### Fiscal federalism

# An unequal balance

## The Constitution mandates that part of the taxes the Centre collects be given back to states. Since the bulk of 'grants to states' goes to schemes chosen by the Centre, this is what allows Rahul Gandhi to loftily talk of the money sent by the UPA to Bihar

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The National Advisory Council worries me, because of the misleading "advisory" in its name. Extra-constitutional advisory bodies are not normally a real source of concern, as decisions on their advice are taken by a constitutionally established government. The NAC, however, is obviously more powerful than the Prime Minister, even the entire Cabinet, simply because it is headed by Mrs Sonia Gandhi. In fact, a more appropriate name for the NAC would have been "committee for directions" because, in realistic terms, the only discretion with the Cabinet, or the concerned ministry, is on how to carry out any advice-direction that the NAC may choose to give.

**Normal plan assistance, which gives state govts elbow room to evolve their own schemes, has come down from a sixth of total assistance in 2005-06 to a tenth in 2010-11, down from ₹70,000 cr to ₹22,000 cr**

One of my worries is that its recommendations will inevitably bring, in their wake, further assaults on fiscal federalism. Though the ability of that other powerful extra constitutional body, the Planning Commission to damage the fiscal autonomy of the states is limited, the erosion has been considerable. The Planning Commission has been limited by the fact that the head of government is the chairperson. In the case of the NAC, there are no such checks and balances. The chairperson of the NAC is infinitely more powerful than the head of government. Its recommendation is therefore a command.

So, how does the unbridled power of the NAC link up to state finances? A disturbing trend over the last few decades has been the exponential increase in the number of central/centrally sponsored schemes, and additional central assistance schemes (referred to jointly as CSS hereafter). According to a discussion paper for the tenth Plan, hosted on the Planning Commission Website, there are as many as 210 CSS. *Economic and Political Weekly* had calculated that these required an outlay of over ₹56,000 crore in 2005-06. This has grown exponentially in the last five years, and is budgeted to cross an astonishing ₹2 lakh crore in 2010-11! The problem is now being exacerbated to a different level, with the central government laying down entitlement-based schemes.

As late as in 1969, the National Development Council, under the chairmanship of Mrs Indira Gandhi, had resolved that 5/6th of central assistance to state plans should be in the form of normal plan assistance (NCA), which is schematically untied and, therefore, permits the state governments enough elbow room to evolve their own schemes. A more than complete reversal had taken place by 2005-06, when normal NCA (₹12,000 crore) was a little over 1/6th of the total assistance (₹70,000 crore). Now, in 2010-11, it will be around 1/10th (₹22,000 crore) against the total outlay of ₹2 lakh crore!

ROHNIT PHORE

Where do these large sums of money for the CSS come from? They come from the pockets of the state governments, who are denied their constitutionally-provided-for entitlements. The ignorance about public finances amongst both the political executive, and the "intellectuals" who shape public policy in India, including the jholawallahs who infest the NAC, is such that I must take a moment to explain how.

The Union government collects taxes on subjects that are listed in List I (the Union list), and the states on the subjects that are on List II (the State list). While the state collects taxes on a very small number of items that yield very limited tax revenues (mainly VAT, registration charges on transfer of property and duty on liquor), the central government has all the major sources of taxation (excise duties, import duties and income tax). As a result, the revenues of the Centre are almost twice the combined revenues of all the states put together. In the year 2009-10, for example, all the states together had tax receipts of ₹3,66,500 crore, while the Central Government's receipts were almost twice that at ₹6,40,000 crore.

The Union taxes do not belong to the central government alone; the Constitution decrees that this is actually a divisible pool. Article 280 of the Constitution provides for a Finance Commission, precisely for this reason. Clause (3)(a) of this states as under: "(3) It shall be the duty of the Commission to make recommendations to the President as to (a) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under this Chapter and the allocation between the States of the respective share of such proceeds." Thus, taxes collected by the authority of List I do not entirely belong to the central government; only a share, determined by an independent body, belongs to the central government. The Finance Commission is supposed to assess the requirement of funds of the central government, for expenditure on central subjects (List I). The balance left over, after taking into account all of Centre's requirements for the responsibilities assigned to it by the Constitution, was to be divided amongst the states in accordance with a formula, also to be devised by the Finance Commission. This is not the place to discuss what the onerous responsibilities of the Union government are, but they certainly do not include running huge and expensive schemes on state subjects—that have quixotically led to the central government's largest ministries being on state subjects. The ministries of agriculture, rural development, Panchayati Raj, social justice, health and primary education are examples. I am told that two-thirds of the IAS officers on deputation to Delhi are posted in ministries dealing with state subjects!

**I am told that two-thirds of the IAS officers posted in Delhi are in ministries dealing with schemes that are supposed to be under the purview of the state govts, according to the Constitution**

Though the central government does not have first charge over the Union taxes, in the matter of how these funds will be apportioned, the central government is a referee in its own cause. It sets up the Finance Commission and determines its terms of reference; after acceptance of the report, the central government interprets the various recommendations according to its convenience, as we in Rajasthan discovered to our cost during the 12th Finance Commission period. To decide what is available in the kitty for division amongst the states, the Finance Commissions have been compelled to first determine the requirements of the central government including that of gross budgetary support to the "Central Plan" (of which, as we have seen above, now only 10% goes as untied NCA to state governments). In any case, the requirement is only euphemistically "central", because a large portion of the funds sought are actually for these 210-and-odd CSS. By grabbing most of the funds for schemes that they run from Delhi, the central government leaves little that can be divided amongst the states—30% to be precise.

Thus, a significant proportion of the moneys that should have gone to the states are appropriated by the central government—ironically, to run CSS on subjects assigned by the Constitution to the states. The schemes that the central government babus and politicians pride themselves on, the "favour" of development that they bestow upon the states, is actually the states' own money! When Rahul Gandhi loftily announced in public meetings how much money the central government has sent to Bihar, it is this money he is mostly talking about.

*The author has been a minister in the central government and chief minister of Rajasthan. This article is the first of a two-part series. Views are personal*