SEMINAR REPORT

Additional Terms of Reference of the 15th Finance Commission: Implications for the States

Saturday, 14 September 2019

Gulmohar Hall, India Habitat Centre, Lodhi Road, New Delhi

Organised By

GIFT GULATI INSTITUTE OF FINANCE AND TAXATION

PROGRAMME

Session 1 9:15 am to 10:20 am	Inauguration and Book Release Welcome: K J Joseph, Director, GIFT Chair: Sitaram Yechury, Communist Party of India (Marxist) Inaugural Address: Dr Manmohan Singh, Former Prime Minister of India Panelists T M Thomas Isaac, Finance Minister, Government of Kerala Jairam Ramesh, Member of Parliament & Former Minister, Government of India D Raja, Secretary, CPI Harsh Mander, Director, Centre for Equity Studies Dipankar Bhattacharya, CPI (ML) Indira Jaising, Senior Advocate
Session 2 9:15 am to 10:20 am	Setting the Context: 15th Finance Commission Story So Far Chair T M Thomas Isaac Finance Minister, Government of Kerala Panelists Haseeb A. Drabu, Former Finance Minister, Govt. of Jammu & Kashmir Abhijit Sen, Former Member, Planning Commission
Session 3 10:35 am to 11: 20 am	Union Government Responsibilities: Perspective of Finance Commissions Chair Balveer Arora, Chairperson, Centre for Multilevel Federalism, Institute of Social Sciences Panelists Sudipto Mundle, Member, 14th Finance Commission Indira Rajaraman, Member, 13th Finance Commission Govinda Rao, Member, 14th Finance Commission Atul Sarma, Member 13th Fianance Commission Abhijit Sen, Member, 14th Finance Commission D K Srivastava, Member, 12th Finance Commission

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Session 4 12:20 pm to 01:20 pm	Implications on Fiscal Stability and Governance Chair Jayati Ghosh, Professor CESP, JNU Panelists Venkatesh Athreya, former Professor of Economics, Bharathidasan University Himani Baxi, Assitant Professor, Ahmadabad University D Narayana, former Director, GIFT, Thiruvananthapuram
Session 5 02:00 pm to 03: 15 pm	Response of the 4th Estate Chair T N Ninan, Chairperson, Business Standard Panelists T K Arun, Economic Times Harish Damodaran, Indian Express Sukumar Muralidharan, Adjunct Faculty, Jindal School of Journalism and Communication Mihir Sharma, Columnist, Bloomberg M K Venu, Founding Editor, The Wire D Vijayamohan, Senior Coordinating Editor, Malayala Manorama Sudipdo Mundle, Member, 14th Finance Commission Govind Rao, Member, 14th Finance Commission
Session 6 03:30 pm to 04:30 pm	Constitutional Implications of Additional Terms of References Chair A P Shah, Former Chief Justice, Delhi High Court Panelists PDT Achary, Former Secretary General, Lok Sabha M G Devasahayam, Former Chief Secretary, Haryana Mridul Eapen, Member, State Planning Board, Kerala A V Jose, Former Director, GIFT, Thiruvananthapuram

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Session 7 04:30 pm to 05:30 pm	Fiscal Health and Development Implications for States Chair Prabhat Patnaik, Professor Emeritus, JNU Panelists C P Chandrasekhar, Professor, CESP, JNU Pravin Jha, Professor, CESP, JNU Sushil Khanna, Professor, IIM, Kolkata K Ravi Raman, Member, State Planning Board, Kerala

Concluding session: 05:30 pm to 06:00 pm	SUMMING UP Chair T M Thomas Isaac, Finance Minister, Government of Kerala Abhijit Sen, Member, 14th Finance Commission & Former Member, Planning Commission

Abbreviations

GIFT	Gulati Institute of Finance and Taxation
RSS	Rashtriy Swayamsevak Sang
ToR	Terms of Reference

Session 1
Inauguration and Book Release

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Inaugural Address:
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Panelists

T M Thomas Isaac
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Secretary, CPI

Harsh Mander
Director, Centre for Equity Studies

Dipankar Bhattacharya
CPI (ML)

Indira Jaising
Senior Advocate

Welcome :
K J Joseph

I have the very pleasant responsibility of welcoming all of you to this Seminar. I won't take much of your time since we have a very tight schedule. The point is that we are living in very difficult times forcing us to deliberate on many issues of much relevance today for the Indian economy and polity. Yet many of these issues are not getting adequately deliberated upon. Hence, we at GIFT felt the need for taking the initiative of organising this seminar on the additional terms of reference of the 15th Finance Commission, given its serious implications on the fiscal federalism in the country and more specifically of the finances of the states. The seminar is organised with the belief that being the largest democracy there is room for deliberation and presenting the other side.

We are happy that former Prime Minister Dr Manmohan Singh and eminent personalities representing academia, politicians, policymakers, jurists and journalists have positively responded to our invitation. With much appreciation, I most warmly welcome all of you to this seminar. Thank you very much for joining us and I welcome you once again.

CHAIR:
SITARAM YECHURY
COMMUNIST PARTY OF INDIA (MARXIST)

I think this is a very timely and necessary initiative taken by Gulati Institute for holding this discussion on the threats to India's fiscal federalism. This is not merely a threat to fiscal federalism. The moves of the government to alter the terms of reference of the 15th FC are a threat not only to fiscal federalism but also to the federal structure of the Indian constitution. I don't want to go into the details on which the experts would deliberate about except put the issue in context of the overall attacks our country is facing over our constitutional foundation of which federalism is a fundamental feature. Our constitution envisages that the country cannot remain united unless there is decentralisation and the states have an important role in running the country but also in keeping our country's unity and integrity. That is why Article 1 of our constitution says that India that is Bharat is a union of states. The states are integral to that and a very evolved mechanism worked out on the centre-state relation. What is happening today is not the normal tendency of any government in the centre to encroach upon the rights of the states which we have seen since independence. But this is a qualitatively new attack being mounted where a unitary state is required for those in power today in order to impose their ideological project. Federalism or all other fundamental pillars of our constitution evolved in the process of unification of India's diversity.

This was a battle between the three visions of India that emerged during India's freedom struggle. One was the vision that envisaged India to be a secular democratic republic that was the vision of Congress when they came to the conclusion that India cannot hold on together unless you have a secular democratic foundation. The other vision was of the left who said that secularism is a necessary but not sufficient condition. India's future would have to be that the political freedom that have been achieved must be extended to ensure the economic freedom of every individual and therefore it is necessary to go towards socialism.

A third vision that emerged then, that was actually absolutely antagonistic to both these other visions, which had a twin expression, was that India would be defined by the religious affiliation of its people. And thus, was born the Islamic state of Pakistan by the Muslim League and the Hindu Rashtra by the RSS. Now to convert the secular democratic republic to Hindu Rashtra that the RSS is seeking you require a unitary state structure. Federalism is thus antithetical to the entire political project of the RSS. What we are seeing today, not only in the fiscal arena but overall on the attack on the states as in Jammu and Kashmir, where a state is dissolved and a union territory formed, I mean all these things constitute part of this overall effort. So, the fiscal part of it, like the terms of reference, which we will discuss now, how they imposed central subjects as subjects to be shared in terms of burden of financing it by the states.

What was initially thought of as a 50-50 revenue sharing has never been achieved. It was promised on the last occasion that 42% would be earmarked to the sates and that is now reduced. And now with this additional term of reference, I don't know how legal is it to change or amend them midcourse. But in the overall context, in the name of building a security state they want everybody to share the burden. And in this way the states' rights are very severely curtailed. This is an extremely important issue. I am glad that it is a very packed agenda. All these aspects should be discussed and after that I hope that the conclusions will be made public through some publication.

We are fortunate to have Dr. Manmohan Singh here. He will be the most competent to speak on this subject because he served as Economic Advisor, Finance Secretary, Governor of the Reserve Bank of India, Deputy Chairman of Planning Commission, Finance Minister and then the Prime Minister. If I am not wrong Sir, I think the initial conception was that the Planning Commission would be the permanent secretariat of the interstate Council which never of course happened. Leaving that apart. It is my great pleasure to request Manmohan Singh to speak to all of us and give us the advise that usually does.

Inaugural address:

Dr Manmohan Singh,
Former Prime Minister of India

Dear friends, I am very grateful to the organisers of this seminar for inviting me to sit through some of the sessions of this very important seminar which is looking at the terms of reference of the Finance Commission. The Finance Commission is a constitutionally appointed body whose significance is very great because it derives its mandate from the constitution of India. And I am going to speak on the limited subject of what is the significance of the additional terms of reference which has been given to the commission at the fag end of its tenure. I am being told that the commission was going to submit its report by end -November and it was in end of July that the government gave additional terms of reference with regard to creation of separate funds for defence and internal security.

Defence, of course, is the prerogative of the central government which is on the union list and internal security is also largely in the list of states though the centre also plays a role. So, the question is what should the commission do? The commission, I am told, once upon a time during the ninth Finance Commission said that it will be guided by the constitutional mandate and will do fair distribution of taxes regardless of what the government of the day may say. Now, I don't know whether this commission will adopt a similar line of thought.

But since internal security as well as defence are subjects which are of great national importance and it would have been the best course that the central government had gone back to chief ministers' conference which is under the auspices of the Niti Aayog if it has to tinker with the terms of reference. Otherwise there would be a strong feeling that the centre is trying to rob the states of their due resources allotment and that is not good for the federal polity of our country and cooperative federalism that we all swear by these days.

So, I respectfully request the authorities to take the view that they will go by the advice of chief ministers if there are any controversies with regard to additional terms of reference of the Commission. Otherwise there is no doubt in my mind that the Commission should take a broader view of its mandate and in allocating resources to both centre and states it must look at what are the requirements of our polity at this moment of time.

There are certain basic issues like allocations for health, education and other important subjects like protection of environment where all states have legitimate interest and what should be done by the government is to evolve a broad national consensus in dealing with these issues. Otherwise there would be bickering and dissatisfaction and this would not be good for the federal polity of our country. Cooperative federalism requires give and take and therefore it is very important that the central government should take initiative to consult states as often as necessary to carry them along rather than imposing their views on a reluctant Finance Commission.

That is all what I wanted to say. I am not competent to comment on other aspects which are before the Commission. But I do believe that it is a bit odd that the government comes up with additional terms of reference at the fag end of the commission's work particularly when the states have already gone to the commission setting out their resource requirement. The commission would have certainly taken note of them.

And now to impose further terms of reference on the commission would complicate its work and that is certainly not good for the federal polity and cooperative federalism that we all desire should flourish in this country. Beyond this I have nothing much to say but I do wish this conference all well - you are engaged in a very important exercise and I sincerely hope that your work and your deliberations would help to strengthen the broad national consensus on issues of cooperative federalism. The Finance Commission is a constitutionally mandated body whose report goes to the ministry of finance and then to the cabinet and therefore the government of the day can take a view that whatever the mandate of parliament the government could abide by that rather than unilaterally imposing its views on the reluctant state governments. With these words I once again thank you for inviting me to this important meeting.

Panelist:
T M Thomas Isaac,
Finance Minister, Government of Kerala

The Indian constitution has always been described a quasi-federal one but it has been always been prone to centralism. But just as Sitaram has said what we are facing today is qualitatively different, it is a concerted attack on the basic federal structure of the constitution. If anybody has doubts, look at the plethora of legislation passed in the last parliament session. The abrogation of Article 370, the changes in the motor vehicles act, the medical bill, the electricity bill. The common denominator in all these changes is the undermining the rights of the state. It is in this background that we are very apprehensive of the change in the terms of reference of the 15th FC. I will briefly narrate to you the story so far.

Some of us finance ministers particularly of southern states took the initiative for a meeting in Trivandrum soon after the changes in the terms of reference of the 15th Finance Commission which got lot of publicity. Suddenly it was posed as an issue between the north and south. The southern states have certain commonalities and the use of 2011 population census data had some implications for them. Therefore, we decided to take up interstate distribution separately and focus on issues of common interest to all states. That is why we had the second conclave in Vijayawada where we were joined by finance ministers from Delhi, Bengal, Punjab and so on.

What were our apprehensions. We thought that the TOR would worsen the vertical imbalance. There was an explicit attempt to review the award of the 14th Commission. The 15th Finance Commissionwas asked to review the implications of the 42% tax devolution to the states which is unpreceded. Virtually suggesting a roll back. Second N K Singh who is the chairman of the Finance Commission also headed the FRBM review committee and the TOR refereed to conditions that could be imposed on the borrowing power of states. The review committee on FRBM had suggested that the overall debt of centre and states be pegged at 40% of the GDP; states at 20% of the GDP. And therefore, the fiscal deficit has to be drastically reduced. The centre would have 2.7% of the GDP as fiscal deficit and states will have 1.7% of GDP. The perverse impact of the FRBM is only one issue. The states have now Rs. 1.5 lakh crore of rupees in 14-day treasury bills. Because you have now a barrier to spend. Keep the revenue deficit target. Therefore, the unspent money goes to the treasury. Now this is going to worsen the situation. So, this was the second apprehension.

Third, the constitution provides, that even after devolution if there is a revenue deficit for the states a revenue deficit grant should be given to them. And the TOR specifically states that the Finance Commission should look at whether the revenue deficit grant should be continued at all. Fourthly, the Finance Commission was encouraged to look at the expenditure side like how to curb the populist schemes. They were asked to enter the political domain. It is not for the Finance Commission to determine what is populist or non-populist, it is the political sphere. This too when Agenda 2022 of the central government were provided funds. These were our main concerns. And after the presentation of the memorandum to the Union President it has some positive impact.

