

Flagship Seminar, March 22, 2021

Centre for Social and Economic Progress

Regional Inequities and Implications for Federalism

Press Release

“Absolute convergence [between states] does not exist. If anything, there has been absolute divergence”, said Pronab Sen, India Programme Director, International Growth Centre and former Chairman of National Statistical Commission, at the Centre for Social and Economic Progress’ (CSEP) Flagship Seminar on Regional Inequities and Implications for Federalism on March 22. However, he added that if one corrects for initial conditions, there has been a degree of conditional convergence between Indian states.

“When we use per capita Gross State Domestic Product (GSDP), we have one inherent problem: we are comparing GSDP at current prices. We are not asking the question: how do you compare the GSDP in real purchasing power terms,” Sen pointed out. Until purchasing power parity indices are developed, Sen believed that our understanding of regional inequities would remain questionable, since we cannot tell whether these changes represent changes in real purchasing power or simply changes in prices. He stated that, “A lot of what we are seeing in terms of the widening dispersion could simply be that the price behaviour in different geographies in India is different”.

Sen was in conversation with Chinmay Tumbe, Assistant Professor, Indian Institute of Management, Ahmedabad and Sajjid Chinoy, Chief India Economist, J.P. Morgan and Member, Economic Advisory Council to the Prime Minister. The seminar was the final part of a three-part series on India's public finances, focusing on the key themes and recommendations of the Fifteenth Finance Commission's report. The session was moderated by Anoop Singh, Distinguished Fellow, CSEP and Member, Fifteenth Finance Commission. Singh began proceedings by highlighting that, despite high growth rates, there have been growing dispersions in per capita incomes across states, and that growth after the COVID-19 pandemic will likely be uneven, consistent with the global outlook.

Elaborating on the limitations of GSDP as a metric for understanding inter-state inequities, Pronab Sen highlighted the importance of looking at consumption patterns, in the context of migration. Even though migrants earn income in a different state, consumption patterns are influenced by the remittances they send back to their families in their origin states. Sen, thus, emphasised the importance of considering whether the family moves with the migrant. According to him, current patterns of migration have helped offset the flow of capital from low-income states to high-income ones.

Responding to Anoop Singh’s assessment of the role of Finance Commissions in addressing inter-state disparities, Sen agreed that “The Finance Commission’s mandate is inherently not equalisation of incomes, GSDP, or consumption. Rather, it is to equalise the ability of states to provide public services”. In his opinion, unless one’s original diagnosis of inter-state inequality is mirrored by unequal levels of public services, “nobody should expect the Finance Commission, given its mandate, to correct for this.”

Chinmay Tumbe, author of the book *India Moving: A History of Migration*, observed that internal mobility in India is still much lower compared to other large countries such as the USA and China, and the bulk of it is intra-state. He shed light on the unique migration profile of Kerala, where remittances sent back from Keralites working abroad amount to over 30% of the GSDP, but since the income is earned abroad, it is not counted as part of GSDP. Therefore, GSDP numbers in Kerala, and in Goa and Punjab, do not represent the full picture. He suggested a Gross State Domestic Disposable Income metric that might better capture these realities.

CSEP Research Foundation

Regd. Off: Second floor, 6, Dr Jose P Rizal Marg
Chanakyapuri, New Delhi 110 021 India
T: +91 11 2415 7600 E: info@csep.org W: www.csep.org

Tumbe noted that the boosting of local economies in certain districts and states affects both centre-state as well as state-local relations. “One of the big issues of how regional inequalities shape fiscal federalism in India is that migration, because of the unique way in which it shapes consumption, does play a slightly distortionary role in the allocation of resources as mandated by the Finance Commission.” He also mentioned issues with schemes such as ‘One Nation, One Ration Card’, with states being unwilling to expand their social security nets to include migrants from other states.

Sajjid Chinoy brought a macro-economic perspective to the discussion. He stated that “The evidence of conditional convergence after controlling for institutional capacity, different starting points, social infrastructure, is quite weak.” Demonstrating significant dispersion in state capital expenditure in the last five years, he asked, “From a policy perspective, can we facilitate through sub-national fiscal rules a greater convergence of capital expenditure across states? Can we incentivise states that have not invested in capex to push those numbers up towards the average, especially where some fiscal space exists?” Chinoy acknowledged that there would be some challenges in accomplishing this including institutional capacity, incentive compatibility, and the post-COVID fiscal crunch.

Chinoy believed that a more differentiated set of fiscal rules derived from a dynamic concept of debt sustainability might be required, given the heterogeneity in state debt, growth rates, and capital expenditures. These new set of fiscal rules can be used to promote efficiency and convergence and can be another way for equalisation, apart from horizontal sharing. He also envisaged a role for central and state fiscal councils, which could work together in real-time taking into account the evolving debt sustainability patterns every 2-3 years.

In moderating the discussion, Anoop Singh brought up the issue of intra-state inequities and the role of intra-state migration, the importance of balancing debt consolidation with increasing capital expenditure, especially on health and education, and the trends in migration and labour participation among women. All these issues will need to be closely followed and assessed in light of the nature of the ongoing post-COVID recovery, and its effects on states and sectors.