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Seminar

Transfer of Budgetary Resources to States: Is it North Vs South or North and South?

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RAJAT VERMA

Hi. Good. Good afternoon. All. Thank you for joining in-person as well as online… for this important topic, the title is transfer of budgetary resources to States. Is it north versus south, or is it north and south? by Professor Pinaki Chakraborty. And in conversation with him, will be Doctor Janak Raj. The context of the today's topic emanates from the fundamental objective of the Finance Commission, which is to restore the vertical balance between the Union and the states and horizontal balance among the states.
And I think it is this critical issue, you know, which, professor, Pinaki Chakraborty will be highlighting over the due course of time. And as we know, that Finance Commission, is a constitutional body which came up which… was established under the article 280 of the Constitution, and it is set up every five years since then.

Now, let me now introduce, the speaker of the day, Professor Pinaki Chakraborty, who's, the Vice Chairperson of the Institute of Development Studies, Jaipur, and is also a Visiting Distinguished Professor at the National Institute for Public Finance and Policy. Before this, he was also the Director and Professor at NIV. He has held several important positions and contributed extensively in shaping, the discourse of, fiscal federalism at the Union as well as at the state level.

He served as a member of the advisory council to the 15th Finance Commission of India and economic advisor to the 14th Finance Commission. He was also the member secretary of the Committee on the Fiscal Statistics, appointed by the National Statistical Commission. Additionally, he was also the chair of the Kerala Public Expenditure Review Committee. In addition to the research and policy level positions which he has taken, he also used to, teach at various places and then he also had visiting positions at the Department of Economics and the University of Ottawa, the University of Carleton, Centre for Development Studies, Trivandrum, and also had taught at IGIDR Mumbai. He has authored three books, one of which I also was privileged enough to read. And that was The GST in India: A simple tax structure… A simple Tax in a Complex Federal Structure, published by Orient Black Swan - and this was in 2019, before that, he has also co-authored two books. The first one is Social Sector in Decentralized Economy India in the Era of Globalization, published by OUP and, in 2016. And in 2014, State Level Reforms, Growth and Development in Indian States. Thank you very much, sir, for, you know, coming here and making the time.

Let me now also introduce, Doctor Janak Raj, who is my colleague, and he's also the Senior Fellow and leads the macroeconomics segment in Growth, Finance and Development vertical at the CSEP. He works specifically on the fiscal federalism in health sector, climate finance, and on also the reforms of the multilateral development banks. He's currently also a member of JM Financial Centre for Financial Research of IIM, Udaipur.

He has nearly four decades of experience working with the with the Reserve Bank of India, IMF and Ministry of Finance. He served as an Executive Director, in the RBI and as a member of its Statutory Monetary Policy committee. He also also served as a principal advisor, advisor of the Monetary Policy Department and the International Department of the RBI, and headed its Department of, Economic Policy and Research. At the IMF he was the senior advisor to the Executive director for Bangladesh, Bhutan, India and Sri Lanka. He has served as an RBI nominee, director on the governing body of the Bombay Stock Exchange, and as a Senior Consultant in the Department of Finance, Financial Services, Ministry of Finance. Thank you very much for kindly agreeing, with that, I think I would like I'd like to call Professor Pinaki Chakraborty for his, address.

Pinaki Chakraborty:

Thank you, Rajat Professor Janak Raj, Professor Laveesh Bhandari Ptofessor Om Mathur,distinguished friends and participants...this is... I'm really very happy to be here. And thank you for this invitation to talk about, my recent work on transfer of budgetary resources. This is a, this is something which I'm currently working on. And some of the major findings of this work has been published in the India Forum recently, and I will… today's lecture is based on what has already been published and, and some of the work I have done post the publication of that article. So, so I just, said this issue, in the context, I think the context here is, you know, there was this, discussions about, you know, denial of fair share of resources to the rich and prosperous regions of the country. And, and this was… basically based on a principle, of understanding that these states are more efficient and in turn, should be provided, more resources basically award for efficiency, if I put it that way. Secondly, you know, the states which are, really not prosperous, they have been getting transferred. That's the argument. And yet they haven't prospered really well. So in that case, should there be a reverse kind of issue, should there be a redistribution of transfer to, to a level which is kind of unsustainable, that that's the kind of argument that was… there. And, and in that context, I thought we should look at, what has happened in the, as far as, centre budgetary transfer is concerned. I am not going into the data. I, I talk from my written notes and… first draft of the, larger article. So, so if we… talk about, you know, redistribution of resources, I just give you a big picture. And the big picture here is, the, you mentioned about finance commissioner Rajat, I, I think… Finance Commission transfer is, is part of the kind of, but it's part of the budgetary transfer. So, so budgetary transfer has again, four components, I would say. The first one is, of course, the finance Commission and transfer, which is something like 70% of the transfer. So, so it's a large part of the total transfer that goes to the states, including the local governments. And then you have got grants. And these grants are like centrally sponsored schemes. We keep hearing about MG and REGA , PMGA, s o National Health Mission, Sarva Shiksha Abhiyan everything is part of that component, which is CSIs or Central Sector scheme. And then, then then then the third component is… your borrowing where it's not a transfer, but… states have to take permission from the centre to borrow as per the act if all we had recommended ever legislated by the state. So… this is where the total regulation of budgetary transfer comes one is the borrowing or that is finance commission transfer. Then there is various central grants. So in this context, if we look at just the Finance Commission transfer I am giving you the big picture Finance Commission transfer and central grants together, it's around 6% of GDP. Now if we look at this as total government expenditure, that means taking centre and state together. It's around roughly 24% of GDP. So 6% actually gets goes to the states. Now all the debate that we see is how this 6% of GDP should be distributed, how much the rich state should get, what the middle-income states should get on, how much the poorer states will get. And there the question of efficiency and equity comes in where the states who are prosperous are saying that we should get more than that now, more than what we have been getting. So, so in this context, let me, let me just raise three issues. One is is budgetary, budgetary transfer the only way to look at financial flows to the states? That's the first question because because it is not the only transfer that goes to the states. So so there are many other transfer that goes and and there are five different forms of transfer which is outside the budget. One is commercial bank credits. So now if we look at the commercial bank credit flow across states, you would see that 86% of the bank credit, commercial bank credit goes to 6 or 7 most prosperous states of the country. And that is not part of the budgetary flow. It is part of the process of private sector investment, growth, etc. prosperity, everything together. So in other words, if we look at credit deposit ratio, you will see the credit deposit ratio is very low in poorer states. That means the large part of the deposit in the poorer regions actually goes back to that prosperous regions of the country. And then if we look at central sector investment, so central government, because central government expenditure is around 12% of GDP to 11 to 12% of GDP, that also gets spent somewhere within the country. And and we did a study for the 13th Finance Commission, a bit dated, but I would say that these transfers are also highly, highly regressive in the sense that most of it actually flows to the prosperous regions of the country, given their nature. So so, for example, if we see the petroleum subsidies, who benefits out of petroleum subsidy most? It is the prosperous region because the petrol consumption is high there. So I'm just giving an example. Similarly, if we look at subsidies for, you know, say fertilizer subsidy, I think its distribution is also very regressive. Prosperous region gets more subsidies.

