Towards a more federal structure

What is the issue?

- India’s choice of a Union, instead of a federal set up, post-independence has had the effect of making states more dependent on the Centre.
- It calls for a rethink, especially given the financial challenges posed by this form.

How does revenue distribution work?

- Direct taxes include income tax and corporate tax.
- In the U.S., both the federal and State governments collect such taxes from individuals and corporations.
- The federal government distributes about 15% of its revenues.
- Unlike this, in India, direct taxes go entirely to the Central government.
- The Central government is then supposed to distribute 41% of its gross tax revenues to the State governments.

What are the concerns?

- State governments get funds from the Central government according to the Finance Commission’s recommendations, based on some formula.
- But often politics intervenes and some States get less and some more.
- Usually the Central government does not meet the 41% target.
- Meanwhile, the Central government has added cess on various items.
- This adds up to over Rs.3.5 lakh crore.
- This (cess) is not shared with the State governments.
- At an all-India level, the States get 26% of their total revenue from the Central government.
- Some of the so-called poorer States get up to 50% of their total revenue from the Central government.
- This makes them even more dependent and gives more economic power to the Central government.

How is regional disparity reflected?

- Maharashtra, Delhi and Karnataka contribute the major share of taxes to the government.

- These three regions along with Tamil Nadu and Gujarat contribute 72% of the tax revenue.
- Uttar Pradesh, which has the largest population in India, contributes only 3.12%.
- But, it gets over 17% of the revenue distributed by the Central government.
- Revenue distribution is based on complex considerations including population and poverty levels.
- For every Rs.100 contributed, southern States get about 51% from the Central government, whereas Bihar gets about 200%.
- The population growth rates in the south have come down to near zero.
- On the other hand, population continues to grow in central and north India.
- So, the cross subsidy from the south to the north will continue to grow.

What is the way forward?

- Making the fund allocation fairer is almost impossible because of politics.
- So, looking beyond the current framework is pertinent.
- One step could be to provide greater economic power to the States.
- With this, they can directly collect more taxes and be less dependent on the Central government.
- For poorer States, a period of transition is perhaps required.
- In all, a transition to a more federal structure would improve Centre-State relations.

Source: The Hindu

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