The Finance Commission announced that they would be following their own methodology. It became inexpedient politically to tamper with 42%. That was the situation before the election. Soon after the election an additional TOR is issued. Now you cannot tamper with 42% the attempt is to squeeze the divisible pool itself. You keep it at 42% but the divisible pool is squeezed suggesting that apart from the centre and states there is now a third component for funds for non-lapsable defence for which a separate mechanism has to be provided. And it is very clear that the attempt is to squeeze the funds going to the states. Now this is the situation. Apart from a few people the response has been muted so we thought we must deliberate on this in the national capital itself rather than making our voices heard from Kerala. So, we are here. Very eminent people have accepted our invitation to come and discuss about this grave threat to our federal framework and make our voices heard. Thank you very much.

Panelist:
Jairam Ramesh,
Member, Parliament &
Former Minister, Government of India

I see a lot of media people. I am going to disappoint you. No masala. This government came to power on the plank of cooperative federalism. And the Prime Minister made it sound as if he invented the concept. Actually, the first time the term cooperative federalism entered the political debate was in 1996 with the Common Minimum Program of United Progressive Alliance (UPA). There was a section on cooperative federalism. And one of the consequences of the cooperative federalism concept was that in the 1997 budget the concept of a single divisible tax was announced by the finance minister P Chidamabram and not by this government. That was how the concept of common minimum program was taken forward.

And in the common minimum program of UPA1, which was issued in 2004 there was a further elaboration of the concept. Cooperative Federalism has a 20-year-old history. It is not something suddenly invented by the prime minister. Our prime minister likes adulteration. I will follow the unadulterated model. He has converted cooperative federalism into competitive federalism, into combative federalism, into coercive federalism and into convenience federalism. These are the five Cs of federalism. Let me give you examples. This morning it was announced that the TMC, the second largest opposition party in the Rajya Sabha, was denied a chairmanship of the standing committee which is its by right and the chairmanship was given to political parties with much smaller number of MPs. If this is not an attack on cooperative federalism then what it is? There is no law on this. But the convention is that the chairmanship of committees is determined by the strength of the political parties. This is what has happened to an opposition party.

I will give you another example of convenience federalism. When the Land Acquisition Act was passed in 2013, Arun Jaitley encouraged the states to dilute the progressive provision of the law by taking recourse to Article 254 of the Constitution. Many states like Gujarat, Maharashtra, Rajasthan, Telangana and Tamil Nadu diluted the provisions using recourse to Article 254. Now when the states are using Article 254 to dilute the provisions of the Motor Vehicle Act Gadkari is crying foul. So, what was acceptable for dilution of land acquisition law is not acceptable to the dilution of Motor Vehicle Act. I am not trying to justify it. I am trying to show you the double standards. You invoke cooperative federalism when it suits you and when it is not convenient you consign it to the dustbin.

Niti Aayog has been the greatest champion of competitive federalism. And the whole anchor of competitive federalism is that it ignores starting conditions, ecological difference, historical differences, ignore history that determines many things that have gone into the performance of the states. When there is no denying the fact that states like Bihar, West Bengal and Orissa felt the brunt of the freight equalisation policy which was abolished after 40 years only in 1992 after the intervention of the West Bengal chief minister JyotiBasu. Now the eastern states are expected to compete as if all the initial conditions were same. So this whole notion of competitive federalism that is now gaining currency is very dangerous because it ignore the diversities.

Combative federalism is seen in the management of politics. Uttarkhand government was overthrown unconstitutionally. Same thing happened to the Arunachal government. Different standards were used in Goa and Manipur when it came to swearing in of new governments. Parties which did not receive the mandate got preference. Post poll alliances were given the first shot in forming government whereas the unwritten convention has always been in support of pre poll alliances. This was done to fulfil the political agenda of the ruling party which is one nation one party. So, this is combative federalism. Never before, even in fifties and seventies when one party was in hegemonic position, such things happened. We see the dangerous consequences of this hegemony position in the centre and states at present.

Finally, there is coercive federalism where you really coerce states to do things which is part of your agenda. If you don't follow you are basically out. Here we have examples of this in political sphere and economic sphere. For utilisation of coercive federalism, you have institutions like CBI and enforcement directorate and others. When the prime minister said he has accepted the 14th Finance Commission report and 42% devolution there was thumping of desks to his support of cooperative federalism. But in the last four years, since March 2015, cooperative federalism has been completely degenerated into combative federalism, coercive federalism, convenience federalism and competitive federalism. So, I think it is a great threat. One nation one tax is fine. One nation one party, one nation one book actually it comes out better in Hindi.

As Sitaram says there is a concerted attempt and the entire approach to federalism is a different model of managing diversity. This is the underlying theme of whatever is happening. Accommodative model of diversity is sought to be replaced by a completely different model of diversity in which homogeneity prevails both in terms of political thought as well as economic policy. So, all I can say is that the initiative has come at the appropriate time when the attempt to tinker with the terms of reference of the Finance Commission at the last minute when there are hardly two months more to submit its report. And this is an attempt to give a fig leaf of respectability to a reduction in the proportion of tax devolution that the government wants in order to be able to fulfil its so-called security obligations both internal and external. So, I think we, all political parties barring the ruling establishment think there is a threat to federalism which is dangerous and we have to really work together both in parliament and outside. Whatever be our differences politically in the state of Kerala, at the national scene it is very clear that the CPM and the CPI the Congress and the regional parties are united in fighting the threat to cooperative federalism.

Panellist:
D Raja,
Secretary, CPI

Comrade Sitaram, friends. At the outset let me congratulate the Kerala Finance Minister for taking this initiative. You are all enlightened people. I don't need to say what is said in different articles of the constitution. You all know what is said in Article 280 of Finance Commission and its powers. Now the concern is that there is a threat to federalism. What is the threat in the context of the 15th Finance Commission, where does the threat come from, how to fight the threat? These are the questions we should address. I am one who believes that politics and economics cannot be separated and we should look at everything from that perspective.

It is true as Jairam pointed out that Modi started by talking of cooperative federalism. What we witnessed in his first tenure and what we are witnessing now is that there is no longer cooperation or federalism. There is only coercion. Everyone agrees. It is an attempt to concentrate all powers in the hands of the union government. Sadly, it is an attempt to subvert the constitution itself using the power of state apparatus in their hands. How to fight it. Jairam is again right.

When we did the common minimum program of the UPA we identified four major planks: secularism, federalism, economic development with social justice and transparent good governance. These are the four planks we identified. Now parliament is itself becoming minimum parliament. Modi talked about minimum government and maximum governance. Minimum government will become minus government and maximum governance will become minimum governance.

Why I am saying this is because parliament is supreme in our democracy as it represents the sovereign will of the people. It is the supreme institution in our democracy. But right now, parliament is being undermined and minimised. If parliament is becoming redundant and if parliament is minimised then what remains. Democracy will die. That is the threat we are facing today.

How to stop this? Federalism is important. I am from Tamil Nadu. I know of the battles for more autonomy and more powers for state government. How Tamil Nadu stood up against the centre for more powers and autonomy. And then they fought. It included everything. Political and economic powers. It is not just asking for some funds from the centre. The Finance Commission is meant for distribution of taxes. It is meant to evolve a mechanism to pass on the money in grants. And all issues have to be decided at the political level at the government level.

How do you understand India as a nation and how do we distribute taxes. Now there is an issue if population is taken as a criterion. Then states like Kerala and Tamil Nadu are likely to lose funds. So how to address this. Now Modi keeps talking about one nation one tax; he talks about one nation one election and one nation one tax. He did not refer to demonetisation that has brought disaster to the economy.

He referred to one nation one tax which is GST. In fact, I was part of the parliament committee which scrutinised the GST. I gave a dissent note along with K N Balagopal. If government effort is to create a Indian common market, then government is determined to serve the interest of corporate houses. Then how will it help the common people, the toiling masses? This apprehension is getting strengthened. The prime minister said that wealth creators are to be respected. Who are the wealth creators?

That is my point. According to the prime minister it is the corporate houses and big business. He does not agree that wealth creators are workers, farmers and those in the various sectors. The finance minister follows it up announcing a slew of measures giving concessions for the corporate sector. The economy is in shambles. Then we need to discuss how to protect the interest of the states.

But how to address the problems. The government at the centre should have proper understanding of the federal structure and federal governance of our country. And the constitution makes it very clear. That is why we have a union list, state list, concurrent list and powers are distributed to centre and states. Even the president does not have the mandate to tell the Finance Commission to do this or do that.

We are a nation. We know that India has tremendous diversities. Not in terms of language, culture and so on but also in terms of economic development. And there are different needs of different regions. How are we going to address all these concerns in a cooperative manner with a federal mindset? One nation anybody can agree. But one culture, one language, one tax, one election, one leader, one party, one religion nobody can agree. That means you are paving way for creating conditions for a kind of presidential from of government. I will say it is nothing but a fascist rule that will emerge. It will be nothing but calamity for the nation. It must not be allowed to happen. Before that we should all stand up. I won't take parties' names. Everybody who believe in democracy and justice, everybody who believes India should be prosperous should stand up and no ambiguity or wavering should be there. We have to fight the RSS-BJP combine, if we are to protect the constitution and the federal system of governance. That is my simple position. I speak directly. We have to take a clear-cut position against the present regime if we have to really fight the threat to Indian federal governance, federal system. Thank you.

Panellist:
Harsh Mander,
Director, Centre for Equity Studies

The 2018 election verdict is seen as a mandate to Modi-Shah government to transform India according to their imagination of the India that we should live in. An India which is seen to be strong, muscular. In all of this we see a growing open impatience and casualness for what the constitution stands for. Therefore, in the next five years we will see a decisive battle playing out in India for the defence of India's constitution. The question then arises what lies at the core of the constitution. What are the values. I was thinking they are justice, equality, liberty, fraternity, secularism, socialism, scientific temper and federalism.

I think the defence of federalism is necessary for the defence of all other core ideas. In a unitary, muscular and centralised nation defence of justice, equality and all such things will become harder and harder. In the last five years we have seen the erosion of institutions. One such instance was the death of the Planning Commission. There was the Planning Commission where the states shared the vision of India. We had concepts like plan and non-plan expenditure, tribal sub plan, special component plan. Al these fiscal spaces were erased. All this happened without much debate or discussion much less with the consent of the states affected by the decision.

What is pushed through are things like GST which propounds things like one tax for one nation. India was imagined as a union of states. There was a role for the union and there was freedom for the states. I think there is once again need for greater clarity on where the state should intervene and where it should not. Here of course there is many opportunistic engagements with these questions. I remember when the communal violence bill was debated there was huge uproar over the freedom of the central government to send in the army in case the state is not acting enough to stop violence.

These are other areas under the threat of centralisation. The last government tried to pass national guidelines on cow slaughter though it was a state subject and they had to pull back. Amit Shah then on the very next day after assuming power passed critical orders that can change India for ever without debate even within. This is an order which authorises every state government and district magistrate to establish foreigners' tribunals and start and extend national register of citizens. There is also talk of amendment of the Citizens Act. We need to go back to what the constitution envisages regarding what should be role of the India government, what should be the boundaries and the role and freedom of the states. And in this battle over the next five years for the defence of the constitution we all need to reclaim, reimagine, reassert, reaffirm the defence of federalism and the right of the states so that the states can carve out their destinies according to their mandate.

Panelist:
Dipankar Bhattacharya,
CPI (ML)

Thank you Sitaram. We are here to discuss the implications of the terms of reference of the 15th Finance Commission. But this is in the context of the growing threat to federalism. I think we all understand that this is symptomatic of the larger and the bigger threat to our constitution and to our democracy. Democracy in a vast and diverse country like India cannot survive if it is not secular and the republic is not federal. Now since our constitution explicitly recognizes India to be a secular country this regime had to target the very concept of secularism. We know what has happened. 'But since federalism is not explicitly mentioned in the constitution so the regime did not have to attack federalism as a term. However they have subverted it in practice.

So cooperative federalism has actually turned into coercive centralism in the country and the most atrocious manifestation of this is seen in the example of Kashmir. Not only in terms of abolishment of Article 370 but also, for the first time in Indian history, a state was stripped off statehood, and a state has been reduced to a couple of union territories. This attack on our federal framework is bound to affect all aspects of governance. Now we are discussing the fiscal implications.

What you see is basically a very systematic misuse of the concept of national security. Because this is being done for increasing the defence expenditure. Consideration of national security are being brought in to undermine democracy. What are the implications of the growing defence expenditure? We are looking at growing militarisation of India. Kashmir is going to be the model of Indian federalism. Obviously, it will need an unlimited amount of defence expenditure. And this defence expenditure is from tax payers' money and has its own cost, namely the people's welfare. And this cost, of people's welfare, is at a time when we don't have purchasing power and there is complete stagnation and recession in the economy.

So, it is easy to understand the implications of this growing militarism. It is very ominous. Federalism is relative to India's diversity. Diversity is the bedrock of unity. I would change the expression "unity in diversity" to "unity through diversity". India cannot remain united without the solid foundation of federalism. Diversity of federalism is being replaced by centralism and unity is being replaced by uniformity. And all this we are talking about like one nation, one election, one tax. It is a kind of homogenisation. That is the end of India as we imagined it to be. The end of India of our dreams. Federalism cannot be selective. It has to be principled and consistent. Because a lot of things that has been happening actually marks an acceleration of a process that has started much earlier. So, the defence of democracy, defence of secularism and defence of federalism has to be principled, consistent and very determined.

PANELIST:
INDIRA JAISING,
SENIOR ADVOCATE

I will give my comments as a lawyer. While I agree with the points made by earlier speakers, there has been debates in our courts on what exactly the meaning of federalism is. The courts are confused. They have used expressions like quasi federalism without explaining the meaning. Federalism means a relationship between the centre and states which is fair and equitable. Given that we elect our representatives on adult franchise as citizens we each have a voice not only at the centre but also at the states.