So then we have got foreign direct investment. We do not have an idea about state wise foreign direct investment is very difficult to get. And then the fourth floor that we are talking about it externally aided projects. So these four and five components, if we take together and if we look budgetary component, another side, my argument in this paper is that the budgetary component constitutes a very small proportion of the total financial flows to the richer regions of the country. So, in other words, if we are saying that budgetary transfer is actually creating inequity, I would say no, it is not the actually it is the non-budgetary financial flow which actually is responsible, for the high growth that you see in the prosperous regions of the country. Now in such a situation, if we say that budgetary flow also should become more efficiency driven, it has got its own economic implication and social implications, development implication.

So in such a situation, should we really be talking about, you know… efficiency should be getting a getting more weightage compared to equity. I think that issue is extremely complex. And we do not really…know the answer. So, so the idea is to… look for some of this concerns of the southern states. Now, if we look at the …question of unfairness in transfers of what is the argument argument. This this started with a question, in the, in the parliament and that was on 5th of December, 2023. So five, six months back, it was question number 232 on start question and that and and this was in the Rajya Sabha. So and which provided state wise information of collection of various taxes. So if we look at collection of various taxes, collection means source of collection. Right. So if I say that (indistinct) I'm just giving an example, pay taxes from Kolkata. So so does that mean that, you know the income is generated in Kolkata. No. Right. So they have pan-India income. So if their head office is in Kolkata they may be paying the taxes from there. So collection means is a source from where the tax is collected or the return is filed. Right. So… collection of taxes If we look at and and it shows that some of the most prosperous regions of the country, so 6 or 7 states contribute very significantly the total collection of the corporate income tax or, or personal income tax. So… essence of the argument made by some of the southern states based on these numbers seem to suggest that since they contribute more to the national pool of taxes, they should be receiving more than what they receive now is devolution. So devolution of taxes.

Now, if we have to, if we take this is the very right argument, the operationalising this proposition would require it an indicator which would actually say that origin of tax, if is, is given some way, taking the devolution formula of the Finance Commission. So, I started looking at old Finance Commission report, and I started looking at it from, from the first Finance Commission report. So, from the first to the ten Finance Commission, only two taxes were devolved to the states. That was Union Excise Duty and the Income Tax… Union excise duty came later. The first it was all union income tax now and collection was given advantage. So it is not something new that those of different demanding.

So collection was there as it, as an indicator of devolution to the states from the first to the ninth Finance Commission. But collection… So, so that means if 100 rupees is collected, 10%, which is given to the collection, that means 10% of that collection should go back to that, state, that the state of origin. So but in the 10th Finance Commission, then finance comes. The timing is very important, that was 94, 95 when, you know, India liberalised. And then Finance Commission had said that there is nothing called locally originating income because the economy got integrated. Liberalisation has happened. Sector movement actually is seamless. So in such a situation, actually, we cannot really say that origin of collection…. Look, there is nothing called a locally originated income. That is the that's the that's the that's the argument they made. And and if you give me one minute time, I just, say what they have said. I think they that the argument they have made that there is no, no concept of locally originated income. And if there is no, no question of having a locally originated income, we really cannot have, a collection as an indicator of devolution.

So collection was (indistinct) by the 10th Finance Commission. So no collection was (indistinct) by the 10th Finance Commission. And then, then Finance Commission was 94-95. So today we are in the 16th month commission…so 30 years have passed. Collection has never come back as a criteria for devolution. So the reason why now, if we compare India of 94-95 and India of 2024-25, if we look at the data on migration across census two census, we will get 91,2001 and 2011..migration has increased. if we look at the Economic Survey a couple of years back, there are some number on migration, which also said that there has been a significant increase in migration, interstate migration. Two major reforms have happened in direct and indirect taxes. One was VAT one was GST. GST actually talked about one nation, one tax and seamless movement of goods and services, business integration, etc… So, so I think the integration is true there locally or there is no conflict of local income has become really, really, really more, more and more, important now, compared to what it was 30 years back. Of course, I am not talking about the agricultural income. You cannot have an agricultural which is not locally originated. So, so, but but, and they are the agricultural it is it is what it is about what I am talking about locally originating income is manufacturing and services. So in such a situation, I think the concept of locally originated income is completely irrelevant. So, so if the concept of locally, originating income is completely irrelevant, and if we are talking about a common market, bringing collection is going to actually make the transfer system more, more regressive. That's… the first issue that I highlight in this paper and my work. And there are data that that don't have it now. But, but it clearly shows that that's the first point. Second issue that I wanted to highlight is when we are talking about collection. And I, and it becomes more regressive then the question is, has the transfer system become more regressive without collection? That's the second question to ask. Even if we haven't used, collection as an indicator, what have we used? We have used income distance or income distances I think I'll just briefly talk about income distance. So so income distance is, you know, the highest per capita income states. For example, if we take Haryana and the lowest per capita income states in Bihar, and if the income distance between Bihar and how, you know, you say x I and that x is given some weightage and very high weightage it in the devolution formula, that means Bihar would get more money compared to say Haryana or the state next to Haryana – Himachal. If we look at 11 Finance Commission report, 11 Finance Commission had given income distance. That means this most progressive component of transfers. So so the more poor you are in per capita income, the more money you will get from the center as tax devolution. So that was given 62.5% weightage. Now if we look at the 15th Finance Commission report, the income distance weightage is 45%. That means over the year, the distance of income and its weightage in the devolution formula has declined. To say that it's only driven by equity is a myth. It hasn't. So, so so if the income distance over time has declined, does that mean Finance Commission is not concerned about equity or finance Commission has deliberately reduced the share of poorer states and made the system more unequal?

