taxes and said it will use data from the 2011 census while making recommendations for the five-year period beginning from 2020.

The southern states, however, want the recommendations to be based on 1971 census data. This is because, as compared to northern states, south India has recorded significant progress in population control or in the replacement rate of population growth.

At a conclave of finance ministers of southern states here, Kerala, Karnataka, Andhra Pradesh and Puducherry opined that ToR was **in contradiction to the principles of Federalism** enshrined in the Constitution and also would **result in revenue loss** to performing states.

According to the 1971 Census, the southern states' population was 24.7 per cent of the total population; according to the 2011 Census data it had fallen to 20.7 per cent. ToR would adversely affect the better-performing states.

Six Major Issues Raised By These States:

ToR NO: 1 – 2011 CENSUS AS THE REFERENCE POPULATION

- For providing comparable level of basic services across all the states, the population size of each state is clearly an important determinant.
- The relevant population to provide comparable services must be the present population, but not the population 40 years ago.
- 1971 population was used for electoral purposes of delimitation as changing that reference year would change the existing balance of constituencies. That is a separate political issue and it should not be mixed up with the Finance Commission, because the Finance Commission is to look at the equity.
- Moreover, there is one provision in 15th Finance Commission's ToR 7(ii) with regard to recognition of the States for their success in reducing the population.

Tor No: 2 – The Commission May Also Consider Whether Revenue Deficit Grants Should Be Provided At All

- This is in conflict with the mandate of the Finance Commission.
- Finance Commissions compare the expenditure needs of states with their available resources and both are based on explicit criteria.
- If there is a gap between the estimated expenditure needs of a state and the revenue resources available after factoring in its own revenue-raising capacity and revenue share from devolution, the Finance Commission provides an additional RD grant to fill the gap.
- The manner of estimating and filling the gap is varied from Finance Commission to Finance Commission. It is in line with the principle of equity.
- All Finance Commissions provided RD grants to fill the gap. So not doing the same would be in conflict with the principles of equity followed by the past Finance Commissions.

There are already provisions for grants in aid for Local Bodies and Disaster Management.

Tor No: 3 – Fiscal Consolidation

- The 15th Finance Commission hopefully follow the global best practice being pursued in many advanced countries and emerging market economies.
- It is setting the structural fiscal deficit as the target deficit level.
- It is to maintain a sustainable level of public debt. That means, actual fiscal deficit ratio being higher than the structural deficit,

when the growth is too low and the actual fiscal deficit can be lower, when the growth is too high.

- Target deficit should be the combined deficit for both Union and the States. 15th Finance Commission has to say how this is to be apportioned between the Union Government and different States.
- Maintaining macroeconomic stability is the constitutional responsibility of the Union Government.
- The deficit apportioned to the States should look at capacity to deliver a minimum level of public services.
- Once again, there is a need for Cooperative Federalism, which can be applied for other macro-economic policies.

Tor No: 4 – Performance Based Incentive Grants

- The 15th Finance Commission has been encouraged to use this approach and prepare measurable indicators for the same.
- They are mostly related to flagship programmes and other favourite schemes of the Union Government.
- These are being supported by central or Centrally-Sponsored Schemes (CSS) of the Union Government.
- Already, the Central Government attaches more importance to its own schemes.
- The incentives for States already built into CSS.
- Now, the Union Government seeks to leverage Finance Commission grants to induce state governments to also focus on these programmes rather than their own programmes.
- This is an unhealthy trend, quite contrary to the spirit of federalism and should be strongly discouraged.

Tor No: 5 – Finance Commission Is Asked To Assess The Impact Of GST, When The GST Council Is Already There

- This concern is unwarranted.
- GST comes under the jurisdiction of the GST council.
- In reviewing and assessing the revenue flow from indirect taxes, the 15th Finance Commission will have to assess the revenue impact of GST.
- Without this, the 15th Finance Commission cannot assess the flow of Indirect Tax Revenue.
- Moreover, the States have been guaranteed compensation for any loss from GST, as per agreed formula for the next five years. So, States need not worry about this.

Tor No: 6 – Conditions For Approving State Borrowing

- The Union Government has been explicitly empowered to approve or disapprove State's borrowing programme against the conditions imposed by it under Article 293, if there are any outstanding loans or guarantees of the Union Government to a State.
- The States no longer borrow from the Union and all such outstanding debt will be paid off from around 2025.
- But, external loans are still provided to the states through the Union Government and against sovereign guarantees provided by the Centre.
- Hence, the State Governments will have to continue to seek approval of the Union Government, subject to conditions it imposes, for their borrowing programme. This is a constitutional requirement.

The time has come for India to move to the **third phase of federalism**. Many of our states are larger than 90% of nations on earth. We need to allow each state to have its **own model of governance, bureaucracy and local governments**, but with firm safeguards to preserve national unity, separation of powers, fundamental rights and democratic accountability.

The **one-size-fits-all model cannot deliver** the desired outcomes of prosperity, elimination of poverty and national greatness in a vast and diverse nation of 1.3 billion people. We need more flexible federalism, strengthening India's unity and integrity, and allowing us to fulfil our potential.

Only the **spirit of "co-operative federalism"** and not an attitude of dominance or superiority can preserve the balance between the Union and the States and promote the good of the people.

Conclusion:

"The policy of sharing central funds with states was hitherto done based on the 1971 census. Now the 2011 census will be taken, and if that happens, Kerala as well as a few south Indian states would be the worst affected as our population growth was just 56 per cent as compared to 150 per cent in certain states in the country.

"If 2011 is going to be used, Kerala will lose Rs 20,000 crore in five years, while Tamil Nadu stands to lose Rs 40,000 crore".

"The need to transfer resources to less-developed regions of the country is legitimate. We **need to redress regional imbalances** in development.

The question is: ‘Should this be done by **under investing in the South?** Should development and population control not be incentivised?” The future course for the Finance Commission, “It must **bring new thinking to the table** and give **incentives to tax mobilisation efforts**; growth engines such as Bengaluru, Hyderabad, Coimbatore, Kochi, etc; and education and employment of women (proxy for population control).”

To conclude, some of the concerns flagged at the **Thiruvananthapuram Conclave** regarding the ToR of the 15th Finance Commission are unwarranted, while others are legitimate. The states should indeed **raise these legitimate concerns.** However, they will hopefully do so in a **spirit of cooperative federalism and** keeping in view both the national interest as well as the overarching principle of equity among the states.