DECISION TO USE OF 2011 POPULATION DATA AS A PARAMETER FOR HORIZONTAL DEVOLUTION AND ITS CHALLENGES BEFORE 15TH FINANCE COMMISSION IN UPHOLDING FISCAL FEDERALISM

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Abstract: -

The present XV Finance Commission has a major task on hand in putting in the transfer system consistent with the recent changes in fiscal federalism, in promoting the co-operative fiscal federalism, with the implementation of GST and ensuring the fiscal stability. In the *inter-se* distribution of the aggregate share of States in Central tax revenues, the population has always been used as the explicit and implicit criterion for the horizontal devolution by the all previous Finance Commissions (F.C).

As per the TOR of the 15th F.C, "*the Commission shall use the population date of 2011 while making its recommendation"*. So there is an argument, that this incremental change to use 2011 population data does not provide adequate cause and it is against the federal spirit of the nation, also the TOR of the 15th F.C for the first time Commission mandated to come up with "measurable performance based incentives" in the progress made by a state towards replacement rate of population growth.

The TOR's of the 15th F.C are significantly different from those of earlier Finance Commissions. While some of the changes are within the mandate of the Constitution, some do not appear to be so. Others appear extraneous which urge the commission to asymmetrical treat a group of States. This Article would this explore this difference and examine whether it will split open demographical fault line between the States or help in bringing the economic equality within the Indian Union.

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1. INTRODUCTION:-

Federalism is the institutionalized arrangement that confers "inextinguishable rights" on sub-national governments. Federalism is supposed to bring about political and fiscal decentralization to realize administrative and economic efficiency in the delivery of public goods. Optimal allocation of powers and responsibilities amongst governments at various levels in a federation is a significant and ever-relevant issue.

The federal entity in India comprises Central/ Union Government, twenty eight States, two Union Territories (UTs) with legislature, five other UTs, several autonomous regions within the States, a three-tiered structure of rural and urban local bodies and an asymmetrical Constitutional setup of the State of Jammu and Kashmir and asymmetric economic treatment of ten Special Category States. Fiscal arrangements in India has got the pre Constitutional roots, especially the Government of India, Act 1935 which established a clear–cut demarcation of subjects coming under the Centre, States and Concurrent. With the independence of the country, the post-constitutional arrangements which have run a course more than 60 years constitute dynamic and lively experiments with the fiscal federalism. India has evolved a *sui generis* kind of federalism which is completely different from the accepted notion of federalism. The evolved Indian federalism is very unique in character and the Union- state relationship has become extremely complex over the years.

Federalism is once again in the focus of political discourse in India as the four southern states Finance Ministers have set the cat out among the pigeon, on the issue of Terms of Reference (TOR) fixed for 15th Finance Commission. The meeting of Finance Ministers have raised several issues and objections' regarding the TOR of 15th F.C, one among was the mandate for the Commission to take into account the 2011 population data for devolution formula, over the previously used 1971 population data, as the population of the southern states have been stabilised over the years, the concern is that their share of tax allocation would reduce.

1.1 RATIONALE FOR FISCAL FEDERALISM

Decentralisation is the best way to ensure that the supply of government services is suitable for regional needs. The reason for this is, first of all, that the government authorities possess better information on the preference of their residents. And also the local citizens can themselves better articulate their needs at the local level. In federalism, the Regional or State governments have their own rationale. On one hand they want to fulfil the desire to be under common central government; on the other hand, they want to act independently to meet the individual needs of their religion.

Even in the case where the primary responsibility for the provision of local public services are devolved to the subnational governments, some portion of required financial portions are ought to be made available to the local governments through intergovernmental transfers due the mismatch between the revenue capacity and expenditure need of the subnational governments; The justifiable reasons for the intergovernmental transfers are to equalize “vertically” (improve revenue adequacy) and to equalize “horizontally” (inter-jurisdictional redistribution). It is widely accepted that the decentralization of expenditure responsibility magnifies efficiency; competition among jurisdictions in providing the basic service results in better efficiency. On the other hand, as long as the resources are more centralized than expenditure, there is an imbalance between their expenditure need and resources at different tires of the government. But most in the all federal countries Constitution have assigned the revenue and expenditure is according to the principle of comparative advantage results in the Central/ Union government have been able to access broader tax and the subnational governments having the responsibilities to provide welfare and social services. Furthermore, there is a wide difference between the States to raise the revenue as the size of the tax bases varies, with these variations in the tax base in the States results in the variations in the standard of public service provided, which goes against the basic feature of federalism, providing the equal level of public service at comparable tax rate is the essential of federalism. This vertical imbalance (between the centre and states) and horizontal imbalance (among the states) will have to be resolved through the system of Intergovernmental fiscal transfers (IGFT) from the centre to states.