I think that would be a very unfair statement to make because one of the reasons why collection, income distance could not be given higher share was because if income distance continued at 62.5%, as was the case in the case of 11th Finance Commission, the kind of redistribution that would have taken place in the last 25 years would have created huge fiscal instability for the richer states, because the deficit would have gone up, they would have got much less money compared to what they are getting now. So…So… Finance Commission actually considered fiscal stability also as an important factor in determining the devolution of taxes. It's not that Finance Commission was not concerned about the fiscal issues of the richer or prosperous regions of the of the country. Finance Commission also had a constraint that the system can really afford only this much level of fiscal equity, because otherwise there will be a significant reduction in flow of resources to the prosperous region. So if we just reduce from 62.5 to 45% now, which replaced this less redistribution, it was replaced by very neutral indicators of need like area started getting increasing weightage. So area got important weightage or its share has increased in the overall devolution. The other thing which got more weightage was population. So the population is a neutral indicator of need.
I am sitting in Delhi, my fiscal need say for a hospital is very low compared to a person who is deciding and say all the medical services are different. Quality of medical schools, both public and private, are very different. So if we put per capita income, which is per capita transfer, that means population as an indicator of devolution. We are not actually differentiating between the fiscal need of a person residing in a prosperous region and the fiscal need of a person who is residing in in less prosperous region in economic terms so more neutral indicators actually have replaced more progressive indicators like income distance. So, so in such a situation, I would say this transformation in the Finance Commission approach or incremental approach, towards more, you know, more and more neutral indicators of devolution used to address the issue of fiscal stability of the prosperous region. That's a second hypothesis. I have. And if we look at the data, you would see another important development. And that data says that in the last 30 years, that means fixed finance commission. If we look at the devolution share of bottom ten states have actually remained stagnant at around 60% of the total devolution. So it's very promising despite reduction in the devolution, income, distance formula, the population, the total transfer still goes to the states in the form of tax devolution is 60%. So so bottom 10-12 states. And but if we look at the richest, it's this share in the total devolution has declined from around 10% to 8%. And we are talking about something like 13 lakh crore per year. So say two percentage point decline is the significant amount of money. And if we look at who

benefited out of this redistribution… So there is a limit to the redistribution because bottom 10-12 states, cities that are 60% high income state share is going down… Now, what is happening is that in the process, the states who benefited most are the middle income states. And middle income states are also very vocal. And some of the middle income states actually have improved their per capita income ranking. And classic example is Kerala. Kerala is, I think, the third highest per capita income state, Tamil Nadu, Karnataka. So their income ranking has significantly increased. And that is one of the reasons why there has been a significant decline in devolution. Last point on devolution, I would like to say is… Okay. so the last point that I want to say on devolution is if we look at share of states, the states that have seen secular decline in their devolution, in the last 4 or 5 finance Commission will be Tamil Nadu, then we will have Karnataka, Kerala, also Bihar and Uttar Pradesh, so that's why I say it's not North versus South, it is also North and south. So Bihar and UP's population will be total population in absolute number will be around 30 to 35 crores. And then if we look at this share in the total devolution, it has also declined. So when I say that equity has a limit because you have to take care of the fiscal stability issue. And when you are talking about fiscal stability issue, you actually see that redistribution also happen from the poorer regions to that to the more prosperous regions. In terms of devolution, to say that, Rich is financing the poorer regions, I think factually is not correct. It's actually actually wrong. So the second issue is about revenue deficit grant, I think, I think I'll just talk about revenue deficit grant.

When we talk about devolution, devolution has two components. One is your tax devolution. Other is if a state is still in deficit after giving tax devolution, a state is given a revenue deficit grant. So when you are giving a revenue deficit grant, it's like tax devolution because it is it is untied. So if I say that, fiscal devolution to a state is x percent after x percent, you have 100 crore deficit, 100 crore deficit is given us. It's gone. Article 275 one grant. So his is this is a constitutional provision. So this is an untied grant. So we just cannot say that devolution has declined. So you have unless we look at what has happened to revenue deficit grant. And if we look at the revenue deficit grant that state like Kerala has received, actually devolution hasn't declined as much as the devolution shares shows. So I think we have to look at both revenue deficit and tax devolution together.

