



## EVENT REPORT

### 12TH CUTS 30<sup>TH</sup> ANNIVERSARY THOUGHT LEADERSHIP LECTURE

#### FISCAL FEDERALISM: THE UNEQUAL BALANCE

DECEMBER 18, 2013

#### Background

Consumer Unity & Trust Society (CUTS), established in 1983, has now entered its 30<sup>th</sup> year, and to celebrate the same is organising a series of public lectures, by eminent friends around the world in cities where CUTS is well known, on contemporary issues which are related to its work agenda.<sup>1</sup>

The aim of the lecture series is to address CUTS future interventions to promote inclusive growth from the point of view of their impact on consumer welfare in the light of contemporary policy discourse on trade, regulation and governance.

It was in this series of public lectures, that the 12<sup>th</sup> lecture was organised by CUTS on December 18, 2013, in New Delhi on the topic 'Fiscal Federalism: The Unequal Balance.' The keynote speaker for the lecture was Yashwant Sinha, Member of Parliament, and Chairperson, Parliamentary Standing Committee on Finance.

The panellists for the lecture were:

- N.K. Singh, Member of Parliament (in chair)
- B.L. Mungekar, Member of Parliament
- Sunil Mitra, Former Revenue Secretary

The session begun with a welcome address by Pradeep S. Mehta, Secretary General, CUTS, which was followed by opening remarks by Singh. Thereafter, Sinha delivered the keynote speech followed by observations of Mungekar and Mitra. The session concluded with a lively question and answer session with the audience, and concluding remarks by the panel.

#### Welcome address

Pradeep S. Mehta welcomed the guests and initiated the lecture by giving a background about the lecture and importance of the subject. He questioned the premise if the federalism practiced in India was true federalism. He mentioned that the Constitution of India does not refer to the role of Centre/Central Government, but to the Union.

#### Opening remarks

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<sup>1</sup>[www.cuts-international.org/30thanniversarylectures](http://www.cuts-international.org/30thanniversarylectures)

N K Singh set the tone for the lecture by stating that the issue of fiscal federalism was contemporary as well as complex, and sets up a challenge between economic understanding of scarcity of resources and political realities.

He mentioned that federal practices have not kept pace with changing dynamics and economic realities of the country. There was no credible and viable mechanism at present, for coordination between states and the Central government. He further observed that the Interstate Council has become defunct, and highlighted that decisions by the Central government, which often affect the states, are not taken in consultation with the state governments.

### **Keynote address**

Sinha began his speech with dispelling the misconceptions about federalism and decentralisation. He mentioned that federalism is coming together of equal partners with common goal to share powers and jurisdiction, while decentralisation is superior entity delegating its powers. It is not an equal partnership and therefore this unequal balance.

In his speech, Sinha touched upon the issues of federalism in Constitution of India, the changing political scenario with the emergence of regional political parties, role and utility of Planning Commission of India, the pending Goods and Services Tax, and the core issue of Centre-State and inter-State relationship which is at the heart of the subject of fiscal federalism.

#### *Constitution of India*

Sinha was of the opinion that the Constitution of India was non-federal. India is Union of states and there are number of articles which emphasise the unitary character of polity. Article 3 gives powers to Parliament to create, bifurcate, change boundaries of and change names of states. This is not possible in a federation of states and hence the Constitution gives preference to Centre. Other Articles related to Centre-State relations are Articles 248, 249, 257(2), 271, 281, and 356. He spoke about the Government of India's practice to impose surcharge which wholly goes in the pocket of Central Government. The Central Government appoints Finance Commission, which affects states to a great extent, but in appointment of which, there is no role of the states. The Central government, under Article 356, can impose President's Rule in a State also.

#### *Role of Planning Commission*

Sinha was critical of the role of the Planning Commission in reviewing the gross budgetary support and the lamented the lack of accountability of the Planning Commission to the Parliament. He noted that the Planning Commission was created by an executive order and has been continuing without any constitutional or statutory backing, but is playing a significant role in devolution of funds to states.