We citizens have a voice both at the centre and in the state elections. States and centre have equal and well defined relations. There is a separate chapter on centre-state relations in the Constitution. So, it is not that we are chartering unknown territory. We have the framework for this relationship in the Constitution itself. I do understand that it is a chapter which is less visited by the courts. Except for the fact that there is intense litigation on the distribution of power between the centre and the states So far there has been no litigation in the courts on the financial arrangements which should govern the relationship between the centre and the states. There are reasons for this with which I don't agree.

The courts see it as a political issue. So, the courts do not enter the terrain.

It is wrong to say that the courts should not enter the fiscal terrain. That is a British view. There too the courts think we should not enter the financial arrangements that the government of the day chooses to make. They say for example we cannot decide what percentage is to be given to education or health. That is for parliament to decide. That is understandable.

In my opinion issues such as finances that impact the relations between centre and states should be justiciable. The kind of scrutiny that the Election Commission of India has been subjected to under our laws has not been applied to the election commission. This is of course something we should revisit and ponder upon. Why is it that the Election Commission was subjected to very intense scrutiny by the courts and made in some minimal sense accountable to the people, but a similar scrutiny has not taken place on the Fnance Commission?

In the UK it is now changing. Though the courts do not decide on allocations they do actually entertain petitions that ask the government to justify why a particular grant is made in a particular way when a citizen approaches them. So, these kinds of issues are reaching the courts in other countries. Bu it has not yet reached here. I will just mention a few articles of the constitution which are relevant for today's discussions.

We all know that when states were organised on linguistic basis by the states reorganisation Act and it continues to be the case today. We know legislative power is distributed between the centre and the states. Article 256 basically says that states ought to exercise their power in consonance with laws made by parliament. Dr Hamid Ansari has said that this is a much-abused provision.

We have also discussed how article 254 requires inconsistencies between laws of states and centre are to be avoided and parliament has powers to pass laws on concurrent list. It is Article 263 that provides for the inter state council whose proceedings are kept confidential. Article 280 clearly states the functions of the finance commission. Now we are told that there is an amendment under which there is to be a separate consideration for defence. Some jurists have taken the view that the courts have overstepped their limits.

I actually had a conversation with a lawyer who also happened to be an economist and asked his opinion on the role of the courts in monitoring and guiding the economy of the country. His opinion was that the supreme court has contributed to the economic decline of the country. He had his own reasons which I will put on record very soon. But this was the evaluation of one of the senior most lawyers who represent corporate houses.

If this is the view of the corporate houses then we all need to sit up and decide what we want to do about it. Where exactly are we in the 2 G case?. The acquittal of the accused in the 2G scam is one instance. The SC has been looking at the forest cover case for 23 years. Somebody should look at whether the share of the forest has increased over the 23 years. Look at what has happened to the rights of Adivasis. There is litigation saying that the scheduled tribes are encroachers. It is being seriously argued in court that the centre has no right to pass the forest conservation act as it is a state subject. I have given examples of where the courts have gone wrong in handling the economy. I would conclude by saying that we need to critically look at the method under which the Finance Commission functions. But not at this time due to reasons which I can't articulate. I will end by again quoting from Dr Hamid Ansari, that the principles that should cover the functioning of federalism are democracy, justice, fairness sand efficiency. Thank you.

Book Release

Session 2

10.45 am to 11:20 am

Setting the Context:
15th Finance Commission Story So Far

Chair

T M Thomas Isaac

Finance Minister, Government of Kerala

Panelists

Haseeb A. Drabu,

Former Finance Minister, Govt. of Jammu & Kashmir

Abhjit Sen

Former Member, Planning Commission

Chair:

T M Thomas Isaac,

Finance Minister, Government of Kerala

We were expecting some four five finance ministers. Now for various reasons, Manpreet has an important cabinet meeting, Narayanasamy was supposed to be here. We were talking to Chhattisgarh finance minister. But we have Manish Sisodia from the second round in Vijayawada. And with Haseeb we have had a long association since his student days who is here.

Panelist:
Manish Sisodia,
Finance Minister, Delhi Government

I represent Delhi and our problem is that the Finance Commission does not consider us a state. Puducherry has the same issue. Sometimes they tell us that you are a state. So, set up your Finance Commission and devolve funds to the local bodies. But when we ask funds for ourselves from Finance Commission then they say we are not a state. For the last 17 years we are getting Rs 3500 Crores each year. Our need for funds for various programs has increased substantially. We have requested so many times for more funds. But…

Before 2001 the Finance Commission had given a different package for union territories based on the Finance Commission formulae. The entire funds were given to home ministry and the home ministry used to distribute funds on the same basis as the Finance Commission through a formulae known as Bagchi Committee formulae. But then in 2001 even this was stopped. One fine day they set a figure of Rs 3500 crore and they continue it each year. We have asked them to put a special reference for Delhi in the finance commission.

Delhi needs funds from the centre for growth. We continue to send requests. Our main demand is that we should be among the list of states considered by the finance commission. They say they are helpless and that it is for the centre to decide and include you. Now it has become even more important. Today Jammu & Kashmir is a union territory, but they are still on the state list for the finance commission. The issue has to be resolved. We will continue with our demand.

Panelist:

Haseeb Drabu,

Former Finance Minister, Jammu & Kashmir

Thank you for inviting me here. I don't represent the J & K government. We are having a crisis of orientation. Amit Mitra, the iconic finance minister, had a very pessimistic view of the finance commissions. And these are perhaps the most regressive terms of reference in the history of the finance commissions. Even then the Finance Commission as Guhan famously said is a dog that barks at the centre and bites the states.

Having said that the ToRs for the 15th Finance Commission are the most regressive now it has become even more brazen with the latest one. The difference being that when you look at the terms of reference, they were really what you call inter alia terms of reference. The Finance Commission should with regard to, having regard for, but now the defence terms of reference which comes in is actually a diktat. The Finance Commission shall do which really makes it a statutory term of reference. One makes a difference. There can be a debate on the legality of additional ToR. Additional terms of reference have been given earlier. It is not unique. But then there is a statutory part and an inter alia part. When the Finance Commission made recommendations and observations, for instance the 10th Finance Commission, of which I was a part, we suggested an alternate scheme of devolution which was not a recommendation but an alternate proposal which then got accepted.

There was a certain degree of flexibility that the Finance Commission had in dealing with these terms of reference. You may decide your core terms of reference on the divisible pool. But then you will have regard for different things. But in this case the important point that we missed is that it is no longer that you have to have regard for defence. Obviously, nobody is going to contest that. When you look at the constitution these are things that the union government has to deal with its own share of resources. Why does it have to come on to the divisible pool?

So, in some way what are these terms of reference trying to do. Immediate perspective is that the effort, right from the moment the terms of reference were drafted and circulated, is to undo the recommendation of the 14th Finance Commission in some way or other. I was very surprised when the 14th Finance Commission recommendation was accepted; one did not expect them to do it. I wrote then that the budget that Arun Jaitley presented was the first union of states budget. It was a landmark budget. But it happened in a certain way, the cooperative federalism way.

But what is being done now is not just the terms of reference. You look around. What is being done now is exactly what was done to the Gadgil pool in the seventies and eighties. It is not about this government or that government. It is about the union governments. They have a certain mindset. Right through the seventies and eighties the Gadgil pool was created to share the resources in the plan side. What did the government do during the seventies and eighties? They pre-empted resources from going to the Gadgil pool. And they built up a separate thing called central scheme, centrally sponsored scheme and so on, and emaciated the Gadgil pool.

There was a point of time that the resources going through the Gadgil pool was less than that going to CSS and other schemes. It led to a debate. It is a point of contention even now. The schemes were not reduced, the CSS became is an umbrella scheme. There are still 300 schemes. There is no criteria. There is no devolution formulae. You used to talk of Finance Commission formula being more progressive than the Planning Commission formulae.

But a large chunk of the resources went to some states. Uttar Pradesh got 18% at one point of time, Madhya Pradesh got 21%. So, the point I am trying to make is that, the basic thing that is being done today to the Finance Commission divisible pool is what was done to the Gadgil formulae. You are adding another stakeholder. The divisible pool was between the centre and states. Now you are bringing a function also.

So, what you are doing is pre-empting the resources. And the idea is that you don't want to share 42% as recommended by the 14th Finance Commission. But it is also the effect of larger things. It is one part. You are facing a lot of issues from GST, slowdown and there is a hunt for resources. And government is making efforts at various levels. One of course was the demonetisation where the effort was driven by the idea to get Rs 3,50,000 crore of free cash coming to the government. That did not happen. So,the next effort was to look at the RBI. They went to get dividends from the RBI. In the 1990s also the RBI dividend was raised 400%. It was just Rs 300 crore. And you also wanted to do a one-time transfer which has now happened.

Again, the hunt for resources is there. We are now trying to erode another institution which is the Finance Commission by trying to change the rules of the game. What is also happening is a trend I see in the last three four years is the squeezing of the second layer of governance and representation. The states are getting squeezed by the panchayats from below and the centre from above. Soon you will have a situation where states government will have no functions. Your basic core function will be done by the panchayats.

The centre is transferring finances directly to panchayats. You have state finance commissions. But money is being transferred directly to panchayats. I see this as a new form of centralisation. Which is centralisation through decentralisation. Five southern states could get together and fight the centre. A situation will emerge when there are 4000 panchayats in a state like J & K. They will not be able to build a certain thing against what is happening. Even if half a crore of rupees is transferred it is going to be a huge amount. The other day Rs 500 crore was transferred directly to panchayats in J & K. at the governance level.

At the political level one is facing the same thing. There is a huge battle. It is manifest in different ways. I saw it in J & K. There is a fight between the MLA and Panachayat and then the sarpanch and the patwari. You have now created a system where the second layer of governance will disappear sooner than later. And that is when actual centralisation will take place. This is some kind of pincer. Whereby the states are squeezed from top and below. In both, earlier it was only in governance now you see it in representation.

I come from a state where as on today an appointed person has the same constitutional right as an entire assembly of elected people had. You have now moved from governance to representation. What has happened in one state can happen in any other state. But I wanted to also move in a different direction on the terms of reference. Two thoughts I wanted to pursue. What generates these kinds of terms of reference?

One of course is immediate compulsions. Monetary compulsions. Second is a mind-set issue. That when you look at the formation of the Finance Commission the entire macro economy of this country was powered by the centre. Public investment would drive growth. In some ways the entire focus was on how you empower centre to deliver in the country. That has changed. The mind-set has to change. We are not looking at one economy. It is better to look at India as 30 different economies. With each powering the economy. If the 5 trillion-dollar number is broken up into 30 states it becomes a much simpler task. Nobody even mentions about J & K in this $ 5 trillion dream. We can double the J & K SDP in three years through two simple initiatives.

The point is that we need to rethink how the macro economics of the country works. That has an implication on how the fiscal sharing should take place. Operationally we also need to look at constantly, since I have been part of governance of a state, it is useful to be critical and it is even more useful when you are in policy making position to be constructive. What can be done? What should have been done, or what should we do perhaps next time around. Don't leave it to the finance commission.

Saying that defence should not be there is not enough. Is there a way to now start reorganising the entire fiscal federal system differently? I have just two thoughts on this after which I will close. One of the problems as I see today is that in the budget there are two parts or in the fiscal federal system there are two parts of the story. One is revenue sharing which is the Finance Commission, which goes alongside expenditure underwriting. The centre underwrites a lot of expenses of states, either through CSS or whichever way. I would think a better way going forward is to abolish expenditure underwriting. So, maximise revenue sharing and completely abolish expenditure underwriting. It may lead to some degree of centralisation of revenues but it will give states tremendous amount of flexibility to spend. Today if you look at a state budget, I am talking from experience of not a particularly good state in terms of finances, the finance minister of a state is invariably a twelfth man in a cricket team.

Salaries, interest, primary expenditure take 90% of the funds. The flexibility to do things is very very limited. So, if we can look at this one part, that is if we can stop this expenditure underwriting totally. Because when the 14th Commission was doing things, they pegged it at around 61% that is overall. That is now being rolled back. The idea being that you scrap off all expenditure underwriting you do. Shift it to the revenue side and you make a cleaner divide. You become a revenue sharing federation rather than a mix of both. Because there is a lot of ad-hocism in the case of expenditure underwriting. And it is causing all this centralisation in political narrative also which was referred to by Jairam in terms of the mega schemes. So, the prioritisation of expenditure gets settled.

Second part is that I think we also have to move away from sharing just not transactional revenues. Today this economy is driven by resources whether oil, coal or natural resources. And India is a natural resource economy. Why is that not being shared with the states. The centre gets a disproportionately large part through CPSUs which transfer dividend to central government. States have no share in this. Should we not look now at a resource sharing -instead of a revenue sharing - federalism, which should be the next step. That would give a lot of latitude in building resources for the states and subsequently things would happen.

Final point, we should now start looking at. The financial resource member being an ex officio member of the finance commission, was to align the thinking of the planning commission and Finance Commission on the plan and non-plan side. That was the bridge. Now the planning commission is gone. Very good. But a good institution has come. The GST Council. It is a great institution. It takes decisions on what is probably the single most important source of taxes. Why is there no synergy between GST council and finance commission?

They must understand what they are doing. Planning Commission was not a constitutional body but GST Council is. In the hierarchy of institutions, the GST Council is higher because it is elected while Finance Commission members are not. So, there has to be some kind of synergy between them. Some kind of institutional reorganisation has to be done which will actually empower the states a lot more.

Manmohan Singh talked about taking the chief ministers into confidence. In 1991 when he was finance minister the state finance minister read in the newspapers the next day the huge changes in the nature of the economic regime and macroeconomic policy. That is not the situation today, it is not that bad today. Thanks to the GST Council. I, Isaac and Sisodia used to create a lot of ruckus. We ensured a few decisions were taken. We were consulted by the central finance minister through video calls every time there was a change in tax. We had a voice there. It was better off in that sense. It is better to empower these institutions if you want a certain empowerment and correct some of the fiscal imbalances that have crept in.