Now, if we come to the issue of equalisation of expenditure and reducing fiscal inequality. Now I was looking at data per capita expenditure, data on development, social and economic services. And if we look at social and economic services, per capita development expenditure difference in India is huge. Bihar's per capita expenditure on development social and economic services together is only around 50% of the all state development spending. I'm not comparing Bihar's expenditure with Kerala. Maybe it is 90% different. The difference will be 90%. So when we talking about, you know, inequality in development spending and we are talking about a redistribution which has got its limit at 60%, we are actually doing a constrained optimisation. We are not going to get a complete fiscal equalisation, given the level of overall resources that we have, because otherwise the macro instability in the centre would not give any money. So there is a limit to what you can give. So, in such a situation we are doing a constrained optimisation. And and if that redistribution doesn't happen, if that rich redistribution does not happen where it is now, I think I think there will be large scale migration from the low, regions, which provided low level of public services because of the fiscal inequality. As I said, Bihar for capital development spending is only 50% of what all state average is. And that migration itself can be, can still be very inefficient. So, we really cannot say that migration we will continue, it is going to have a is a natural it is natural equaliser to the extent that we have an understanding of how it is natural equalising, it is equalising in both ways. It's not an equalisation. It is not one way process. Today, if we say somebody is migrating to a prosperous region and sending money transfer to his back home, to the original state, it's an equaliser. Yes. But at the same time, there is no study in India yet which actually tell how migration has kept the labor cost low and added to the value added in the richer regions. So so we we have no idea. So if we estimate that, I think we will find an extremely unequal system and that inequality I think has as accentuated significantly post liberalisation. So we need a need, system which can address this level of inequality. And it is not going to happen now, happen without but if we just talk about finance commission (indistinct). Last but not the least, I think I think what we haven't disussed and it is completely outside the radar of public policy debate, is the issue of, which is only restricted to revenue expenditure because all the grants, all the transfers that we are talking about, it actually talks about equalising revenue expenditure. It does not talk about equalisation of capital expenditure. Capital expenditure is determined by the level of borrowing. So, if a state is allowed to borrow up to 3% of GDP, and if a state does not have a revenue surplus, I assume that revenue surplus is zero. And if you do deficit is zero, then 3% is the threshold of your capital expenditure. So, when there is no capital expenditure, equalisation and revenue expenditure equalisation is limited to, you know, certain social services because most of the revenue expenditure is a expenditure on education and health and to an extent rural development. So we are actually not talking about balanced regional development. So there has to be some instrument which actually can speed up capital expenditure at the… you know, in less prosperous regions of the country. And in that context, I would like to draw your attention to the recent changes in the central government's policy, where they started doing this on lending free, interest free loans to the states. Then I started as a part of Covid, stimulus. Initially it was 10,000 crore now it has become 1,30,000 crore. I think that and that is given based on the devolution formula of the Finance Commission. So there is lot of capital flowing to the poorer regions of the country. But I think that it is very small, one lakh, 30,000 crore is something like 0.3% of GDP. I think that level of capital expenditure equalisation is not enough. I think we need to have a larger capital grant to the states based on a flexible design, because the capital expenditure need of prosperous region and capital expenditure need of poor the region will be very different. I think we need to have a capital grant fund mechanism to address the level of fiscal inequality that we have and which has got accentuated over time.

So that's the that's the broad idea of what I wanted to speak. And thank you very much for this opportunity.

RAJAT VERMA

Thank you very much for, for, those insightful words. Now, I would request Doctor Janak Raj to kindly take it forward.

JANAK RAJ:

Now, thank you very much, Doctor Chakrobarty for this wonderful presentation is a very thought provoking, two-three points which you have made in your presentation, I will just touch upon… I like, you know, it's not only the, the resources… the resource transfers from the Finance Commission, but also the fact which matter lot… Because if you are getting more credit and you have been developing faster than, you know, you have higher income, and that goes into than new funds transfers, that's a very important point you made. And you also made another important point. It actually it comes out very clearly from your presentation, it's not North versus South, it’s basically North and South because we have seen the top, top states which have high highest per capita, but they are getting less transfers from the Finance Commission and also the, lowest (indistinct) also you made the point very well that it's basically middle-income states, which are low, which have got high, largest share, I would say. B ut the issue still remains like why the states are feeling so much squeezed like they feel they get more resources because they also have expenditure. Because if you look at the data, which I just had a glance, states have 60% of expenditure where they have resources only up to 40% too. So very mismatch, which of course comes through vertical transfers. I'm just wondering whether this, so much squeezed which some states are feeling, is it too is it to do with the vertical transfers like whether vertical transfers are not enough? let me refer to particularly to sales and surcharges. That amount has increased very significantly in the last ten years or so, from something like 70,000 crore to five lakh crore or so. And this is not a part of divisible pool. What… had it been a part of the divisible pool. Then perhaps all states would have more money. how do you respond to this?

PINAKI CHAKROBARTY:

Yeah I on that thank you. I think there two issues I think yes. the share of divisible pool actually has declined because of the continuous and steady increase in sales and surcharges. So non divisible pool as increased. I also add to this, you know, how, you know, structural structural changes in the economy actually resulted in windfall gaining non tax revenues for the centre. Twenty years back, we never had an idea that it will be a 2G spectrum auction and you are going to get non-tax revenues… so so (indistinct) spectrum… these are new sources of revenues and it's part of the non divisible pool now (indistinct) have also have also increased. So in that context I think two issues become very relevant.

One is a part of the (indistinct) actually go to the states to finance their, centrally sponsored schemes. So if the (indistinct) are not there, it hasn't been completely accumulated. And it has, it becomes part of the divisible pool. That means you are taxing, not imposing. Says so if you don't, if you tax, it will become part of \the divisible pool…so…and it goes to the states. Then you also have to talk about what will be the sharing of formula of centralised polities with. It will then be 60, 40 or something else, I think. I think that issue becomes then very relevant. So it is linked to the restructuring of CSS (indistinct). I think there is an incentive to finance large, CSS (indistinct) because you can impose (indistinct). I think there needs to be a restructuring of CSS as it is something like four lakh crore rupees or three lakh plus, so it's a large sum of money. And it's actually when there is a 60-40 devolution, sharing formula calling it as CSS also is not fair because states are also putting 40% of their money into it. So so I think I and the case also is this, you know, generally states say that one size fits all do not apply because some states have differential fiscal needs. I think CSS needs to be reformed. I think I think there is a need to restructure CSS so that absorption is better, and it actually meets the specific need of states. Now on the non divisible pool, how much (indistinct) is financing centers expenditure and not providing resources to the state is also an issue that needs to be discussed, quantified and evidence is generated I think we haven't done that. I think that is very important. The last point, I would say that this, feeling of, you know, not having enough resources. I think if you look at data, two things have happened after Covid and after Covid, it's the new normal. One is, states deficits have gone up in the revenue account, but their capital account is, reduce…. the capital account expenditure hasn't really increased because the fiscal deficit is at 3 - 3.5. So that is one development. So a lot of states actually having revenue large states. And they are they are saying that money is required to finance it. So it is also about state level expenditure efficiency that has changed after Covid. And last issue is with respect to borrowing, we will talk about squeeze. I think states are also finding innovative ways to, you know, encourage your budget borrowing because if RBM puts a hard budget constraint on their on their finances, I think that is where now that we, we are debt to GDP ratio at 27, 25, 8%. And if I give you a review committee in 2018 said that it is it come down to 20 to 20% for the states by 20 to 23. We are way off the mark. I think it is very important that we talk about what kind of flexibility or what kind of readjustment in the fiscal space required at the state and the union level to bring the state debt to GDP ratio in the medium term to at least 25%