2. FINANCE COMMISSION IN INDIA- AN INSTRUMENT OF EQUALIZATION:

Constitutional framers have recognised the facts that the financial resources of the States may prove inadequate for undertaking welfare and development activities so they devised a unique and *albeit complex* arrangements relating to the flow of funds from the Centre to the

States. Thus the equilibrium between the functional responsibilities of the State and revenue need is revised by the Inter-Governmental Fiscal Transfers IGFT through the Finance Commission and other various channels.

The Constitutionally mandated functions of Finance Commission under Article 280 are reproduced as such in the TOR of all the Finance Commission, I) the distribution of net proceeds of divisible pool between the Union and the States; II) inter se distribution of State's share; III) principles which should govern the grant in aid to States by the F.C, IV) measures to increase the Consolidated Funds of a State to supplement the resources of panchyats and municipalities V) any other matter can be referred to F.C in sound interest of Finance.

It was in 1950-1951 budget session speech that the Finance Minister had announced the constitution of first Finance Commission, an epoch- making constitutional arrangement for the evolution of fiscal federalism in India. Since then 13 more F.C have submitted their reports, the last being the 14^{th} F.C which submitted its report on Feb 24, 2016, with the mammoth 42%(which is 10% increase from previous 13^{th} F.C) devolution of taxes to states. Since, the 12^{th} Finance Commission was explicitly charged in its TOR with the reference to review the current state of the finances, deficits and debt levels of the Union and States and to recommend a fiscal consolidation roadmap for sound fiscal management.

Recommendations of the Finance Commissions constitute the core of fiscal federalism in India. Reports of the Finance Commission highlights contemporary issues in Centre- State relations and record measure suggested by the Finance Commission, from time to time, to solve them.

The XV-FC has been appointed at a time when there have been significant changes in India's fiscal policy establishment. The Planning Commission, which watched over the development needs of the country, has been replaced by the NITI Aayog, which does not have the allocative role- thus the problem of multiple channels of resource transfers is addressed. This has also meant that the distinction between plan and non-plan expenditure, has conferred full freedom to the XV FC to look at the entire revenue expenditure. Further, with the introduction of Goods and Services Tax, wherein the union and states share a larger common tax base and there are expected changes in revenue collections. As the revenue impact of all the States was yet known after the implementation of GST, the XV FC will have the challenging task of addressing these issues as its recommendations are applicable till 2024-2025, beyond the five year duration of compensation scheme under the GST.

3. CRITICAL EVOLUTION OF TERMS OF REFERENCE OF THE FIFTEENTH FINANCE COMMISSION:

3.1 USE OF POPULATION DATA IN SHARING OF UNION TAX REVENUES:-

The Population has always used as an important criterion for determination of horizontal devolution among the States, to enable the States to provide a comparable level of services at comparable tax rates. "Population is an indicator of the expenditure need of a state. It is a simple, objective and transparent indicator that ensures predictability". Because the larger the population the greater will be the expenditure need, it is the only criterion ensures the equal per capita transfers to all states.

Finance Commissions which are obliged to ensure the poorer States have adequate resources to finance socioeconomic development and critical infrastructure, to ensure balanced regional development that's inclusive and equitable. That would invariably mean higher transfers to the laggard States, sometimes at the expense of the more prosperous ones. Therefore, the fears of southern States are not entirely misplaced. Their share in India's population has declined between 1971 and 2011 while that of the economically laggard States of the North has correspondingly increased.

Unlike in the past the previous eight Finance Commissions which were specifically asked to use take into account 1971 population data, the present 15th Finance Commission has been asked to use the 2011 population. Before we analysis the impact these changes may have on the Union Tax revenues sharing, we will examine why the population criterion is signification for States.

3.2 THE POPULATION CRITERION

The Population was allotted a weightage of 80% for income tax devolution and 100% for devolution of Union Excise duty by the 1st F.C. The weightage was reduced to 10 by 11th F.C and it was again raised to 25% by the 12 F.C, 13th F.C retained the 25%. 14th F.C raised to 27.5% which explicitly means that 27.5% of States share in the divisible pool was determined by population.

