

Steps to ease the Fiscal Federalism tension

What is the issue?

- The fiscal relationship between the Centre and the States is deteriorating fast recently.
- The one tangible solution to restore the fiscal balance is to grant State governments the powers to levy income taxes.

What is happening now?

- After the Centre's entry through the Goods and Services Tax (GST) into the territory of taxation powers of States, it is now arming itself to elbow the States out entirely of its fiscal powers.
- This is a dangerous development, especially coming at a time when the nation is at its divisive worst.
- The primary responsibility of a State's elected government is efficient governance and accountability to its voters.
- This government is typically granted the powers to be able to raise revenues through taxation of its citizens and incur appropriate expenditure for their benefit.
- Over the past five years, democratically these governments have been stripped of almost all powers of taxation.
- There is an attempt to palm off the Centre's expenditure obligation to the States and there is now talk of even limiting expenditure powers of the States.

What is the meal scheme lesson?

- In 1982, the Chief Minister (CM) of Tamil Nadu MG Ramachandran (MGR) wanted to expand the midday meal programme to all 70 lakh children across 52,000 government schools to improve student enrolment.
- This entailed an additional expenditure of ₹150 crore, which the government didn't have.
- MGR decided to levy an additional sales tax on goods sold in Tamil Nadu (TN) to cough up the amount needed.
- The programme was then further expanded by successive governments under the Dravida Munnetra Kazhagam (DMK).
- In just three decades, TN was counted as one of India's most literate States

(Literacy rate - 54% (1981) to 83% (2011)).

- MGR and other Chief Ministers of TN made the decision to implement a midday meal programme and impose additional sales taxes to fund it in Chennai itself.
- But in today's India, MGR would have had to dash to Delhi and seek approval.

Why is this today's case?

- Typically, more than 80% of government's revenues come from taxes, primarily from income tax (direct tax) and sales taxes (indirect tax).
- State governments in India don't have powers to levy income taxes.
- With GST, the Centre stuck its nose into the metaphorical indirect taxes tent of State governments.
- States lost their sole powers to levy indirect taxes.
- Instead, they depend on a GST Council to determine tax rates and revenues, in the mischievous disguise of cooperative federalism.
- So, a democratically elected State government in India can neither levy income tax nor sales tax.
- Representation without taxation, as the Americans might say.

What are the planned steps?

- The Centre has proposed that there be a **permanent expenditure fund created for defence spending** out of the total tax revenue pool.
- Instead of using Centre's share to spend on defence, the present government wants to palm off this expenditure to all the States.
- This will likely further reduce the tax revenues distributed to States for their own expenditure.
- Under the garb of nationalism, it wants to further dilute the overall tax revenue pool of the States.
- Now there is talk, supported by the Prime Minister's economic team, of constituting an **Expenditure Council**, similar to the GST Council.
- With this, the States will lose their taxation powers along with its sole spending powers.
- An elected CM of a State with no discretionary powers to earn or spend for the people of the State can virtually hand over the reins of governance to Delhi.
- It is a terrible mistake to presume that all of India can be governed from Delhi as it has huge economic and cultural diversity among the various States.

What is the solution?

- The one tangible solution to restore this balance is to **grant State governments the powers to levy income taxes.**
- Since the birth of the republic, State governments haven't had the powers to levy income taxes on citizens, except for the agriculture taxes.
- In large federal democracies such as the US, the State governments and local governments have the right to levy income taxes.
- In India, it is vital that democratically elected State governments are given powers to raise revenues and incur expenditure in accordance with each State's needs and priorities.
- It is foolhardy to think that a council in Delhi can determine all revenues and the expenditure of each State.
- There is a new report of the **direct tax code** that has been submitted to the Finance Minister recently.
- The present government's biggest intellectual misgiving is perhaps its inability to make a distinction between unity and uniformity.
- **Uniformity is not an essential condition for unity.**
- On the contrary, a celebration of plurality may foster greater unity in a nation such as ours.
- The days of imperialistic London are over. It is the era of Gandhinagar, Chennai, Lucknow and Kolkata.

Source: The Hindu