JANAK RAJ:
Okay. Now you raise the issue of this centrally sponsored scheme… If you recall, you know, the Fourteenth Finance Commission has recommended that in the head. You raise the issue of centrally sponsored scheme, if you recall that the 14th Finance Commission had expressed concerns the centrally sponsored schemes and it said, it's basically these are specific transfer type transfers, unlike general specific transfers, which are free, that states are free to spend the way they feel the most appropriate and keeping in mind. And many states, of course, are represented to the 14th Finance Commission, keeping in view their concerns. 14th the Finance Commission had, tried to do with the most centrally sponsored schemes. The allocation and money was increased to general specific terms, which are the tax devolution, which was the share of which was reduced from 31% to 32% to 42%. And of course, this issue has been there for a long time. I am not getting to the legality of the issue. Of course, the case I had gone to the Supreme Court and the Supreme Court had said no state central government has the right to, you know, formulate the, centrally sponsored scheme. So there was no issue in that but still, there has been a proliferation of centrally sponsored schemes. And, of course, one of the reasons which the central government gives is that whatever money they are getting from (indistinct) that which you also mentioned, is going through central sponsored scheme, but wouldn't it be better if instead of, you know, of course, this also promotion of ownership of central sponsor scheme, you basically, you know, designed at the centre sometime before states and consulted we I'm talking about NHM we had discussions with many state governments, and some of them, of course, felt that, they have just to implementing agencies. They have not been consulted when the scheme was formulated. And it's also the fact that none of the state has said no to CSS. So it has been there … So my point is that is it not better to, to have more general transfers to states than these tight transfers in the form of centrally sponsored schemes? And also, another reason is that these are the areas which are within the domain of states, like the health is in the domain of state. I'm just giving you one example.

How do you respond to these issues?

PINAKI CHAKROBARTY:

Yeah. Thank you. I think I think that this is a very complex issue and… I would try to answer in two parts really quickly, I think, I think the first issue is, 14 Finance Commission and, CSS, I think, what, 14 Finance Commission…Let me let me put it this I think the 42% was not about restructuring of cases like I would. I would say that 42% was basically a merger of planned and non-planned expenditure, because Finance Commission was only looking at non planned revenue expenditure is the 14 Finance Commission, which was the function that comes just to your state, that one… But it was… silent on whether finance commission should look at non planned expenditure or planned expenditure. Was the planning Commission responsible. So since there's no mention of planned and non planned, the Finance Commission in it's wisdom decided that they would look at both the plan and all that. So when it looked at both plan and non planned, it was discovered that 32% was the baseline scenario because that was 13th Finance Commission's recommendation and if we look at the plan transfers to the (indistinct) formula then what's 6% of the divisible pool. So 32 plus 6% of the divisible were made it 38 and then 13th Finance Commission had given a lot of under, tight grants. The 14th Finance Commission decided not to give tight grants. So that was around 2% of the divisible. So actual increase was only two percentage point. It's not when you take planned and non planned. So it is not 32 to 42. I would say it was 32 to 34. And and then on the CSS Finance Commission said that CCS should be reformed and Finance Commission suggested a framework and finance commission said you really cannot have a hundred plus CSS and you should have CSS restricted to two kinds and which should be based on two consideration. One is externality and other is national priorities. So externality and national right. So if we think that, you know, poverty is a national priority, that's what a poverty is, a national priority you can't really have a CSS. But if we say that something like, which is which, we can be done more efficiently by a state government or a local government, it shouldn't have CSS in such areas. So that is something which hasn't happened though the number of CSS has come down. But, but the volume of money that goes through CSS is still very large. I think that is where large reforms are needed. So that so that this discussion about (indistinct), macro stability, revenue deficit, actually, addressed. Yeah. As a fiscal stability issue rather than scheme. I think, I think it is very important. And finally, I would say that if we look at union government spending on union list and union government spending on state list and concurrent list in the last 20 years, union government spending on state list and concurrent list has increased significantly, and union government spending on union list has declined. So I think that is because of CSS I think that needs to be reformed. And that's an area of that requires a lot more work.

JANAK RAJ:

Coming to this, reforms of CSS we had done some study on health care and National Health Commission as I was mentioning, that we had consulted various state governments. So, and they also mentioned that some of the states felt that they were mere implementing agency because there was they were not consulted. So what what do you feel, how that do CSS could be reformed to create more or to generate more ownership at the state level.

You know, unless you generate that ownership, it is very difficult to get the desired outcome..

PINAKI CHAKROBARTY:

I think I think CSS has an ownership at the state level do this to complain about cases. I think for many states like it, this the money directly go to the department. But absorption is low in some states because you have to pay 40% matching contributions. So if we look at, say, relief and allocation release that actual expenditure, you will see large differences and especially the absorption is low in poorer regions. So that is where I think lot of flexibility, I think flexibility pool of CSS should increase. So there is a flexible pool. But the flexible pool now is very small. So so if we are saying that it is centrally designed for some of that case, it can have a central design. But in some cases a part of the CSS should be flexible, a flexible pool, because there is a lot of discussion about that. Some of the states do not require primary health centre. They probably require tertiary health care. So in that case, what you see is this would not be the form that the money flow for. I think that is where state specific programs can then also be financed through CSS.

I think that kind of flexibility, large flexible pool this would be, would be a way forward. But… that would also require an institutional mechanism. So if, if some states come with a flexible design of absorption, of CSS, of accessing CSS one I think that's evaluation that institutional mechanism should have… I think it to be more and more trust based other than, you know, you know, central thing that you should do this and this is the way it should be done, I think I think that is where that is where we also need, need a very robust institutional mechanism.

JANAK RAJ:
Now, you know that there is a bit of income distance in this, by all, the finance commissioner the weight has come down. We have done a study recently which found that, you know, it's very difficult for poorer and poorer economies, for economies, the international level and also for states within the nation to develop unless they have adequate human development resources, because they mutually reinforce each other. So there have been various parameters on which this formula of finance commission is based. Do you think that there is room for factoring in some human resource development, which can then, you know, this thing, propel for economies to develop faster?