Panelist:
Abhijit Sen,
Member 14th Finance Commission

I am a clear misfit here. I am not going to go into what should have been discussed in this session. I am not competent because I am not a state finance minister. Let me take two points both coming from Manish Sisodia. The first one is that union territories are not within finance commissions' ambit. In the case of Delhi whether it is a state or a union territory. And complicated by the fact that you have J & K that used to be a state and is now a union territory. Should it get the same treatment as union territory or a state when it comes to the finance commission.

In the present situation the case seems to be that UTs can be treated as a state so that the Finance Commission will provide grants. Now I think the essential point of the discussion in the previous session of the seminar was of the idea of federalism and the extent to which it is being eroded by action being taken at various points including the conversion of the state to a union territory.

This I think was the main set of discussions in the previous session in which of course the focus was much wider than the finance commission's one. But I think Sisodia's point brings around that issue which is becoming extremely important in the sense that we are heading towards a nation in which the way we have regarded the rights of the states are to be taken towards either Delhi's treatment as state and union territory or as J & K's treatment as state and union territory from the other side? Is this the confusion that now prevails amongst us? In this will the Finance Commission itself merely be a tool because it would not know what is going to be done?

And of course, as far as the Finance Commission goes my view of course is that the Finance Commission should simply disregard the particular additional terms of reference. It is not that finance commissions are fools. It is not that previous finance commissions have treated defence or national security as items which are unimportant. They have all recognised that at least defence is entirely in the central list. They have recognized that and have actually made their devolution accordingly.

The centre can choose to spend any amount on defence from its own part of the kitty. And if it needs more, under emergency it actually even have cesses which automatically cut down on states. And it does so regularly. But the important thing, perhaps that is why Manmohan Singh's final statement was that at the end of the day what we require apart from strong institutions expectation of the Finance Commission itself. But it also requires on the part of the government to consult. Cooperative federalism requires consensus rather than compliance. And in that it was suggested that NitiAayog could be the vehicle through which it could happen.

An idea which has been mooted in the past and continues to be so, is that one place for consultation should be the terms of reference of the finance commission. Everything else of the finance commission is in the constitution itself. The finance commission should have the power of consensus behind it. The terms of reference of the finance commission may be discussed before it is finalised.

Session 3

11:20 am to 12:20 pm

Union Government Responsibilities: Perspective of Finance Commissions

Chair

Balveer Arora,
Chairperson, Centre for Multilevel Federalism,
Institute of Social Sciences

Panelists

Sudipto Mundle,
Member, 14th Finance Commission

Indira Rajaraman,
Member, 13th Finance Commission

M Govinda Rao,
Member, 14th Finance Commission

Atul Sarma,
Member, 13th Fianance Commission

D K Srivastava,
Member, 12th Finance Commission

Abhijit Sen,
Member, 14th Finance Commission

CHAIR:
BALVEER ARORA,
CHAIRPERSON,
CENTER FOR MULTILEVEL FEDERALISM,
INSTITUTE OF SOCIAL SCIENCES

I think we have a tight schedule and a number of distinguished speakers. And another session before lunch. So, I will try to keep time to the best of my ability. Let me make a few introductory remarks. The institutional memory of past three finance commissions surrounds me and we will have no doubt further light on how they dealt with the terms of reference given to them particularly as was noted in the last session the use of the word *shall* in the additional terms of reference which is not normally used.

Now there are two or three issues I would like to flag. The question of institutional credibility. Institutions are undergoing attacks which lead us to question their credibility. There is this claim to cooperative federalism but there is at the same time the deactivation of federal consultative institutions. Regarding the GST council which is being touted as a model for consulting states, I think we need more clarity on how it has functioned, it is very opaque it is not accessible but I am open to the idea that it could be the way to go forward except that the constitution which doesn't formally recognise the equality of states does so in the case of the GST Council. So, if you look at the numbers it would be an uphill taskto try and build a majority if it comes to a vote. I don't know if the GST Council did ever vote.

There has been a long-standing demand that states be consulted in the framing the terms of reference. What has emerged is a very strong tradition of unilateralism. By and large successive finance commissions have retained their freedom to interpret the terms of reference. But the independence of thought they have displayed have gone into establishing and consolidating their credibility as autonomous institutions responsible and answerable to the mandate spelt out in the constitution.

I would throw on the table two or three elements from the federal theory but I will be brief. One is the concept of federal pre-emption which exists in all federal systems but is applicable only to items in the concurrent list. Where the federal government can occupy the space and decide how much space the states can have. States are given specific domains to permit the coexistence of both of shared responsibility and so logically if you are asking the Finance Commission to have centre and states share responsibility in matters of defence logically, I am not saying it is even a remote possibility, it should be transferred to the concurrent list. The idea of federal pre-emption mechanism works only in those cases.

There is also the twin concepts of progressive and regressive federalism. I am leaving the Cs used by Jairam Ramesh. When the central level indulges in regressive federalism the possibility should remain open for the states to pursue progressive federalism. So that duality that exists which is the rationale of allowing different streams of thought and different approaches to co-exist in a federal system. I would suggest that they are essential to salvage and safeguard the constitutional values and so progressive federalism must be given its space.

Finally, the question of multi-level federalism and the mandate which accompanies it. We have had some discussion of how the top level and the lower level are squeezing the middle level and we see a new pattern emerging where the district panchayats and BDC would occupy the entire political space in J & K. But the fudging of responsibilities contributes to blurring of levels. So, unless you decide that you want only two levels, you need to make up your mind because there is plenty of empirical evidence that this has been happening despite the Finance

Commission recommendations. The 42% share that the 14th Finance Commission awarded that has not produced the results they expected because of what can only be called fudging. Therefore, it is incumbent on the Finance Commission to take note of this evidence while framing its recommendations.

The last point is the sad situation of the delegitimization of the independent statutory institutions. Against this backdrop of the erosion of this credibility, I am very much encouraged by the comments by Indira Jaising, because they correspond with something I was thinking; while the courts can look the other way when it concerns the determination of expenditure because that is a prerogative of the executive and parliament the terms of reference handed down to the Finance Commission ought logically to be justiciable. It should be possible to challenge them because they are interpretations of the articles of the constitution.

And while there is no disagreement on the part which reproduced those articles later on, they indulge in all sorts of constitutional fantasies and that I think it has to be halted and somebody has to say under the name of sound public fiancé, which is a vague catch all term, you can't introduce anything and everything.

PANELIST:
PROFESSOR SUDIPTO MUNDLE,
MEMBER 14TH FINANCE COMMISSION

Thank you Mr Chairman. Let me first congratulate GIFT and the Kerala Government for hosting the seminar. Let me get straight to the point. Let me begin on the terms of reference that are added on. Under Article 280 the constitution actually makes a provision for any other matter that may be considered important in the interests of sound finance.

And under that every finance commission, especially the one I was associated with, dealt with a huge number of items ranging across vast issues. But as has been said, the commission can ignore them. It has the right to do that or they can politely address them and say something without making any strong recommendations. It is under that Article that the present terms of reference, which was already controversial, have now been made further controversial with this recent amendment. The word shall is there. They have been careful. Having said shall, they also said examine whether such a mechanism is necessary or not. But everybody is aware it is a way to try and extract a larger share of the available pool of resources in some way for defence and security.

But let me put this in a somewhat larger context to try and make some sense of what it is all about. First is the question of federalism itself whether it is a move from cooperative federalism to coercive federalism. That is another issue. But there is a macro economic situation which is germane to what we are discussing today. We have seen a collapse of growth and this is of course reflected in a crunch of resources.

In my view part of the growth collapse itself has happened because of a huge expenditure compression and this year the projections are completely unrealistic, with tax revenues expected to go up by 20% as compared to less than 10% last year. In the context of huge resource crunch the centre is looking for grabbing more resources to finance its expenditure.

And in fact, as you see it in the last budget the defence expenditure has compressed to 1% of GDP which is a significant compression. This is happening with the centre feeling squeezed for resources on one hand. On the other hand, there are large expenditures that the centre has undertaken on issues on subjects of the state government or on the concurrent list.

So, this is a peculiar situation. Now it is in this context that I wish to put forward a somewhat radical proposal which is in some way completely opposite to what Haseeb has put forward about completely leaving expenditure out of the reckoning. But in fact, addressing the same issues he has raised. This is the business of the mismatch between the revenue side and the expenditure side and so on.

What I really want to suggest is that the GST Council for all its limitations is today perhaps the most successful example of a federal platform where the states have a real voice. Though it is limited it is better than anything else. That is on the revenue side. On the expenditure side there is no such thing. There was some consultation during the era of the planning commission which is now gone. Some forum is needed to discuss the entire expenditure side of government budget of both central and state governments.

A GST type expenditure council with central and state finance ministers. A much better way is the interstate council. This got parked in the home ministry completely disempowered. This can be reversed through a constitutional amendment and it can look at the spending side and it can address all issues. I want this to be given some thought.

Panelist:
Indira Rajaraman,
member 13th Finance Commission

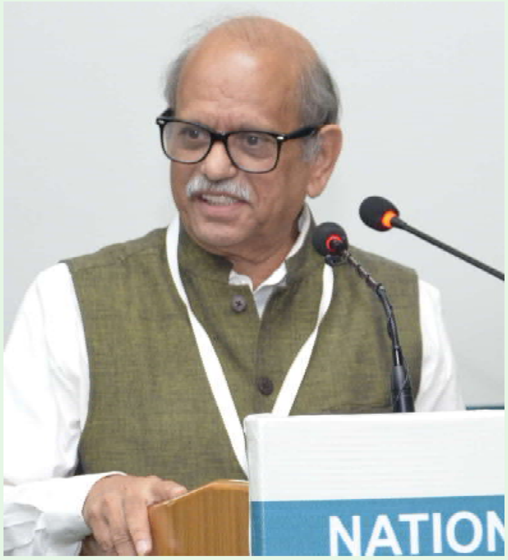
I am going to stick to the business of the additional terms of reference that is the focus of this seminar. In the opening session Yechury asked how legal it is. And Indira Jaising pointed out that courts have had very little to do with finance commissions. Additional terms of reference had been given to all finance commissions since the 11th. There are abundant precedents.

Haseeb said that the use of the word shall makes it a diktat. It also has been used before. But what matters is what follows shall. The 11th financial commission was given a command to split the revenue deficit cover for states and another that was to set up a fiscally monitorable program on the reduction of revenue deficit. It raised a furore and it did not work very well.

In the case of the current additional terms of reference what redeems it is that it says shall also examine whether a separate mechanism for funding defence and internal security has to be set up and if so, it leaves open the possibility that they might not find it necessary to set up a separate mechanism. So, it is actually not a diktat at all. It respects the finance commission. The autonomy of the Finance Commission has not been assaulted. They have been requested as an independent professional body to find out how it can be operationalised.

So, there is nothing alarming in the additional terms of reference. I don't think there is any assault on state rights. I think it needs to be seen as an opportunity to look at defence funding. Defence expenditure can be met though monetisation of defence assets. The defence establishment has huge tracts of land. It can be used for housing or personnel. There are other multiple uses. This is a rare opportunity for the Finance Commission to speak about the land holdings of the defence ministry.

In the 13th Finance Commission report we said that the public sector units should take an inventory of land with public sector units and look at ways for their productive use. Finally, I think the reason for the additional terms of reference in July was because the reduction in budgetary provision for defence pushed the government to reassure the defence establishment by asking the Finance Commission to look into the issue. This is a huge opportunity which should not be lost.



PANELIST:
M GOVIND RAO,
MEMBER 14TH FINANCE COMMISSION

Let me thank GIFT for inviting me for these important deliberations. What I am going to do is to stick to the topic: on union government responsibilities and mandate of the finance commissions. A text book characterisation of the central responsibility is that the centre has a comparative advantage in terms of macroeconomic stability and redistribution and in terms of the allocation it is the national public good, and those public services which are considered to be highly meritorious or with significant interstate externalities that is where the union government responsibility rests. Obviously, the constitution has taken cognisance of this. And you see that issues like defence, national security, foreign affairs, space, atomic energy, money supply, overall indebtedness and all macroeconomic stability issues and national public good issues have been taken into account.

The comparative advantage is also that there is a comparative centralisation in tax powers and since there is centralisation of tax powers there is also an independent Finance Commission to resolve the vertical imbalance. Now irrespective of the governments that have existed over the years the finance commission, which is a major source of resolving issues, never had overall control over the transfers. The total transfers are essentially determined by the central government.

Plan transfers are under Article 282. There were questions whether Article 282 was the legitimate means of transferring resources. That is a different issue. But the fact of the matter is that overall control over the transfer of resources to the states was always with the centre. It was not the intention of the constitution that the Finance Commission was to be a temporary body. Article 280 says that the president shall appoint a Finance Commission within two years of the commencement of the constitution and thereafter every five years or earlier as may be required. It basically implies that you can have a Finance Commission for five years and then another one after five years. You can have continuity in the system. That is the opinion given by leading constitution experts when the 9th Finance Commission raised the issue.

So, the fact of the matter is that Finance Commission does not have full control over transfer of resources as possibly envisaged in the constitution itself. I don't want to go into the question of Article 282. But what has happened over a period of time is that the central sector and centrally sponsored schemes has become an important means of balancing. If the Finance Commission gives a little more attention you can cut down on that.

After the 14th Finance Commission had recommended transfer of 42% of the divisible pool to the states, which is considered to be huge which is not the case as I have argued as you have to take into account plan transfers too. The union government acted on two fronts.

