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Fiscal Federalism

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Why is in news? The severe erosion of fiscal federalism

On February 8, Kerala Chief Minister Pinarayi Vijayan will lead a protest in New Delhi against the Centre for "placing Kerala on a financial embargo". The Kerala government has accused the Centre of pushing the State into a severe financial crisis by imposing a limit on its borrowings.

Kerala has moved the Supreme Court contending that the **Centre's imposition of a Net Borrowing Ceiling (NBC)** on the State, which limits borrowings from all sources, violates Article 293 of the Constitution. The wide array of constitutional issues that are now thrown open point at the severe erosion of fiscal federalism in the country.

About Fiscal Federalism:

It deals with the **division of financial powers** as well as the **functions between multiple levels of the federal government**.

It has within its **ambit the imposition of taxes as well as the division of different taxes** between the Centre and the constituent units.

Similarly, in the case of **joint collection of taxes**, an objective criterion is determined for the fair division of funds between the entities.

Usually, there is a constitutional authority (like Finance Commission in India) for the purpose to ensure fairness in the division.

Some measures to achieve Fiscal Federalism:

The Constitution of India defines the **powers and functions of taxation and expenditure for different levels of government**, with clear demarcation between the central government and the state governments.

The **Finance Commission** is a constitutional body (Art 280) responsible for recommending the distribution of tax revenues between the central government and the state governments. It also suggests ways to augment the financial resources of states, promote fiscal discipline, and ensure stability in fiscal matters.

The **GST** is a comprehensive indirect tax that replaces multiple central and state taxes on goods and services. It's administered by a GST Council consisting of representatives from the central and state governments.

The **grants-in-aid system** (Art 275) involves the discretionary transfer of funds from the central government to state governments for specific purposes or schemes. These grants aim to supplement the resources of states and address regional disparities and developmental gaps.

Challenges to achieve fiscal federalism:

The **share of the States in divisible pool is shrinking** despite their carrying a higher burden of expenditure

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High share of committed expenses: Status of States' financial health had taken a turn for the worse with the implementation of the Ujwal DISCOM Assurance Yojana, farm loan waivers, as well as the slowdown in growth in 2019-20.

Pandemic impact has worsened the fiscal positions of State governments.

Dependence on centre: The major source of revenue of other States is Central transfers. The Constitution grants the Union government more revenue raising powers while the States are tasked to undertake most of the development and welfare related responsibilities.

Imbalance: According to the 15th Finance Commission's report, in FY19, the Union government raised 62.7% of the total resources raised by the Union government and States, while States had borne 62.4% of the aggregate expenditure. This allocation of taxation powers and expenditure responsibilities results in an imbalance and the gap between the share recommended by the FC and the actual devolution has widened.

Inequality: India's fiscal federalism driven by political centralisation has deepened socio-economic inequality, belying the dreams of the founding fathers who saw a cure for such inequities in planning.

Allegations of bias: There have been allegations of political bias in the allocation of funds to the states, which undermines the principles of equitable distribution.

Inadequate data and assessment: The assessment of the needs of the states may not always be accurate due to inadequate data and varying criteria for allocation.

Suggestions:

Distribution of resources was also essential **alongside decentralisation of powers** for achieving economic growth.

The Union government needs to **invest resources towards facilitating effective consultation with States** as a part of the law making process.

It is critical that the Union establishes a system where citizens and States are treated as partners and not subjects.

Recommendations of PV Rajamannar committee of 1971 needs to be considered which suggested that the Finance commission be made a permanent body.

Local governments should be strengthened by providing them with adequate resources and powers. This will help in ensuring that the funds are utilized effectively at the grassroots level.

Address Regional Disparities: Special attention should be given to the states that are lagging behind in terms of socio-economic indicators. This will help in reducing regional disparities and promoting balanced development.