PINAKI CHAKROBARTY:
Well, I think, you know. Finance Commission's devolution formula has a very limited purpose. And, and the purpose is to provide, comparable level of public services at comparable levels of taxation. So that means basically standards of public services across the country should be same, almost same. So, but that we don't have a measure of standards of services across the country. So the fiscal gap that we estimate is through per capita income, distance, area, population. Now, if we put, you know, a specific expenditure need within the devolution formula, given that expand need is also more in the poorer region. And already we are putting an income distance. I think it will also result in double benefit to this state. So that can lead to serious instability. The issue that we are talking about North versus South. So finance Commission, we have to be careful what best reflects fiscal need. And if we look at successive Finance Commission, they have tried to do it through the income distance rather than going into the expenditure. I think they did not look at fiscal expenditure, because fiscal expenditure also determined by how much when it goes from the centre, especially to the poorer regions. So so I would think that existing mechanism is, a very reasonable one. And, and how you take it forward to address the question of equity is a matter of how much weightage you give to equity versus efficiency or neutral indicator of it, like population.

JANAK RAJ:
Okay. You know, this conversation with you, it was a Renu Kohli was to have conversation with you. But for some reason she has to she had to take leave. But she had raised one question which I am putting on her behalf. Note my question, she said, has not the separate carving out of shareholders or sources of defense expenditure of centre undermine reduced devolution to States.

So states does this respect required correction for by future finance commission, and would the overall (indistinct) through this in inclusion have impacted revenue deficit expansion of some or all states directly or indirectly?

PINAKI CHAKROBARTY:
Well, that was a TOR but Finance Commission actually hasn't carved down anything for defence.

So that TOR was also in a way it was not an implementableTOR, but, why in fact, there was a seminar where I made this point, I made this point when this over was, given as additional terms of reference to the Finance Commission, it is about assessing expenditure need of the Union government because defence is in the in the union list. Now, if we separate out a fund for defence, then they expenditure need that… the Finance Commission would assess will be total expenditure minus defense. Right. So in and then if we talk about devolution then the expenditure need of the union will be much less than the states because defense has already been come down. So… I think, I think this TOR actually had no meaning, but it created unnecessary controversy and financed cohesion I think did the right thing.

They said that anyway, Union government expenditure has been assessed. So there is no separate fund required for defense. I think that's the best thing to do it.

JANAK RAJ:
Yeah. So now that next phase 16 Finance commission has been set up. So what according to you should be the reform agenda for this 16 Finance Commission?

PINAKI CHAKROBARTY:
I think the Finance Commission should not be taking up any reform agenda. Finance Commission's job is to divide resources between the union and…..

JANAK RAJ:
No, no, I mean to say in terms of no, no, it's not a political party.

PINAKI CHAKROBARTY:
Yeah. So… I think Finance Commission should… the constitutional mandate is very clear. No, no.

JANAK RAJ:
No, no, I'm… aware of that. What I was trying to say that whatever parameters it has, that it which it takes into account, like how it can divide in order to have better equity terms of vertical transfer and also for horizontal transfers.

PINAKI CHAKROBARTY:
I don't want to, you know, make it guess there, but I think 3 or 4 issues will become very important. I think first issue is that we are talking about an elevated level of debt and deficit, which was not the case when the 15th Finance Commission was considered. Debt was low, deficit was low. I think Finance Commission, though, that (indistinct) very constitutional kind of it is built. You are only three issues have been given to the this finance commission. So it depends how finance commission approaches. It can be very expensive. It can also be very restrictive. So… that that would depend on the Finance Commission's approach. But I think 3 or 4 issues they have to consider, I think I think what is going to happen to growth in the next five years, because that would determine how much that will be available. That is one. Associated at a very realistic estimate of growth will be very important. Second, I think Finance Commission needs to give a part. I think there needs a policy. I think for the purpose of fiscal stability, finance Commission needs to give a path of deficit to a new level. It cannot be, you know, something which was pre-COVID. I think, given that there is a high debt and everything, what is and realisable path what can we actually achieve that kind of an exercise finance commission needs to do? Third issue, I think that as far as specific issues are concerned, they said, you know, Tamil Nadu share has declined. Karnataka is saying that it is creating fiscal instability. I think if there are, I think I think the issues that is arising due, if there is a decline in transfer in real terms and that created a fiscal instability, I think how these state specific concerns can be addressed and specific purpose, intervention grants, etcetera can be thought of. But the basic structure of finance commissions, devolution and the duty of it, if we look at for the last of last 75 years, I think the focus is equity, and I think it will continue to remain the focus.

JANAK RAJ:
Well, thank you very much. I'm done from my side now and you need to…. Rajat.

RAJAT VERMA:
I think, before I just open it to the floor. I also had one question, while we were talking about (indistinct). Right. do you think the, the, the principle which the 10th Finance Commission used, and saying that, you know, we have more integrated economy now and so therefore you don't you, you cannot use collection as a base as an indicator.

Can similar principle be also used to include (indistinct) within the divisible pool.

PINAKI CHAKROBARTY:
Of successive finance commissions, actually to include divisible pool in the (indistinct) into the divisible pool require a constitutional amendment. The Finance commissioners have said that have a constitutional amendment, but it was not done.

RAJAT VERMA:
But thank you. So let me now open…

LAVEESH BHANDARI:
So you've, very interesting, points and really fascinating discussion. You framed this problem or the set of not not the problem, the issue that north and south, let me throw a question to do, which I feel is more like east versus west. And that's actually related to the climate change and all the transition that we are going. A lot of the renewable energy assets that are coming up from the western side of India and coal, is on the eastern side. How do you think this will Impact some of the transfer issues? And as we go forward.