They redefined the contribution of the states in the centrally sponsored schemes in the name of rationalisation and consolidation and you divide them into core and core of the core and optional and make the states share a higher proportion and secondly all the new union tax proposals since then were all by way of cess and surcharges which is not sharable. This is what really has happened and in fact the total transfer of resource to the states there has not been any change. It has continued to be what it was. And the share of states in overall central taxes has come down as compared to what the Finance Commission wanted. In other words, there are other ways of nullifying the Finance Commission award to some extent.

Now the question is the issue of whether we need to have a separate fund. I don't want to go into the motivation for giving this. It is also quite possible that after visiting several states the chairman of the Finance

Commission has been saying that look the states are asking for 50% or more. So, there is a fear that even in spite of all the nudging that was done in the initial terms of reference there is a fear that the Finance Commission may cut down the share of the centre.

So how do you really cut it down. We want new India 2022. We haven't defined that. And obviously in the name of defence asking them to have an additional term of reference. I will not say that there is anything wrong in that. The terms of reference can do many things. The issue is also about the use of the word shall. It was also used for the 9th Commission and it was contentious. In that they said the commission shall follow the normative approach. There was a lot of controversy over that. The chief minister of Kerala Nayanar wrote to the chairman saying that it is not in keeping with the constitutional provisions.

The Finance Commission chairman wrote to the state chief ministers saying that there is a term of reference like this. Under Article 280 we can adopt any approach and methodology that we feel appropriate and we will be equitable and just between the union and the states. I do not know the motivation for this. Even in the original terms of reference there is already a reference that basically says you must take into account the requirements of defence etc etc. To have an additional reference I think there is something more to it than meets the eye. The ideal thing for the Finance Commission to do is that the Finance Commission is not bound by any of these things. And as far as devolution and grants are concerned Article 280 sub clause a and b in fact it is a constitutionally given power. There is no need for union government to impose any restrictions and even if they do the Finance Commission can simply ignore it. That is what I wrote in the article saying that the Finance Commission should simply ignore the diktat and take into account the requirements of the states and the union as given in the constitutional provisions.

PANELIST:
ATUL SARMA,
MEMBER 13TH FINANCE COMMISSION

I thank GIFT for the opportunity to participate. I would be very specific to the issue of the additional terms of reference. I will cover three issues. One on terms of reference. Second is what might have prompted the government to have the additional terms of reference at the fag end of the Finance Commission when the consultative process of the Finance Commission through which it operates is already over. And the third is that what could the 15th Commission do and what the 15th Commission should not do.

The terms of reference have raised the apprehension that it will affect the divisible pool. I share the concern, it is possible. But if you examine whether a separate mechanism for funding defence and security should be set up the issue is how such a mechanism can be operationalised. The terms of reference of the Finance Commission is constitutionally defined. It is basically to do three things. First, the distribution of taxes. Second, recommend principles that govern the grants in aid. Third ,to augment the state finances to help the panchayath raj. But there is a fourth clause which allows the President of India to refer any other matters.

In the case of fifth Finance Commission there was an additional term of reference. Though any other matter can be referred in the interest of sound finance under Article 280 D of the Constitution, if you look at the additional terms of reference it reflects the concerns of fiscal management and budget management. But this is a little different because the issue is how does additional terms of reference fit in. In the framework of the constitutional provisions incorporated under Article 280 defence is in the union list and responsibility of the union government while internal security is largely under the states list even when some situations when para military forces are used the states have to defray the cost.

The additional terms of reference on internal security may have been added to make it look like a union- state issue. What has prompted the centre to do this? Previous speakers say there might be two reasons. The defence expenditure declined : it has fallen from 2% of GDP 2014-15 to 1.45% of the GDP in 2019-20 budget. This is a concern. The defence expenditure as percentage of government of India expenditure also declined from 14.3% in 2014-15 to 11% in 2019-20. The other reason is that with the slowdown in the economy it would be a challenge to even maintain this lower level of allocation and while maintaining the fiscal deficit at 3.3%. Hence the attempt is to ring fence the defence expenditure. That would probably be the motivation.

But having been referred to the Finance Commission it has to do something or ignore it as Govinda Rao has said. But in my view, it has to deal with it. The FC is already required under the original terms of reference to take into consideration the demand on the resources of the central government particularly on account of financing defence, internal security, infrastructure and so on and so forth including that committed of the government. So, what the 15th Finance Commission can do while assessing the requirements of the Government of India, it should explicitly take into consideration the fact of declining defence expenditure as percentage of total expenditure and make appropriate provision in expenditure projection as the 14th Finance Commission did.

But one important thing is that the Finance Commission looks into revenue expenditure but defence budget comprises more of capital expenditure. So even if the Finance Commission deals with it, it is only a smaller part of the defence budget it can consider. The larger part of the capital expenditure is outside its gambit. That has to be realised.

It should do it. It should build up the projection. Taking explicitly in consideration the decline in defence expenditure and secondly protecting the defence expenditure as the 14th commission did. What the 15th commission should not be doing is that over the last 70 years or more the Finance Commission has been able to establish itself as a neutral and fair body. And it should not do anything against this reputation.

There are a lot of threats to the divisible pool. First thing is that Finance Commission may not be able to maintain the share. The second thing is that with the slowdown in the economy the divisible pool may be affected. Thirdly, the GST revenue, though it is protected for five years, it is not fully protected for the entire period of the 15th Finance Commission. So, this GST has not emerged as a buoyant tax and therefore there is a challenge to maintaining divisible pool. So, the 15th Finance Commission should not do anything that will affect the divisible pool. And for all these reasons I submit that the 15 th Finance Commission deal with the terms of reference in a way that would not have adverse impact on the divisible pool and further weaken the fiscal position of the country.

PANELIST:
D K SRIVASTAVA,
MEMBER 12TH FINANCE COMMISSION

For a moment let me draw your attention away from the word "shall" and let us focus on the word "funding ". Funding could be read as financing or financing through a fund. The idea of a mechanism for funding most probably refers to financing through a fund and if you also look at the discussion that happened before these additional terms of reference was issued, the word Rashtriya Suraksha Nidi was being used which means national defence fund. So, the idea is whether it would be appropriate to create a national defence fund and if so, how should it be financed.

So, the word funding by itself covers both these aspects. Funding of the fund. There is only one example where a cess financed fund has been created at the behest of the finance commission. And that example is the cess financed calamity contingency fund. This happened at the time of the 11th finance commission. It would be amiss of me if I do not acknowledge who was responsible for creating a mechanism of a cess financed calamity relief fund and what substantive arguments were given and whether the same arguments can apply in the present context of defence and internal security fund.

The person responsible was Amresh Bagchi ,member of the 11th finance commission. I was the principal consultant to the commission. This was suo moto. It was not in the terms of reference. The idea was mooted by Dr Bagchi and we discussed it before he took it to the commission to convince the commission. We discussed the set of circumstances under which a cess financed fund may be justified. I present the same arguments so that you can test whether the defence and internal security fund will meet those tests.

The first condition was that there would be an inadequate attention paid to the subject concerned in the normal budgetary process. We were finding that as far as financing of calamity was concerned and particularly funding for preventing calamity was concerned there was hardly any allocation ; it was always a response to a calamity. So, we thought that it may be useful to set up a separate new mechanism where we can overcome the issue of inadequate allocation of budgetary resources in the normal decision making processes. That was condition one.

But the defence and internal security fund does not meet this condition because it has the first claim. As you know in public finance texts, we say defence is the example of a pure public good. It is to be financed by the mother tax. Not cesses and surcharges. It is the first claim of any taxation by any government who has the responsibility of defence is to finance it through the taxes it has. Therefore, there is no question that it is subject to inadequate allocation. It is the first claim of all tax revenues.

The second consideration we had was that it should be a shared responsibility between the centre and the states. Calamity relief is met jointly by centre and states and nowadays even by local bodies. Defence, when supplemented by internal security, could also be interpreted as a subject of shared responsibility. So, that test will be met.

The third condition that we had was that this is a subject that should be subject to unanticipated shocks leading to spikes in concerned expenditure. Calamity is like that and so it can have a separate fund. Now defence has these twin characteristics. There is an ongoing demand for expenditure on defence but it also is subject to, from time to time, spikes of expenditure particularly during war time or during other internal security emergency. Defence meets the condition

The fourth condition that we thought relevant was the fact that the mechanism should be such that there is a constant flow of funds. It will never go short of finances. And for that purpose, a separate contingency fund was the answer. Because the moment you spend money out of the contingency fund it is to be refilled; it has the first claim to refill. In the case of defence and internal security fund actually a contingency fund can come to the rescue of the union government. We have as you know a contingency fund of course and it is very short funded. But we can always increase the amount that remain in the contingency fund of the country to meet any spike in expenditure. So the mechanism already exists.

The fifth condition is that the fund should be such that it should be non-lapsable. It should go into the fund and should accumulate. In my view it is this last fact that has bothered the central government right now. It is the main motivation why the additional terms of reference have been given. And the reason is that they are not fighting against the state governments or the claims of the state government. They are fighting for a space for defence and internal security against other union ministries. What happens in general and defence in particular, on the capital expenditure side and to some extend on the revenue expenditure side is they are not able to spend the budgetary allocation. So, the idea is that if you create a fund if you are not able to spend for a variety of rigidities that plague expenditure, the allocation does not lapse.

The state governments are not so innocent. They have been setting up funds after funds last few years in order to bypass the fiscal management act and a variety of other reasons. There has been a lot of non-transparency in the management of public finance both by the union government and the states. So, the issue now is whether defence and internal security would merit the creation of a fund and financing of that through a cess. The moment you say that there is a separate cess you actually then rule the states out of that sharing. That needs to be avoided. But as long as you are going to finance it through the mother tax then it is a matter of the divisible pool. It is up to the Finance Commission to work it out.

Suppose we go back to the 80th amendment prior to the alternate scheme of devolution when some taxes were only shared the centre had separate mechanisms for different taxes. That is not possible any more. Now that GST has come such mechanisms are not possible any more. Now the only decision that has to be taken is whether it is to be financed through a cess or by earmarking a certain portion of the divisible pool.

PANELIST:
ABHIJIT SEN,
MEMBER 14TH FINANCE COMMISSION

I have actually said what I had to say in the previous session. This was a session on the views of the previous finance commissions, on the priorities or how to treat the terms of reference that they were presented with. The 14th Finance Commission took a view which was rather different from that of the 13th Finance Commission. And I think the respect for finance commission is most important rather than the terms of reference.

The second point which was made by a lot of people is that it is the first Finance Commission after the demise of the Planning Commission. Therefore, it has to make up its mind on those sets of issues. These particular terms of reference coming at the end make life very much more difficult for the 15th Finance Commission given the other big issue of the missing Planning Commission and the fact that there is a GST which did not exist before.

Finally, I think that this entire area cannot be seen outside the scope of the centre trying to define certain topics and certain items of expenditure being more important than others rather than in terms of either the constitutional division between the states and the union or their functional importance from the point of view of budgetary procedures. So, they are trying to impose ideas of importance which are outside the domain of the finance commission.

Session 4

12:20 pm to 01:20 pm

Implications on Fiscal Stability and Governance

Chair

Jayati Ghosh,
Professor, CESP, JNU

Panelists

Venkatesh Athreya,
Former Professor of Economics, Bharathidasan University

Himani Baxi,
Assitant Professor, Ahmadabad University

D Narayana,
former Director, GIFT, Thiruvananthapuram

N J Kurien,
Former Advisor, Financial Resources, Planning Commission

CHAIR:
JAYATI GHOSH,
CESP, JNU

We are very short of time. We will begin by broadly looking at macroeconomic implications. We have a very distinguished panel. What is important to bear in mind is that we are operating in the context of economic distress. And in a context when the centre has decided partly because of extremely bad management on the tax revenue side and partly because of a mistaken commitment to some notion of fiscal responsibility or at least appearing to be fiscally responsible even if they are not to restrict expenditures . We are operating therefore in a context where not only is the centre itself restricting its expenditures and adding to the economic depression the country is experiencing but it is also imposing something similar on the states.

We find therefore it is not just in the nature of the Finance Commission and the awards that it is going to deliver this adverse implication lies. We find there is pressure on the states to have lower deficits than the centre, there is further reduction in the revenues that they can access. So, the overall fiscal stance of the centre and state put together is due to become even less expansionary than we have experienced so far. For this to happen in a period of downswing will have very severe macroeconomic implications. So I think it is very useful that we have with us a panel that can look at these implications and at the results for both economic and fiscal stability of the country.

Panelist:
Venkatesh Athreya,
former professor of economics,
Bharathidasan University

I am only concerned with the current macroeconomic situation and how the centre 's effort to pre-empt revenue going to the states will impact the whole scenario. We have now a narrative built up on the current economic downturn which essentially says that corporate sector is the wealth creator in the country, they need to be incentivised to invest and, in the process, therefore the people must bear greater burdens. I think that is the narrative we need to question. States are directly close to the people ,dealing with issues people face. Centre is more remote in such areas of governance.

Therefore, the centre can afford to say, tighten your belts. The states cannot do it. They are pretty tight already. They are squeezed already in the last few years. The original terms of reference were already bad. For instance, raising the question whether the states at all require a revenue deficit tax. The centre should make a more serious effort to tax the well to do. In the long run you cannot address the crisis through Finance Commission awards.

They are important. The states have been continuously and illegitimately denied revenue by the unilateral action of the centre in lowering tax rates for the well to do in the country. It is time to revisit the whole regime of neo liberal policies of taxation. And one must raise a demand for greater direct taxation of a form that is sharable by the states. And states need to have additional resources given that they have a very large remit on the ground. Centre should confine itself to minimal functions. I think we should reopen the whole issue of centre state relations on a larger canvas in the period ahead of us.

