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Centre for Social and Economic Progress

NK Singh on the 15th Finance Commission report

Press Release

Building India's overall resource availability is the only viable solution to the issue of rising cesses and surcharges imposed by the Centre: NK Singh at CSEP's seminar on India's Overall Fiscal Architecture

Toward this, a constitutional amendment that stipulates that at least a portion of cesses could form part of the divisible pool should be considered as part of the lasting solution to the issue of rising cesses and surcharges, said N.K. Singh, Chairman of the Fifteenth Finance Commission, at the first of a three-part Flagship Seminar series on India's public finances, hosted by the Centre for Social and Economic Progress (CSEP) on March 8. "Short of a constitutional amendment, everything else will be a subterfuge, almost like a cat and mouse game where every increase in devolution is neutralised by an increase in cesses," he explained. This is an issue that also engaged the earlier Finance Commissions, who have also groped for what could be done to mitigate this phenomenon. It requires a wider debate and consensus among all stakeholders before any conclusion can be reached by policymakers.

Singh was in conversation with Shankar Acharya, Honorary Professor at the Indian Council for Research on International Economic Relations (ICRIER) and Member of the Twelfth Finance Commission and Anoop Singh, Distinguished Fellow at CSEP and a Member of the Fifteenth Finance Commission. The session was moderated by Rakesh Mohan, President & Distinguished Fellow at CSEP and former Deputy Governor of the RBI and Secretary, Economic Affairs.

The seminar was the first of a three-part series on India's public finances, focusing on the key themes and recommendations of the Fifteenth Finance Commission's report, as well as the unique challenges faced by the constitutional body amid the uncertainties caused by the pandemic.

NK Singh shared a comprehensive overview of various structural issues in India's federal framework, highlighting their far-reaching implications for public finances. He linked these issues with multiple aspects of the Commission's report, highlighting the constraints under which it had to operate.

On Rakesh Mohan's question on the asymmetry between centre and states, Singh said that there was a need to revisit the Seventh Schedule of the Constitution, which divides Centre-State functions, "we need to fundamentally go back to the drawing board and look at what kind of Seventh Schedule would be relevant to today's contemporary challenges, electoral expectations, and the nature of the governance rubric," he said.

NK Singh also pointed out the complications arising from the rising use of Centrally Sponsored Schemes in the States' domains. India needs to "go back to the drawing board" and learn from international best practices on how to improve expenditure efficiency and improve their outcomes, in the context of considering what long-term framework of public finances would be appropriate for us, said N.K. Singh.

The role of GST

Regarding the two key constitutional bodies in Indian fiscal federalism, NK Singh emphasised the importance of establishing a working relationship between the GST Council and the Finance Commission, drawing from the examples of Australia and other countries. "The working of the Finance Commission is integrally related to the decision-making process of the GST council," he said.

According to Shankar Acharya, among the key reasons for India's persisting low tax-to-GDP ratio is that the GST did not turn out to be revenue neutral in terms of the Centre and State taxes it replaced or subsumed. This compounded the problem, and the states lost out on their most productive tax, the state VAT. "It is absolutely necessary to make GST much more productive without being more distortive in the years ahead," he said.

The panel discussed the unique challenges faced by the Fifteenth Finance Commission from the COVID-19 pandemic. On the key issue of resource availability, NK Singh explained that the Fifteenth Finance Commission chose not to revise the tax devolution rate in the interests of stability, continuity, and predictability. Shankar Acharya applauded this, saying said that while the Commission had the option of revising the tax devolution, say to 36-38%, to give more fiscal space to the centre, this was "politically unthinkable" in a COVID year when states were already hit hard; looking ahead, India must find a sustainable resource solution for the centre and states.

Anoop Singh, member of the Fifteenth Finance Commission, highlighted the overarching importance of building the underlying fiscal architecture, and improving the quality of public spending, whose weaknesses have been highlighted by the Covid-related pressures on resource availability. Toward this, he said a critical step has been taken by the Finance Minister in the recent budget, when she discontinued distortionary off budget borrowing and committed to bringing all expenditure and financing liabilities transparently on the budget. Anoop Singh referred to the three pillars of fiscal architecture India needs to build over the coming years, and this needs to be done in full collaboration with the states. "Given the current pandemic, whether we have had such a fiscal architecture in the past is now not that important. It's more important where we are going in the next five years," he said.

The Finance Commission is a constitutional body constituted every five years by the President of India under Article 280. It makes recommendations regarding inter-governmental fiscal transfers, particularly from the Centre to the States in the form of tax devolutions and grants-in-aid.

The Fifteenth Finance Commission's recent report, which makes recommendations for the years 2021-26, recommended that 41% of the divisible pool of taxes be transferred to the states in the form of tax devolution. In doing so, it opted for continuity in the status quo, with the Fourteenth Finance Commission having recommended 42% tax devolution for the 2015-20 period. The adjustment of 1% is on account of the reorganisation of the erstwhile state of Jammu and Kashmir into two Union Territories. For horizontal sharing of resources between states, the Commission devised a formula that gave 12.5% weightage to demographic performance, 45% to income, 15% each to population and area, 10% to forest and ecology, and 2.5% to tax and fiscal efforts.