He further mentioned that, "the Planning Commission is the biggest obstacle in the path of federalism. It should be restructured to do perspective planning and implementation without being empowered to micro-manage the states' financing and functioning, which is the task of the Finance Ministry."

He mentioned that Government of India has created plethora of schemes which are supposed to be implemented by state governments, having varying funding patterns. There is no prescribed rule about the funding patterns, which is one of worst systems perpetrated in the polity. The total number of schemes are around 149 but in reality there should be around 10-12 schemes.

He further mentioned that there is an absence of zero budgeting and no review of the role of Planning Commission. The sectoral allocations are done by the Planning Commission and concerns of state governments are not taken into account. He was of the opinion that the Planning Commission needs to be restructured. It should be restructured as Perspective Planning and Implementation Commission and stop interfering in functioning of state governments.

### *Goods and Service Tax*

Sinha questioned the approach to the Goods and Service Tax (GST), to implement which a Council having Finance Ministers of State governments as members, who will be in majority, has been proposed. He felt that this could unreasonably tilt the balance in favour of state governments.

Sinha raised concerns about the complex Constitutional Amendment Bill on the GST. He was of the view that potential problems of the Central government in its implementation have not been adequately highlighted.

He mentioned that the GST has many complexities and is the first attempt to change a very important part of the Constitution of India. Powers of taxation under Schedule VII are being changed and this can be operated only with a first rate information technology system. GST is worrying states as states want some powers to remain with themselves. The issues amongst the states and between Centre and states need to be resolved effectively.

Further, Constitutional Amendment Bill that introduces GST is so detailed that things that should be in rules are sought to be included in the Bill. This could make life difficult as for small changes also the Constitution will need to be amended. Further, while states are afraid of GST, nobody is airing the concerns of the Government of India. There would be issues in making budget for the Government of India. It has been recommended that the Council for implementation of GST will be presided by the Finance Minister, but will have states in majority. It seems that the Government of India is surrendering far more authority than states for implementation of GST. All these issues need to be taken into account before adopting GST.

### *Role of regional parties*

Sinha was of the view that, "We are gradually moving towards federalism considering the fact that many regional parties are ruling in states". He mentioned that overtime, regional parties have emerged, which have put pressure on Central government to cede more powers to states, and thus the country is progressing towards a federal structure wherein states are demanding more and more powers.

### *Cooperative federalism*

Sinha mentioned that what India truly needed was cooperative federalism, i.e. co-option of state governments in policy making, and need for greater cooperation between Central and state governments in critical areas, including security.

He mentioned that the already existing Empowered Committee of Finance Ministers of various State governments on GST has been a successful experiment in discussing inter-State concerns. The same approach can be taken for other subjects as well, such as a committee of State home ministers to deal with security matters.

### *Other issues*

Sinha mentioned that performance of states on the issue of fiscal deficit was much better than Centre. He was of the opinion that the Centre must work with states to moderate or abolish the Agricultural Produce Marketing Committee (APMC) Act.

### **Remarks by the panel**

#### *B L Mungekar*

Mungekar said that India is a natural federation considering the plurality of cultures, language, religion etc. He clarified the distinction between centrifugal and centripetal federation, the former being found in US and the latter in India. Unlike the US, India provides for a singular national identity and citizenship, thereafter divided into administrative federal units, which was adopted to reflect its decidedly Central federal structure. Fiscal federalism is important in the perspective of unequal structure of economy, topography and resources.

Mungekar stated thereafter that there were two primary instruments for regulating the economic conduct of states, namely the monetary and fiscal policies employed by the Centre. Fiscal Federalism was an extension and employment of this tactic for reigning in the states. The validations for these measures were:

- For the equal distribution of resources between the federal entities so as to ensure that states met their budgetary and plan allocations, had access to relevant resources and were provided support on the basis of specific peculiarities of each State.
- For the financial stability of state governments to conduct their duties and responsibilities efficiently.