PANELIST:
HIMANI BAXI,
ASSISTANT PROFESSOR, AHMEDABAD UNIVERSITY

When we looked at the state level scenario, we find that the actual overall transfer of financial resources from centre to states has not gone down or in certain cases there is a marginal reduction. Given this background when we look at the additional terms of reference the question is will the new terms of reference further hamper devolution. If there is an adverse impact then the states will be in a difficult situation. We all know that manufacturing states are suffering from the GST implementation problems. Till 2022 they will have a 14% compensation. Budget of states like Maharashtra and Gujarat have gone up significantly. The other concern is at governance level. Many states are failing to implement state Finance Commission awards. The additional terms of reference if it reduces the resources to states will cause further problems for the third level of government.

PANELIST:
D NARAYANA,
FORMER DIRECTOR, GIFT

The basic point I am going to make is that the additional terms of reference actually is a continuation of some of the concerns in the previous terms of reference. The perception of constrained fiscal space of the centre is evident, for example, if you look at TOR 6.4 where they talk of revisiting the award of the 14th finance commission. The concern was that the states have been given more funds and the centre is squeezed.

The implicit message in TOR 6.5 is also that the resource flow to the states are protected -the impact of GST, the 14% compensation and so on. So, the message conveyed is that the revenues of the states are protected by compensation clause and so on. Basically, saying that if this continues the centre has no money to pay for defence.

Let us just look at the capital expenditure , the total budget and that on defence in the last 12 years. What comes out is that between 2008-09 and 2013-14 there was a doubling of capital expenditure both total and that of defence. But in the next five years while total capital expenditure goes up by 70%, that of defence goes up by only 35%. That is in nominal terms. If you take into account inflation the capital spending on defence has virtually stagnated.

If you look at defence capital spending in total capital spending ,from over 40% before 2014-15 it goes down to 30%. This period also saw the fiscal deficit go down from 6.2 % of GDP to about 4% of GDP that is a

2.2 percentage point drop. Along with that you also saw a 1.8 % point drop in revenue deficit. But in the next 5 years the fiscal deficit came down by 0.7 percentage point and the revenue deficit by about 0.6 % point. What it really means is that while your revenue expenditure has been going up by around by 10% per annum , the capital expenditure has not been growing at that rate.

Basically, the message is that there is a deceleration in capital spending and growth in revenue expenditure. And in some years the growth has been much higher. Like the latest, an election year, it is over 20%. Why has such a situation come about?. That is, the revenue expenditure growing by such a high rate. This has been answered by the 14th Finance Commission. The union government spending on states list subjects has increased from 13% to 20% and on concurrent list subjects from an average 13% to 17% and they conclude that expenditure functions under the union list fell predominantly under general and economic services and the share of these has progressively declined from 66.3% in 2001-02 to 53.2% in 2014-15 too. In fact, this trend continues after 2014-15. So, you are spending more on the revenue expenditure and squeezing the capital spending. You know the implication of that for GDP growth and also for defence capital spending and then looks like this additional ToR is somehow to protect that.

Panelist:
N J Kurien,
Former Advisor, Financial Resources,
Planning Commission

My deep gratitude to GIFT. Our constitution part 5 lists out the subjects for the union and part 6 the subjects for the states. The expenditure responsibilities of the states far exceed the revenue sources of the states. That is why constitutionally mandated finance commissions are established and they give their mandate and usually the Government of India accepts them in toto.

Through this additional TOR my impression is that the centre wants to increase its share by opening another window, though Indira Raja Raman and Srivastava have indicated the possibility of the Finance Commission taking a different line. Let us hope they do that. If they don't do it then it will be a serious issue as far as states are concerned. As indicated though the 14th Finance Commission increased the states' tax share from 32% to 42% it was only a mirage. The Planning Commission has been done away with and the situation is almost the same as earlier. I spent a few years in the finance ministry and moved out to the Planning Commission for a full 10 years. The Planning Commission has been replaced by the Niti Aayog which is functioning as the PMO. Finance Commission has got a huge responsibility to ensure the federal fiscal transfers without any kind of consideration for defence. Defence and internal security are two of the three largest expenditure areas of the central government and if they are removed from the centre's share of tax revenue then of course centre will have lot of moneys to play with and use for their purposes that is more and more intervention in state subject areas through centrally sponsored programs and others. I hope and expect that the Finance Commission will take a very independent and objective line in this regard. Thank you.

Session 5

02:00 pm to 03: 15 pm

Response of the 4th Estate

Chair

T N Ninan,
Chairperson, Business Standard

Panelists

T K Arun,
Economic Times

Harish Damodaran,
Indian Express

Sukumar Muralidharan,
Adjunct Faculty, Jindal School of Journalism and Communication

Mihir Sharma,
Columnist, Bloomberg

M K Venu,
Founding Editor, The Wire

D Vijayamohan,
Senior Coordinating Editor, Malayala Manorama

Sudipdo Mundle
Member, 14th Finance Commission

Govinda Rao
Member, 14th Finance Commission

Chair:
T N Ninan,
Chairperson, Business Standard

We have an abundance of speakers.

I don't know how many people know this. In 2014 when the government was elected and the 14th Finance Commission report went to cabinet, there was a move to reject it. Because it was in favour of the states. I think it was Arun Jaitley who intervened and said it would set a bad precedent . We need to accept it and that is how disaster was avoided. There is a larger revenue crisis partly because of the slowdown but not entirely due to it. The assumption that GST would reduce the tax leakages by casting the net wider has probably come unstuck.

Indira Jaising raised the question of justiciability or judicial accountability of the finance commission. The additional terms of reference talks of carving out a new space. How do you carve out new space? It is a major issue. On the 2011 census the issue is looking at states and persons as a unit. If you are using 1971 census you are against the poor states.

N K Singh had spoken about the 2011 census and the wording. There were 2 or 3 sessions where open discussions were there. I saw members of three finance commissions there.

Panelist:
Arun T K,
Economic Times

I think we have to understand this move not as a fiscal compulsion but as a part of the overall centralisation.. As much as 14-15% of the revenues raised by the centre is in the form of non-sharable cesses and surcharges. So, it is not really that the centre doesn't `have access to resources ; it does not want to share, and that is forcing the centre to resort to this kind of mechanisms. And asking the commission to make a provision for defence is not the only form of centralisation that is being resorted to using the commission. The commission has been asked to set up a committee to deliberate on the desirability of transferring health from the state to concurrent list. This government has started funding health insurance as a form of central largesse to the people of the country. The earlier suggestion made by D Narayana of each level of government confining its expenditure to its assigned areas in the constitution and therefore optimising the use of its resources is not something acceptable politically to this government or its ideology. And I think that is in this light the finance ministers who want to resist the move must approach this problem. And I do not really think that just by raising objections to the way the centre is going about this will cut any ice with any institution in the country. The Finance Commission will do what the government wants it to do. As will probably the courts, much of the media and practically every other institution in the current polity. Unless there is an alternative narrative, a larger narrative that people can relate to, and not just finding fault with one particular move or another of the government will finance ministers be able to counter this offensive against the basic unification drive of the perfectly federal state.

PANELIST:
HARISH DAMODARAN,
INDIAN EXPRESS

I think one reason why we are debating on the additional terms of reference is that there is a full squeeze on revenues. Because there is no spending happening. I don't think this would have been a problem in 2006 or 2007. The entire revenue of the government is squeezed. Hence the debate. The entire assumption behind GST was that it would buoy up revenues. So, you increased the devolution to the states. Every state supported this move. The major consuming states were expected to gain the maximum. The entire thing was based on the expectation of a seamless system. I don't think that anybody thought through the whole thing completely. On paper something like GST made absolute sense. Entire thing was based on the assumption that there will be a fantastic system where immediately you will have a seamless kind of tax collection.

What we have seen now is possibly one of the greatest deindustrialisation scenarios since the colonial times. Jobs are disappearing. There is no possibility of spending in such a scenario. There is not much circulation of cash. There is only slackening of demand. This is a classic recession. India never had a demand constrained economy. So, the government wants to increase its revenues in all possible ways. Minimum power charges in Uttar Pradesh is now Rs 7. It is not just the centre which is trying to protect its revenue turf. Many states will also try to raise revenues.

This is happening at a time when there is private spending compression. Both private and government consumption will be compressed for some time. The terms of reference of the Finance Commission has lost relevance. GST assumed 14% revenue growth. They are now growing up by a slow 4-5%. Where will the money come from? What will happen in the next two years? We need to look at the short term. This goes much beyond the finance commission.

Panelist:
Sukumar Muralidharan,
Adjunct Faculty, Jindal School of
Journalism and Communication

I will just make some general observations of the nature of politics that we are going through at this time. The vast increases in income and wealth disparities over the last few decades has happened beneath the veneer of democratic politics. I think the veneer is wearing thin now and the authoritarian tendencies are more and more apparent. And also, a politics of disentitlement and disenfranchisement is manifesting itself. There has been a shift in distribution against the working class and farmers and this cannot be pushed further without an overt recourse to authoritarian politics.

So, it is no coincidence that after an election the khakhi tinge should be spreading to the politics of fiscal federal transfers also. This has ominous implications for the practice of politics. The word federal occurs just a few times in the constitution. Federalism has been largely built up through practice. That practice has gained traction after the erosion of the monopoly in power, of the Congress. This has also been triggered in many ways by increasing political participation and greater inclusiveness in politics. The older hegemonic classes had to yield space to newer emerging classes in the practice of politics. It is more pronounced at the state level.

State level politics continue to be much more inclusive than the national level politics. In fact, till 2014 the national level politics was a mosaic created by the outcome of state level politics. That is no longer the case. Greater and greater centralising tendencies and also authoritative tendencies seek legitimacy though frequent invocation of national security imperatives which shelter in many ways behind khakhi of the armed forces

This particular aspect of current politics which we are discussing today is one element of the larger canvas and I think it is important that we resist it at every possible level and every possible way. But it is just one part of a much larger struggle against the greater marginalisation of various sections of our people from politics. It is a virtual overturning of the promise of equal opportunity and participatory democracy. that we made to ourselves at the time of independence. There is much more to be dissected in terms of the actual practical implication and the technical details of it but I will leave that to others who have greater expertise in that.

PANELIST:
MIHIR SHARMA,
COLUMNIST, BLOOMBERG

On the first point on new terms of reference, I think, it has happened before but it is not common. The 14th Finance Commission had its terms of reference amended because it had to deal with a new problem: the bifurcation of Andhra Pradesh which was an emergent problem. You can't in any way say the defence and national security is a new and emergent problem in the same way. So, it is a little odd as Manmohan Singh said.

But it is not odd as Arun said in the context of a larger narrative of centralisation. If you look at what is down the list in the existing terms of reference as compared to the earlier ones, we find some strange wording. It included a direction to the Finance Commission that it should look into using a state government control or lack of it in incurring expenditure on populist measures as a condition as to whether it should get a larger or smaller share of the tax pool. This is rather odd because the rest of the terms of reference seems to make no such constraints on the centre. In fact the TOR specifically says that the states should be given more money depending on how well they implement the New India 2022 program which is a set of welfare schemes of the central government.

So, when the centre has welfare schemes it is considered non populist and the Finance Commission has been directed to give states more money that follow that particular brand of populism and to not give money on the state's own welfare schemes. It is not a competition between populism and non-populism but a competition on who gets to determine the direction of populism.

Regarding the use of 2011 census population the 13th Finance Commission said like the one before said use 1971 census data and the 14th Finance Commission said use 1971 census data and consider population changes since then and now the 15th Finance Commission says use 2011 census data which will put some states who have achieved population control at a disadvantage. Finally, the TOR specifically says to look at whether revenue deficit grant should be eliminated. This is odd because the constitution specifically says that the purpose of the Finance Commission is to plug gaps in state revenues.

So, you have a larger narrative of political centralisation here that is very clearly determined in the bureaucratic language of the TOR. It is different from TORs before. It can't be maintained it is not. There is a narrative of centralisation that is very politically powerful and which has demonstrated its political power by winning elections. If a counter narrative is to be formed it will have to demonstrate its power by winning elections. Then it will be able to push back against the kind of things you see in the terms of reference. Again, this narrative of centralisation has wrapped itself around questions of identity and so on. I very much fear the counter narrative will also be wrapped around questions of identity rather than on more nebulous concepts like fiscal federalism.

So today when we look around how concerns of language have re-entered public space after a long absence, how states like Karnataka and Andhra Pradesh are imposing constraints on people from outside. It shows how politics of India is reorienting itself in this sort of anti-Delhi frame that is identity carrying out the process of counter mobilisation to what we see in this term of reference.

PANELIST:
M K VENU,
FOUNDING EDITOR, THE WIRE

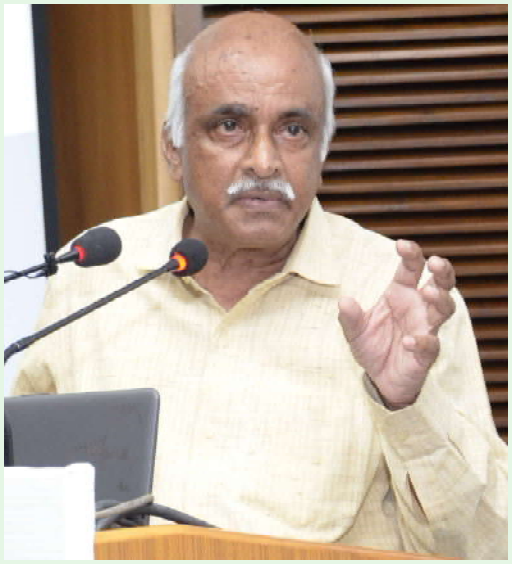
I would like to focus a little more on the media response to the erosion of federalism and centre-state relations as envisaged by the constitution. In political economy terms the big victory Modi got in 2019 accentuated the process of increasing centralisation and creating a unitary system of government along with an ideological project which was already there. The unexpectedly large victory made the government push through its agenda with a sledge hammer in just a few months.