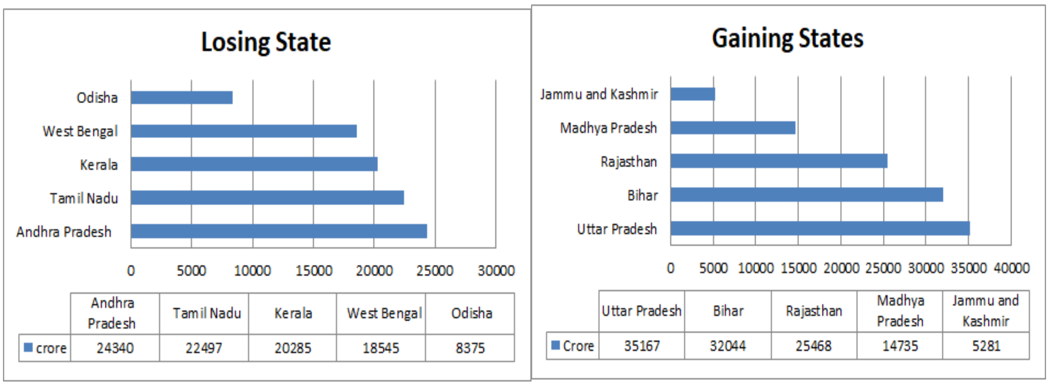
However, does not only impact that the population has in the determination of inter se devolution among the States, the population data are also to sale the other criterions also like per capita income, fiscal distance capacity, and fiscal discipline etc. so, the population is used both explicitly and implicitly in determination a State's Share of the divisible pool. So the use of population data of 2011 can make a huge impact they than the population parameter per se. population criterion is like an iceberg, it much greater than it is visible.

Example- The XIV FC have allotted a weightage of 17.5% to 1971 population data which means directly 17.5% of a State's share was determined on this basis. Indirectly, it has used to scale the income distance criterion to which it had allotted a weightage of 50%.

The direct and indirect use of population in finance commission calculations has marked an effect on States share in the divisible pool. To demonstrate, Chart 1 lists out the top 5 States and the amounts they would have gained or lost their share if the XIV FC has used 2011 population data both in its 17.5% population criterion and in calculating the income distance criterion.

Impact of use of 2011 population data both in its 17.5% population criterion and in calculating the income distance criterion

Chart- 1



Source: Authors own calculation, based on the Report of the XIV F.C

As the Chart 1 shows that by using the population data of 2011 would result in potential losses for the states like Andhra Pradesh, Tamil Nadu, Kerala, West Bengal, Odisha along with Karnataka, Punjab and Assam, because the population of these States has been drastically reduced by implementing various rigours family welfare/ planning schemes. This was in consonance with National Family Welfare Policy, 1977 this was done to ensure that states take effective measures to moderate the growth of their population. The five biggest potential gainers are Uttar Pradesh, Bihar, Rajasthan, Madhya Pradesh and Jammu and Kashmir.

The direction to use the 2011 Population data is not correct because of the following reasons listed,

Over the last four decades, since 7th F.C 1971 population data has been used criterion for the determination of States share of the divisible pool both directly and indirectly, even though the subsequent population data. Direction to use 2011 population data is against the National Family Welfare Policy, 1977 which guaranteed that the 1971 population data will be used as the parameter for the computation of States share in the divisible pool. The assurance was made in the National Development Council (NDC) in its meeting in 1979 again recapped in National Population Policy, 2000. The direction to change the population base to 2011 in the proposed TOR should have been made after consultation with States. This change contradicts the assurance giving by the Centre to the States in 1977, 1979, 2000.

The trust between the federating members is the vital component of vibrant federalism, the trust can be strengthened when the changes in norms are discussed between the members and discussing is made unanimously, if not with the majority. As the southern States believes that they lost the trust will the Centre, as the Centre has made a unilateral decision in adopting the population data.

4. CONCLUSION

TOR of XV FC are considerably different before the previous FC, because some of TOR relative news to the F.C like to make framework of incentivises and deterrents, to reward states that control expenditure on populist scheme, and to provide performance based incentives for States, as some of the TOR of the XV FC appears to urge the commission to asymmetrically treat a group of States. Again going the TOR under part 4(ii) "Effort and Progress made in moving towards replacement rate of population growth" which was added to make that there is no inherent bias or mandate in TOR against the States which made the good progress in population control. As that now is that the XV-FC needs to take an effective view on which it will approach its work, the FC has very duty to remove the fear of the southern states.

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