RAJAT VERMA:
Let me collect two more, one from here…

ANONYMOUS:
Although you mentioned very clearly just a little while ago that Finance Commission isn't a policymaking body, but the whole question of devolution, linking it to development and to meaningful expenditures predicated upon whether or not you are able to achieve a meaningful delegation to the third tier also. So whenever we looking, whenever we are looking at, you know, urban centres or cluster the growth centres, a lot of it can be achieved only if you are able to create institutions and delegate you know, some financial power to the urban local bodies or to the panchayati raj institution. Now, although there is no constitutional mandate, as my understanding is concerned, for financial commission to actually impose. But how can this be tweaked in a manner that, states actually start devolving? Because the bane of, financial devolution has been centre does not devolve powers to the state. State does not devolve it to the (indistinct) and the urban local bodies.So what would be your suggestion? Or how. ….This, you know, how this conundrum can be circumvented?

RAJAT VERMA:
Thank you. Yeah. Professor Chadha and then Professor Mathur.

RAJESH CHADHA:
Thank you. Doctor Chakraborty, listening to you once again after some time was pleasure. And you referred to, GST being one of the major reforms. And you recall that in the 13th Finance Commission, the GST was suggested, but later implemented in 2017. So around seven years ago, and in between came the 15th Finance Commission. Would you, would you have something to tell us about how did the GST reform and the role of Finance Commission played, played out in the 15th Finance Commission? And has it really made any difference because this is supposedly one of the… major tax reforms? Thank you.

RAJAT VERMA:
Professor Mathur…And then we can.

OM PRAKASH MATHUR:
Pinaki, you did a very fine, very intensive, study for the 15th Finance Commission or the State Finance Commissions. But, you know, nothing really happened in terms of the Finance Commission taking into account the fact that two of you and your colleagues had done that the conclusion was the same, what had been noted by the earlier Finance Commission as well, that we are not able to use it. How how do we sort of get over this issue of not being able to use the State Funds Commissions the you know, prima facie, it would seem that it is very difficult to make use of the (indistinct) reports on the ground that the power rules and functions of the municipalities in different states are very, very different. And therefore, to frame a common thread out of that, to be able to be used by the (indistinct) it's a very difficult undertaking, but do

you see any possibility, that there is an opening somewhere which is not being exploited or which is… not come to our attention? This is that this is one question. The second question, just going back to the work that you did. And if you combine that work along with all the data which is, which has come out of the 15th, but particularly the 15th Finance Commission, which sure is somewhat similar issue North-South in municipalities, everything was just fair. You will find that the southern municipality, the southern states, and also the west, there's this part. So there is a problem east and west as well as north and south when it comes to (indistinct)…..Do you think the time has come when this kind of a and this issue or the East-West issue in matters of urban local government finance should also be front loaded? These were the two points just on the… defence issue that Dr. Janak Raj raised for this commission have started making recommendations for the cantonment areas now. So there is this very minor opening that we see coming from the Finance Commission on the defence front. That's all.

PINAKI CHAKROBARTY:

I think, on coal and renewable and, East-West, division, I think… it's an extremely complex issue. If we are talking about, you know, transition to a more, renewable kind of, energy, mix. And… trying to stop fossil fuel production. I think it has got huge revenue implications for poorer regions, I think. And he's also, 3 or 4 states, Jharkhand, Chhattisgarh, Odisha and West Bengal and, and it's also an issue of livelihood transition, I think. And since these states are also dependent heavily on Indian (indistinct), but I think except West Bengal I think what what is the revenue implication of this transition for these states, and what is the expenditure implication of these transitions because there is a need to provide livelihood security to these people who will be displaced and need alternative livelihood, I think needs quantification. And that that hasn't been done. I think that that is apart from the kind of climate sensitive expenditure that we should do for mitigation, adaptation and loss and damage. So I think we will find an extreme inequality in terms of resource requirement and resource transition, that resource requirement for a transition that would be required. But what more work? In terms of, you know, taking both revenue and expenditure side, just looking at transition, I think it hasn't been done. I think that is… very important. Third tier of local bodies , of PRIs and ULBs the question that you raised, I think I think I would say that a couple of things have happened. I will one good thing that has happened, I think we have been talking about there is no data available in the local level. I think data has become it is not that bad now. I think it has improved and improved significantly. That's the first point. RBI has published a report on municipal finances. They have published a report on Panchayat finances. The trying to make it as an annual publication and city finance portal has statewide data. So I think I think there is a lot of data that is available may not be very robust, but I think now that we have started getting data, I think it is also about making this data comparable because municipal accounts, account the way it is. Okay. If there is no tender standardisation and definitions are not really strictly followed. So in that case, I think a company like if we look at big finance account, we know if it is an income tax revenue, you know, what is income tax revenue. But what is so local, what is whether you are looking when you look at property tax, whether it is actually property tax or not, you do not know. So I think… it is very important to have that standardisation and quality of data has to improve. On the question of PRIs and UBLs I will also add the two questions that you raised. I think the study that we did for the Finance Commission, for 15 Finance Commission, we were looking at (indistinct) reports and then we had this understanding, we started, you know, then quantifying it, how much delay you need. But I started up submitting the report, how much delay in taking action taken report, etc., and then how many reports have been rejected by the state government. And then we had a closer look at the (indistinct) report. And some of the safety recommendations were not implementable. So rejection was because it couldn't be implemented because one of the states, it said that you should give transfers based on budget estimates of revenue. Now it will give it on the basis of budget estimates of revenue. How do you then actually reinforce that with 1000 - 500 local governments, if financial management will then become a big issue, this also. So there are two issues. One is the point about quality (indistinct) reports. So I think there is wide variation in quality of (indistinct) reports across states. I think there is some kind of it is very difficult. This reform is probably next to impossible, but I think some discussions should happen. I think 14 Finance Commission started meeting and I actually met all the, past SFC members and chairmen and I and if there were aspects of any of this particular state, they also came. I think such consultation Finance Commission should do. I think it's more about, you know, sensitising its offices, to do something. Second thing I think is if is do not follow the Constitution mandate in most states, because the divisible pool is very clear, even in that 73rd, 74th constitutional government, in some states this is its own revenue. In some states there is a total revenue. Some states this is the part of the tax, I'm sorry, the one tax. So so we really do not know. So I think there is a need to sensitise, have more discussion on these issues. On the question of not is owed municipal revenues sir, I think, I think it has also got to do with, rural, the kind of prosperity these regions have. I think that itself actually impacts the revenue. And if we look at per capita property tax collection, I think… it's a much higher in the southern states compared to say, by East or North. So one part is, the other part is the natural growth, etc.. I think, I think we need to look to, to have more work on that. I really do not know. But I think this inequality is going to be more as it is, become the drivers of, greater, you know, prosperity and growth. Right? I think there's a need to look at this on the GST and 15th Finance Commission and the I think my understanding, is that since Finance Commission is a constitutional body and GST is also a constitutional body with a very different mandate, I think, I think coordination is important, but Finance Commission should not be entering into an area of taxation which is purely on policy. I think that the 15th Finance Commission, they have taken note of the development, but I don't think it has actually impacted the decision on transport. But I think I thought that was the most prudent thing to do.