The media responded in a certain way to the new terms of reference especially the 1971 population issue taken up by the southern states. It was seen in the southern media. The outcome was a south versus north contest and the southern states piped down a little. But the narrative was there. By some estimates the southern states were expected to lose around Rs 1.5 lakh crore in devolution due to the use of 2011 census. In fact, the southern states piped down in spite of the assumed losses. Northern newspapers, especially the Hindi ones with around 100 million readership, were not very concerned because they were the gaining states

In the present context I don't have any doubt that the centralising tendency is gaining momentum in a big way and rapidly. The Kashmir 370 is one example. There are now unexpected moves at a sharp pace. We knew it was in the manifesto. But not that it would come so soon. The point is the idea of carving out a new fund for defence and internal security is actually of a piece with a larger narrative of national security which was a big theme in the last elections and this theme will intensify ,remain for some time and Pakistan and Kashmir will be pretext for doing all sort of things. That is where I see things going.

It can be an electoral issue. I don't rule it out. The media is increasingly finding it difficult to speak the truth. The economic downturn has also hit the media. Spending on news gathering and real reporting has gone down. There is not much hope for building a more objective counter narrative in regard to erosion of all forms of federalism. I am hopeful but not sure if it will come through.

It is a red herring. All are underfunded central government schemes. The idea is to reduce discretionary grants and increase that of centrally sponsored schemes.



Panelist:
Vijaya Mohan,
Senior Coordinating Editor,
Malayala Manorama

The whole discussion is going in one direction. Taking the states into confidence will not help much as most of the states are BJP ruled states.

Let us take New India 2022. Was any of the states consulted?

Media does not report on the State Finance Commission reports. Only the 2011 census use was a topic of discussion. There are no major discussions. I am more worried about the data provided by the government. If the data is not credible what is the point in discussing other issues.

Session 6

03:30 pm to 04:30pm

Constitutional Implications of the Additional Terms of References

Chair

A P Shah,
Former Chief Justice, Delhi High Court

Panelists

PDT Achary,,
Former Secretary General, Lok Sabha

M G Devasahayam,
Former Chief Secretary, Haryana

Mridul Eapen,
Member, State Planning Board, Kerala

A V Jose,
Former Director, GIFT, Thiruvananthapuram

CHAIR:
AP SHAH,
FORMER CHIEF JUSTICE, DELHI HIGH COURT

I will give you an idea of how the Indian federal structure has been viewed by the Supreme Court. Judgement of the Supreme Court has been generally in favour of a strong centre, not in the context of fiscal federalism. In case of discord usually the central views prevail. Secondly, I am not sure if fiscal policies are justiciable. Scope of judicial review has expanded considerably now. Courts may be expected to take a view. Maybe even the award of the Finance Commission may be justiciable if it violates the federal structure of the country.

But there will be tremendous limitation on court's power to review TOR or any decision taken by the finance commission. Courts normally try to keep out of the matters falling in the economic sphere. Experts have given warnings about the emergence of a very strong centre. I fear we are heading towards having a very strong central government. Experts have warned about development that may be constitutional but not democratic. A federation can give rise to a dictatorship. A government which is allowed to kill parliamentary democracy in the states may also kill it in the centre.

Experts on cooperative federalism like Jain was in favour of discussion, agreement and compromise and not a central diktat. One point I have raised is that the centre has not consulted the state governments before the finalisation of the terms of reference. The additional terms of reference at the fag end of the term of the commission also raises the question of propriety. Why should there be no consultation between the centre and the states. A dialogue between the centre and states is also is necessary.

PANELIST:
PDT ACHARY,
FORMER SECRETARY GENERAL, LOK SABHA

I will confine myself to the additional terms of reference given to the finance commission. The president has asked the Finance Commission to examine whether a separate mechanism for funding of defence and internal security ought to be set up and if so, how it can be operationalised. This is the additional term of reference given to the finance commission.

I will examine from a legal and constitutional point of view what exactly are its implications. I will come immediately to article 280 regarding finance commission. It also says that any other matter can be referred by the president to the commission. But then there are two words which are significant: sound finance.

So, it is not an unguided exercise of power by the President. Any matter referred to by the President has to be in the interest of sound finance. The Finance Commission is also duty bound to examine it from that point of view and give recommendation in the interest of sound finance. States now fear the new TOR will pull down their fair share from the divisible pool if this goes through.

The government's intention behind the proposal is to set up a non-lapsing fund to meet the needs of defence. Internal security has been brought into this though it is not in the central list maybe because they want to create some kind of security consciousness among the people. It only makes sense from that point of view, otherwise no. We have to examine it in terms of article 280 3 D and see whether it is in conformity with this provision.

The problem is or the apprehension of the states is whether their share will come down. If their share comes down it will affect a lot of programs of the states. If it affects them, it cannot be said to be in the interest of sound finance. If that is the case then it will be challenged as it is not in the interest of sound finance.

Secondly, if this fund goes through what will happen is that you will be locking in a huge amount of money without utilising it. A non-lapsing fund will remain there unutilised for a long time because after all it will be used for buying weapon systems. As you know weapon systems are not easy to procure. It usually takes 10 to 12 years to acquire a new weapon system. Often by the time you acquire it sometimes will be obsolete. So, this money will remain unutilised for a long time which is against the principles of management of public finance. Certainly, it will not be in the interest of sound finance.

Another point is the money required for acquiring weapons have never been a problem in our country. The constitution has given many routes the government can use to access money. There is the supplementary demand provision, there is excess fund and there is contingency fund. All these routes are there in the constitution. Any government can make use of it. I have never seen a case where the government did not have the money to acquire weapons when they wanted. That is not the case at all. But then why does the government think of setting up a non-lapsable fund for procuring weapons. Parliamentary committee report has recommended many times the setting up of a non-lapsing fund for defence.

I can say with a certain authority that these standing committee reports which deal with particularly ministries are not expert reports but reflect views of parliamentarians. They look at only the requirements of defence. They don't have a macro level view of things. They take a sectoral view. It is not safe or prudent to entirely depend on a parliamentary committee to set up a fund like this. It is not very safe.

Maybe they want to fast- track the acquisition process. There is a great sense of urgency in acquiring weapons especially from friendly countries. A new orientation is there to foreign policy. When we look at this issue, we should analyse it in the context of what is happening around us. This particular proposal is not in the interest of sound finance so it is not in conformity with article 280 3 D. That is my opinion.

Panelist:
M G Devasahayam,
former chief secretary, Haryana

The issue that we discuss now has very huge implication on democracy, constitutional scheme of things, centre-state relations, national security and governance. I will deal with national security and administrative part of it. The additional ToR has been given to create a Rashtriya Suraksha Nidhi. It appears from the reports that the defence ministry had made a presentation to the Finance Commission where they said that national security should be included in our understanding of sustainable development.

Objective is for the states to share financial burden of maintaining and upgrading its security apparatus including buying equipment from global suppliers. So, defence has been clubbed with SDG goals for 2030. SDG has 17 goals but there is no mention of security. What is security ? State has four kinds of threats. Proxy war, insurgency, real war and law and order. Based on this wisdom we should have had a national security doctrine. But Indian army has one drawn up in 2004. Before going in for any national security fund it should go in for a national security doctrine. They have not done that ;instead they have a Doval doctrine: In the game of power justice lies with the strong.

Human security is the best form of security. That is why the top 3 goals of SDG are no poverty, zero hunger and good health. Democracy centred on human security should replace threat centred state security. It is time that India framed a national security doctrine based on these realities before thinking of a national security fund.

Panelist:
Mridul Eapen,
Member, State Planning Board, Kerala

Certain things have come out clearly. The fact of the seventh schedule, the fact of the mandate of the finance commission, the issue of federalist structure, the fact of the timing of TOR. I feel quite convinced that this particular TOR is in a way unconstitutional because it violates the seventh schedule of the constitution and it lies outside the mandate of the finance commission. It will definitely reduce the share of the divisible pool but also the absolute amount going to the state government. I will just make a few observations.

The need to expose the political agenda of creating a sort of insecurity and fear psychosis in the economy that there is imminent danger from neighbours and so on. This is the political agenda of the government.

Second observation is on the hunt for resources. It is not just the centre who want resources. But states are also desperate for funds. We now prioritise our expenditure. The centre should also do this instead of spending on subjects which are in the state list.

The third thing is, is it legal or technically permissible to frame terms of reference in a way which is nudging you towards helping the centre.

Fourth observation is the constitutional implications of this particular TOR. Suppose this TOR goes through and the share of states gets reduced. Then social sectors gets affected which affects women and vulnerable sections of society. What happens to those constitutional rights once this particular TOR goes through? This is a serious implication that has to be kept in mind.

This particular term of reference is unconstitutional and it is outside the purview of the Finance Commission and should be very strongly resisted.

Panelist:
A V Jose,
Former Director, GIFT,
Thiruvanathapuram.

I am not a constitutional expert. We are all provincial identities who came together under a federal banner for economic reasons and there are compelling political reasons to maintain the federal structure. Any unilateral intrusion violating the fiscal autonomy of the provincial entities has got to be resisted. There is a genuine apprehension about the states that their autonomy is going to be eroded in the days to come.

It is time for us to think of ways to strengthen the federal polity, which essentially means redefining the rules of the game that can strengthen the federal structure. In any case the financial autonomy enjoyed by the states is not to be compromised. There is no way the union government can unilaterally dip into the divisible pool of resources that is meant to be spent on capital expenditure for sustainable development projects.

This essentially means that there ought to be consultations like what Dr Manmohan Singh mentioned about to arrive at meaningful approaches so we can raise the resources which are now shrinking. Which means, enhance the tax base, go back to the notion of progressive taxation and think about new approaches giving greater attention to expenditure taxation. More important, give leverage to the states to borrow. All these are issues which need to be given greater attention.

Finally learn from the mistakes of the past. I am quite sure that in the months to come GIFT will probably with the able guidance of all of you will take the lead in generating that national debate of the ways and means of strengthening the federal polity and reinstating federalism to its rightful place in Indian history.

Session 7

04:30 pm to 05:30 pm

Fiscal Health and Development Implications for the States

Chair

Prabhat Patnaik,
Professor Emeritus, JNU

Panelists

C P Chandrasekhar,
Professor, CESP, JNU

Pravin Jha,
Professor, CESP, JNU

Sushil Khanna,
Professor, IIM, Kolkata

K Ravi Raman,
Member, State Planning Board, Kerala

CHAIR:
PRABHAT PATNAIK,
PROFESSOR EMERITUS, JNU

I will make one or two comments. It is now fairly well established that an additional rupee transferred from the state government's kitty to defence expenditure is net welfare reducing. Here welfare expenditure includes not only health and education but also agriculture and other such subjects which are under the domain of the state governments. As growth slows and revenue growth decelerates and the fiscal deficit of the government is fixed then government expenditure also goes down. So, it is pro cyclical.

In a situation where there is a shift of a rupee of expenditure from welfare towards defence then you will find that welfare expenditure would go down even more sharply than GDP growth rate. So, it is particularly a matter of concern quite apart from the centre- state relationship this is going to bring about a significant shift in the pattern of government expenditure. Now this is particularly significant at this moment for another reason which I suspect has not been discussed. Defence is something which is import intensive ,and hence any such shift from welfare to defence spending will reduce demand for the domestic economy.

It has a recessionary effect when the idea should be to enlarge domestic demand. What we are having is a policy which has a net contractionary effect on domestic demand. There is a big difference between defence expenditure and say agriculture or other expenditure. The amount of money you need to get a unit of security depends on the government's other policies. If you do away with article 370 you need more defence expenditure.

If you have reasonable relation with Pakistan you require less defence expenditure.

So, the idea at this moment should be to try and shift resources from defence to welfare or other such things which are demand augmenting and to look after defence by having reasonable foreign policy, a policy of good neighbourliness rather than going the other way round which is both welfare decreasing and as well as demand diminishing which will only accentuate the economic crisis that we are caught in.

PANELIST:
C P CHANDRASEKHAR,
PROFESSOR, CESP, JNU

I want to just look at two features. First of all, we must recognize that crude aggression that has come to characterise this government which brought in the new TOR at the last stage to try and reduce the resources of the states using the defence excuse which essentially appeals to the new patriotism. But if you look at it in a longer sense there is a basic source why this kind of tendency has become quite important. Professor Gulati 's works show that tendency towards vertical imbalance is not a new phenomenon, it is a long-term phenomenon.

But this trend has got aggravated after the shift towards new liberal strategy whose essential feature is that you should have a lenient tax regime to incentivise the private sector because the idea is that the state is a facilitator and not a provider of goods and services. A lenient tax regime will be soon reflected in the tax-GDP ratio at the central level. You would have a certain kind of difficulty for undertaking expenditure particularly since there is a 3% limit to the fiscal deficit. So if you have a limit to generation of tax revenue and fiscal deficit obviously there is going to be a limit to the ability to spend even if you look to off budget resources

What we are seeing now is that a particularly aggressive government is choosing this particular route to increase its room for manoeuvre to increase its resources. The states did make some mistakes. The states went along in many ways. They implemented FRBM laws at the state level which is a kind of acceptance of the notion there must be underlying austerity on the part of the state. You tie up the arms of the state government in terms of their ability to spend.

The other mistake, for reasons which may be justifiable, was for going along with the demand for having the game changing GST in place. You now have a significant shortage of resources. If you look at the GST collections and GDP of states there is a very clear connection between them. The better off states are better off in raising GST and the notion that consuming states will benefit has been proved wrong.

What we are finding is that the deviation of GST to GSDP ratio across states is much less than the deviation that existed in terms of own tax revenue to GSDP ratio in the earlier regime which essentially means that the inability of the weaker states to pull themselves up has actually got aggravated by the shift to the GST regime.

The battle against the tendency towards increasing vertical imbalance is not just a fight against a set of terms of references but it is also a battle to try and say that this regime since 1991 works towards increasing vertical imbalance and we should begin a battle to undo it including thinking of ways in which we can get out of the legislation which would bind yourself to targets irrespective of the situation.

