Reimagining India's Fiscal Federalism

What is the issue?

There is a need to refresh India's fiscal federalism by restructuring its four pillars.

What is the need?

- India's Constitution-makers thought of India as a union of States with a strong centre.
- It was done to preserve the unity and integrity of a newly fledged nation.
- Since then, the Indian economy, polity, demography and society have undergone many changes.
- India is now firmly on a growth turnpike.
- It is in this context that we need to redesign India's fiscal federalism around its four pillars.

What are the 4 pillars of India's fiscal federalism?

- Finance Commissions
- NITI Aayog
- Decentralisation (Local public finance)
- Flawless or model GST

What are the imbalances faced by federations?

- **Vertical imbalance** - It arises because the tax systems are designed in a manner that yields much **greater tax revenues to the Central government** when compared to the State or provincial governments.
- The Constitution mandates relatively greater responsibilities to the State governments.
- **Horizontal imbalance** - It arises because of **differing levels of attainment by the States** due to differential growth rates and their developmental status in terms of the state of social or infrastructure capital.
- It involves two types of imbalances.

1. Type I is to do with the adequate provision of basic public goods and services.
2. Type II is due to growth accelerating infrastructure or the transformational capital deficits. They are known to be historically conditioned or path

dependent.

How can the pillars be strengthened?

- **Finance Commission -** Union Finance Commissions should only be confined to focussing on the removal of the horizontal imbalance across States of the **Type I** Horizontal imbalance.
- **NITI Aayog -** It is the most appropriate institution to tackle the Type II horizontal imbalance.
- Planning Commission used to give grants to the States as conditional transfers using the Gadgil-Mukherjee formula.
- Now as the Planning Commission disbanded, there is a vacuum as the NITI Aayog is primarily a think tank with no resources to dispense.
- NITI Aayog should be engaged with the allocation of capital in a formulaic manner, complete with incentive-compatible conditionalities.
- It should be mandated to create an independent evaluation office which will monitor and evaluate the efficacy of the utilisation of such grants.
- **Decentralisation** - It is crucial because **intra-State regional imbalances** are likely to be of even greater import than inter-State ones.
- It can be strengthened by forming **local public finance** through the creation of a local body consolidated fund.
- This **requires the amendment** of Articles 266/268/243H/243X of our Constitution to ensure that relevant funds flow into the consolidated fund of the third tier.
- Further, the **State Finance Commissions** should be accorded the same status as the Finance Commission
- **GST -** GST should be simplified and coverage should be extended.
- Centre and States should **contribute an equal proportion** of their **CGST** and **SGST** collections to the local body consolidated fund.
- The **GST Council** should adopt **transparency** in its working, and create its **own secretariat** with independent experts also as its staff.

Source: The Hindu

Quick Facts

Finance Commission

- **Article 280** of the Constitution of India provides for a Finance Commission.
- It is a **quasi-judicial** body.
- It is constituted by the President of India every fifth year or at such earlier time as he considers necessary.
- The recommendations made by the Finance Commission are **only of advisory nature** and hence, not binding on the government.

NITI Aayog

- National Institution for Transforming India (NITI Aayog) was established replacing the Planning Commission.
- It was established on January 1, **2015**.
- It was created by an **executive resolution** of the Government of India (i.e., Union Cabinet).
- Hence, it is neither a constitutional body nor a statutory body. It is a **non-constitutional or extra-constitutional** body.
- It is the premier **policy 'Think Tank'** of the Government of India.
- In the spirit of federalism, NITI's own policy thinking too is shaped by a **'bottom-up' approach**.

GST Council

- It is a **constitutional body** established under **Article 279A** of Indian Constitution
- It makes **recommendations** to the Union and State Government on issues related to Goods and Service Tax.
- The GST Council is chaired by the Union Finance Minister and other members are the Union State Minister of Revenue or Finance and Ministers in-charge of Finance or Taxation of all the States.
- The Constitution **(122nd Amendment) Bill**, 2016 was passed in Parliament for introduction of Goods and Services tax in the country.
- Consequent upon this, the same was notified as the Constitution (**101st) Act**, 2016.

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