Identifying the Finance Commission as the agency that carried out these functions, Mungekar went further to express his doubts on the Fiscal Responsibility and Budget Management (FRBM) Act, 2003. He believed that no nation had ever enacted a legal instrument or statute that artificially restricted State expenditure without due considerations of the market and economy. He stressed upon the need to restructure the FRBM Act and the need for more autonomy states. He advocated for greater autonomy for states without hurting certain powers of Central government.

Citing the example of the 2008 financial crisis, he elaborated that in an environment that saw all developed countries registering an abysmal 0-1 percent rate of economic growth, had it not been for the Government of India's recognition of the prevailing financial conditions, we would not have been able to maintain an above average 6+ percent rate of growth.

Mungekar then shifted his focus to the instruments of imposition of unbalanced fiscal federalism. Identifying the Planning Commission he stated that it was the instigator for pointless expenditure by the Central Government. Instead of planning for the future, the Commission had simply become an agency for incurring expenditure and making budgetary allocation. Surely this job was well suited to be carried out the Finance Ministry. What was the need then for the existence of the Planning Commission today, he asked. He further criticised the National Development Council for merely ensuring gross budgetary support for initiatives and thereafter conducting delayed reviews mid initiatives and stressed that it was in serious need of restructuring.

To conclude, Mungekar asked that the states be given the freedom to manage their own fiscal and monetary affairs with minimal budgetary interventions by the Centre. He further requested that central allocations and policies should operate from the premise of favouring the states over the Union and to ensure that plans made are not discriminatory for the states when compared to the Centre. He signed off by highlighting the need for the co-operative federalism model and wished to remind the government that "India was made of states that came together... it was not that India had made these states."

#### *Others*

Sunil Mitra agreed with the views of his co-panellists. He mentioned that there is a great need for looking into the issue of fiscal federalism from perspective of opinion of his co-panellists, which will require fundamental change in the way fiscal management is done

Both parliamentarians Mungekar and N. K. Singh, having been members of the Planning Commission, too expressed their reservations about the functioning of the Plan body and suggested that it should be wound up.

#### **Question and answer session**

The addresses were followed by a lively question and answer session. The audience included parliamentarians, Messrs V.P. Singh and Rangasayee Ramkrishna, amongst other eminent citizens, economists and media personnel.

On a query of the steps needed to bring back India to growth trajectory, Sinha responded that government should create an environment to enable reduction in interest rates and ensure speedy clearances of pending projects, which are currently in the range of Rs. 138,000 crores. He emphasised that the major lag is trust, which needs to be brought back.

Mehta suggested that as a seed to cooperative federalism, mainstream political parties should also explore a grand coalition in forming a stable government, such as in Delhi State, as practiced in Germany, whereby the legislature can function without going in for fresh elections.

V.P. Singh raised the issue of imbalance caused by subsidising commodities such as electricity. Sinha responded that states must have a very clear understanding regarding subsidising the electricity sector or making it free to any set of consumers. Then, the expenses shouldn't be borne by electricity companies but under the State budget, and be shown under the balance sheet of the states.

Thereafter, it was also enquired if 'cooperative federalism', would be plausible in the current political climate. Sinha seemed pretty sure in response regarding his idea of 'cooperative federalism' and commented that it is possible to work very closely with State governments in all major issues also.

Mungekar commented on scrapping of APMC Act, because it is turning the agricultural markets to be monopolistic. To which, Sinha also nodded and added that it should be abolished as soon as possible.

It was also asked that Reserve Bank of India (RBI) has not reduced the interest rates to which Sinha replied that the RBI cannot act in vacuum, and government has to create a space and enabling environment for RBI to act. These are long term issues he suggested.

### **Concluding remarks**

The panel wholeheartedly echoed the need of cooperative federalism in India, emphasised that the same was feasible, and the need to rechristen the Planning Commission of India, as Department of Planning and Cooperation, as it has outlived its utility in its present form.

Further, the meeting issued a fresh call for scrapping the APMC Act, and to establish an empowered committee of State agriculture ministers to review the same.

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