Panelist:
Pravin Jha,
CESP, JNU

There is near unanimity that it is a major assault on the constitution and fiscal federalism. The question is what is to be done. It is a total fraud on the constitution. Is it possible to suggest to the chair of the Finance Commission to get back to the government and say we cannot do it? If it is a total fraud it is extremely important to do something about it. Is it possible to have a coalition and go to the Supreme Court and basically say that this must be taken note of urgently and something done?

There is very little doubt that this is constitutional impropriety if not illegality. I wish to make a few points put together by the centre for budget and governance accountability which is very simple. This estimates what might be the impact of the new TOR on the states. This has already come on top of the 15th Commission TORs which was heavily loaded against the states.

The defence security fund was in a sense was already in the pipeline. If you look at the TOR of the 15th Finance Commission. Paragraph 6.2 gives the details. Of course, there was no separate security fund. So let me just give you the number on what will happen. This is something the 14th Commission had considered.

We look at centre's net tax revenue from 2015-16 to 2019-20 in the 14th Finance Commission projections. We will look at the actual divisible pool and the modified divisible pool of the states. It shows that that states will have a substantial shortfall and simply as a share of GDP the state's share in divisible pool would fall from 3.7% to 2.6% of the GDP in 2015-16 and in 2019-20, 3.8% to 2.8%. Obviously there are very substantial reductions even when the 14th Finance Commission was not burdened by this amendment. We don't know how the 15-Finance Commission will do. The decline can be slightly less or slightly more.

What is obviously clear is that it is not just a small decline and as has been pointed out by Mridul , changes of this kind will cause a range of activities and sector to suffer. If you look at social sector expenditure in the last thirty years or so, a recent PhD paper says, the rate of growth has gone down very significantly. And within the social sector it is much worse for certain sectors. That means we are in for very difficult times.

Panelist:
Sushil Khanna,
Professor, IIM, Kolkata

Let me summarise what we have heard since morning. There are actually two views. Some former Finance Commission members seem to look at it as a benign, mild directive which is normal procedure if you look at the finance commissions. Some said the government only wants a non-lapsable fund. They don't need Finance Commission permission. Vajpayee had implemented a non-lapsable fund for the north eastern states. That is a benign view to which I don't agree. This attack goes far beyond finance. And this begins with the abolition of a state and I am surprised how muted the response has been. A state is still under guns, leaders behind bars, a state has been abolished. Our response is weak. People are behind bars. Even businessmen who are friendly to government are behind bars.

The first session was actually on coercive federalism we are moving into. The response we are having here is weak. The Finance Commission members who were invited were afraid to be seen here. This was not the case before. The times are different. We are living in a country where states can be abolished. Fiscal rights of the states are only a minor part of the story. This calls for much bigger fights including legal rights. Jaising said that nobody has gone to the Supreme Court on the finance commission. But she also said this is not the court to go to. This calls for a deeper response. States should question the abolition of the state. Only article 370 abolishment is being challenged. When there are only a few members in parliament you have to fight on every front.

It is obvious that the centre wants more funds. We need to resist it with all our might. Fight for all the right of states. The very federal structure is under attack.

PANELIST:
RAVI RAMAN,
MEMBER, STATE PLANNING BOARD, KERALA

The first two minutes I will talk as a critical scholar and next in my official capacity. Unless and until we bring in geo political factors in the whole analysis we would be unable to understand the significance of the implementation of the additional terms of reference. The classic writing of Charles Steeling points out in the case of European history war making is nothing more than state making. He said it in the advanced country context. We now find it is a broader reality. It is a universally valid statement. It has become a broader reality.

With the growth of big governments and also with the increasing corporatization of military complexes as in India this has become a broader reality. If somebody says that India goes along this trajectory she or he cannot be blamed. Three purposes would be served. The ruling hegemony would be able to construct the nationhood of their imagination. Second, we should note that all corporate houses are competing to get a share of the armament industry. India is the second largest global importer of arms. We import 70% of our armaments as against 30% by China and 10% by USA. Modi can easily link this with"Make in India". So, "Make in India" will be linked with subsidisation of big business houses in the name of indigenous components of armaments industry. This is how they will strengthen corporate capital. Third point is that states are adversely incorporated in this process of increasing corporatisation of the military complex. That would create a lot of issues.

Any discussion on Kerala should be based on recent disasters. The PDNA in which more than 70 experts participated came to the conclusion that the cost of reconstruction would be around Rs 31,000 crore or 4% of the SDGP. If you take five years you would require Rs 62000 crore each year. But we were barred from taking foreign aid all in the name of national pride. For the victims it is only a case of misplaced national pride. They also did it in Uttarakhand.

The additions to the ToR will obviously worsen the flow of resources to the state. If federal constraints we have fought it. We made KIIFB functional. I am sure we will set an example. We are more worried of the structure of the population. We have a large share of elderly and of migrants. We need more funds for them.

An injury to Kerala is an injury to all the states because of two reasons. Kerala is a model state as far as indicators are concerned. You should help the lagging states to catch up with the model state. It is your duty to help sustain the model state as well as lagging states. That is why I specifically say that an injury to Kerala is an injury to all other states of India.

Concluding session

05:30 pm to 06:00 pm

Summing Up

Chair

T M Thomas Isaac,
Finance Minister, Government of Kerala

Panelist

Abhijit Sen,
Member, 14th Finance Commission &
Former Member, Planning Commission

Chair:
T M Thomas Isaac,
Finance Minister,
Government of Kerala

I hope everybody will agree that this has been a rewarding day. I am talking about what I am taking back from here today. There is no consensus document. There was diverse opinion. But some dominant trends in thinking. Most important point is that you have to locate the Finance Commission in the larger context of what is happening in India. Of course, even if you say 'shall' the Finance Commission has the right to interpret the meaning of the term' shall' in the terms of reference. But nevertheless, we take it that as the trend which is very clear. Federal principles are steadily being undermined. It will be foolish to discuss Finance Commission forgetting this larger trend.

I think it was an attempt to get this issue of centre-state relations into the mainstream discussion and focus that was the objective of this seminar. I was thinking GIFT, will take initiative to have other sectoral meetings in other places in India. Fisheries, electricity, education, health care how states' rights are being undermined. That is one thing we are deciding.

Second, coming to the TOR, one thing is clear. Article 270 is very clear on whether pre devolution you can tamper with the pre-divisible pool. Article 280 also says you can only divide between the centre and states. You can't have a third component. Therefore, this has to be a fund located within the centre's share. Anything against that will be challenged in the courts. That is certain. Then what is the objective of the additional TOR. It is to simply pressurise the Finance Commission to reduce the 42% so that the share of the states goes down.

The 13th Finance Commission only looked at non-plan spending. Suppose you add the plan assistance and the discretionary grants then the net increase due to the higher tax share allocated by the 14th Finance Commission has been marginal. There is a long table in our book which shows that the vertical imbalance in fact increased in recent years ,especially the last two years. Therefore, this is an attempt to drastically reduce the state share in the name of defence. It would be difficult to deal with it politically. That is one reason why some of the states didn't come here today.

The share of defence expenditure in GDP has in fact declined over the years. However, spending on state and concurrent list by the centre has gone up dramatically . I am with Haseeb. Do away with CSS. Do what is your duty. I am not very much in favour of what Sudipdo says. I am wary of what the centre says. I will stop here.

(ANOTHER PANELIST.....)

Thank you very much. I will summarise some of the important issues that have come up today and give some views on additional TORS. I think there is this discussion of rights of states and union. I think why we are having this seminar today is if the central government wanted a separate fund for defence and internal security, they could have put it in their memorandum to the commission. Instead of that there is a TOR from the president which is creating a controversy and makes the issue very different.

Now when it comes to the rights of the centre and the states there are three issues. One is the issue of 42% and what is left is left with the centre is 58% of the divisible pool, non-tax revenues and then the borrowed resources. Finance commission does not deal with borrowings but only revenue expenditure. Capital expenditure is part of the borrowing program and is only monitored under the FRBM act.

In that context if you look at the defence expenditure the 14-finance commission award has projected the defence expenditure in 2019-20 to be Rs 2.57 lakh crore and the entire divisible pool for the whole 2019-20 was Rs 18.76 crore. It indicates 13.69% of the divisible pool taken as assessed defence expenditure of union government by the finance commission. There was no controversy then. It was taken as a part of the expenditure need of the union government. That is the way to go. There is nothing wrong in asking for defence expenditure. If this assessment is a reasonable one and is applied on the expenditure side of the budget and then centre spends from the money there is no problem it is business as usual. That is the way to go about it. On the creation of a fund and then keeping it in a separate account I am not in favour as argued. You better go the way it is.

The second issue is why are they are asking for a separate fund. I think there is a issue of defence expenditure declining and there is a case for saying why they have asked for it. But why is it happening has been in the larger context on how the central government is spending in the last 15-20 years. If you look at central expenditure, then centralisation has happened because of proliferation of CSS. Central expenditure on state and concurrent list is now around 16-17%. Compensation that goes to the states from the GST our latest estimate shows, is above 19-20% of the total expenditure.

Central spending on the union list subjects has come down because of that. We need to get that expenditure priority right; it is not about creating a separate fund. That is what is to be discussed or conveyed to the finance commission.

Third issue is that there is a continuous decline int the capital expenditure of the central government because a large part of it prior to 2005-06 was loans to the states which is now borrowed directly by the states. The small amount of capital expenditure left is for defence and you are unable to spend it because the revenue deficit is growing and that large revenue deficit is because of the large number of CSS. So, we have to reform the CSS. Centre needs to stay away from state subjects and spend where you need to spend. The expenditure priority that has got distorted has to be corrected and that correction can only happen if the finance commission doesn't appropriate assessment of need of both governments given the constitutional requirement.

I think there is also an issue of redistributive expenditure be it education health or nutrition which are all in the state's domain. The centre is also spending on the subjects. That is a political economy question which is a larger question. Who should do what? That is where the conflict lies. It is not much because of defence.

If conceptually this 13.69 % is taken out of the divisible pool and give you as a sperate fund then I don't separately assess that need from the expenditure side. If I am not assessing that expenditure from the expenditure side the money that is available for me to give to the states in that case will be higher as a share. Then in that case we should not be talking of 42% we should be talking about something else. What that number should be is what we should discuss. I stop at that.

Panelist:
Abhijit Sen,
Member, 14 Finance Commission and former
member Planning Commission

This interesting seminar covered three different levels sometimes in different ways. At level one the question is what to do with the new additional terms of reference given at the last minute. We have to look at the numbers involved and the legality of doing so. Indications are that the numbers are potentially large. And secondly there may well be illegality involved in case the Finance Commission departs because of this demand. There might be other perceptions also.

At level two we have to look at the context in which this has come. Especially the economic context. Here there are broadly two dimensions. One is the short run impact of the present slowdown in economic growth and the squeeze on resources in both states and centre. And the centre took this opportunity to what it saw as an implication of falling taxes. To take care of the problem there is an immediate need to spend more by centre or state to get the national economy moving again. But there is a different economic background to the situation we are getting into as pointed by Venkatesh and Chandru. Over time the cut in government spending due to the neo liberal ideas that private sector should take over investments which was facilitated thorugh progressive cuts in tax rates. One of the huge missing items in the way the Finance Commission has worked is that what happens to capital expenditure is undefined. That was supposed to be carried out through the planning commission earlier and then through market borrowing which are now covered by fiscal rules. That has its own implications. Various people say differently but asking the question of what happens to capital expenditure and in the context of that what happens to defence capital expenditure also stand. This is an unresolved issue that you passed over but this needs to be looked at. But then why do you need to pull this up in July. You could have left it to the next commission.

That brings me to the last issue that came up which is not the economic background but the notion of federalism. Indian constitution does not define federalism anywhere. Constitution is federalist or quasi federal. But the constitution does not define federalism. It has a vision of federation which is now changing. As somebody said in the morning, I agree with the idea of one nation which is okay. But not the concept of one election, one language or one tax. Though it was one nation there was unity in diversity.

The other idea which came out from the very first session as Manmohan Singh said was in the context of the narrowest of the questions namely the particular amendment. What you need to do is to consult the states which then opened up and then came back in other session of the TOR being drawn up after consultation between centre and states and also of the justiciability of the additional terms of reference.

But at the end of the day a meeting like this has not had enough people coming in support. That is what is happening today. But not enough number of state finance ministers has come in support of our view. Certain states are considered as union territories and certain states have become union territories. Can the centre decide which is a state?. That is what the entire thing is about. Where do we put our priorities becomes subsidiary to that?

Finance Commission cannot include union territories in their scheme of things. Now certain states are regarded as union territories like Delhi; and states are now treated as union territories. Is it for the central government policy to decide whether a state is a state or not? All this is done on the basis of what is perceived to be a national security problem today. Then you can link it up to the national security problem. This is what the entire thing is about. It is where we put our priorities. Is national security whose repository is the central government and everything becomes subsidiary to that or whether or not that is the case is up to the states to be brought into the deliberation process before moving elsewhere.

Vote of thanks:
Dr K J Joseph

My colleagues and I thought here is an issue that should be discussed in Delhi itself. Working with my Chairperson, Dr T M Thomas Isaac, on organising this seminar turned to be a great learning experience for me. I am sure all of you will hold the view that the seminar was a great success thanks to the immense contribution from all of you. My sincere thanks to all of you. Many people helped us in organising this seminar. Apart from my former Directors, Dr A V Jose and Prof D Narayana, my colleagues, three of them are here, we much helpful - Please give them a big hand for their hard work. I must also thank Shri Jayaprakash, Prof Dinesh Abrol, Prof Sachin Chaturvedi, Director General, RIS and his colleagues for their help at crucial times. Thank you all once again.