RAJAT VERMA:
So there's also one question from online, by Mr. Abhay and he says, do you see any merit in calculating income distance at the level of districts?

PINAKI CHAKROBARTY:
With I think at the level of districts, there was some discussions in Finance Commission report, but ultimately all finance commissions ended up taking strict per capita income because, you know, it's a devolution to the state. So it's also an entire district…. Inter-State inequality is a state subject... and then and then, but if and so the central government giving money on the basis of districts can can be be quite challenging.

RAJAT VERMA:
But are there any more questions? Okay. so just this round for Shifali and then…

SHIFALI GOYAL:
So thank you so much, Professor Chakraborty, for this insightful presentation. So my question is largely about North-South debate. So since there have been arguments, that some states, especially, southern states like Karnataka, Kerela they have been complaining of, declining share in the devolution of taxes. So there have been arguments that these states may also make a plea that, calculation of GST, we may exclude income from exports as it do not yield taxes to these states.So do you think is it a fair, fair ask of these states? Like, what's your view on that?

PINAKI CHAKROBARTY:
Yeah, that's a very important question. I think. I think it's just, export is zero rated, so, so socially. So the more you export, your tax goes down because you also have to give input tax credit to the exporter. So that way, certainly if we look at as first round effect, certainly there is an impact, but which we have to look at. The second round effect also because when there is a growing unit which is exporting, actually, it also contributes to the local economy that has an impact on growth, that has a multiplier effect. So, yes. But if we are not exporting, what is the counterfactual that we are not doing right. And if we look at six states contribute more than 50%..... 7 states contribute more than 50% of India's GDP. And their combined share in India's export is 73%. So, so so I think that argument that I am exporting, I am not getting revenue is.

RASHMI KUNDU:
Thank you, sir, for the, wonderful presentation. I have a question regarding the condition side by the 15th finance condition. So they had put forward two conditions, for the states to be eligible for intergovernmental transfers, and one of them being that from 2020, 23 to 24, growth in property tax collection should be at least equal to the average growth in the state GDP in the past five years. So given the state of property tax collection in the country, do you think stringent conditions such as these might backfire and make states and especially local governments, more funds strapped?

PINAKI CHAKROBARTY:
Okay. yeah. That was a condition which, you know, which actually assumes that, property tax will grow equivalent to the rate of growth of GST. I think I think that condition is, it can work for first two, three years because the states (indistinct) and all but to assume that, you know, property tax will grow at the rate of the SDP, may not whether it is directly related or not, we really do not know. And that condition can result in lower absorption of fund, that… part. But what I do not know actually what has happened. We have to look at that data. But that's a very important, point that you are making.

(indistinct)

JANAK RAJ:
I just want to know one another. I think I would what point to give us some of the key. So when we take that into account, we need to take that into account based on a cycle. Because property market has cycles so like 8 to 10 years cycle. So there could be phases when the property side market is booming, you have to have high taxes and there'll be period of 8 to 10 years when the property market is depressed. So what I'm saying is that all we are taking into account, it should be measured only for based on the cycle year rather than on a year on year basis. Yeah. yeah. Yeah, absolutely. Yeah.

ANONYMOUS:
So my question is regarding that recently, there was a tussle between the government and the central government, and only after the intervention of the Supreme Court, some relief was provided in terms of. But they were not unable to pay even the salaries. So how do you see that as well, in the context of North-South debate? Because to expect that from like a southern state facing the fiscal. Not the fiscal but the revenue crises. So do you think that the limit that is there should be state specific or the uniform one? And what should be the criteria to like, set that limit that a state cannot cross.

PINAKI CHAKROBARTY:
Well I? I really do not know, but I, my my broad answer would be that center and state should talk. They should not talk about codes. So so that's the only answer I can give at this stage.

RAJAT VERMA
Okay. Thank you very much. So now I think, let me ask Shruti to closing.

SHRUTI GUPTA:
Good afternoon everyone. Hello. Yeah. So as we conclude this insightful discussion on the transfer of budgetary resources to states, I would like to express my gratitude to our distinguished speakers. Professor Chakraborty and Janak Raj , for their valuable contributions, and Rajat for moderating this and all of you for an active participation. We delved deep into the complexities of budgetary allocations, exploring whether the issue is truly a North versus South debate, or if a more integrated approach is necessary. Professor Chakraborty, provided a comprehensive overview, emphasising that while sharing of union taxes and grants are fundamental to addressing regional disparities, there are several other criterias to be pondered upon as well. The criteria for tax devolution and grants must be designed to ensure equity and efficiency in balancing the development needs of less developed states. Cooperative federalism is paramount for ensuring that the allocation of resources supports national growth and regional development simultaneously. A significant takeaway from today's discussion is the idea of capital grant fund mechanism to boost and equalise infrastructure growth among states. More focused, centrally sponsored schemes should also be thought upon. Besides, non budgetary transfer should be evaluated to get a better idea of the total transfers to each of these state. In this in all of this data transparency and better or better data availability plays a big role. So looking ahead, it is clear that we must continue the discussion on strengthening the federal structure. At CSEP we continue to make efforts to evaluate the role of states in various areas of development, from health to climate change. We are also actively working on fiscal transitions and its distributional impacts. In closing, let's take today's discussions back to our respective fields.

Thank you once again to speakers, to the organisation, organising committee and, to all the participants. Lunch is set up in the reception area. So you may proceed towards that. Thank you.