Interview

"There should be a mechanism by which GST Council and Finance Commission can coordinate": N.K. Singh

PUJA MEHRA

N. K. Singh, Chairman 15th Finance commission, at a press conference in Mumbai on September 19, 2018. File photo: Vivek Bendre

The Fifteenth Finance Commission is up against unprecedented challenges. First, the Goods and Services Tax has introduced an element of uncertainty in the revenue projections of the Union and State governments. More importantly, the Terms of Reference notified for the Commission have stoked controversy so sharp that even the Fourteenth Finance Commission, Chairman Y. V. Reddy, has said that it signals a shift in the balance of power away from States and in favour of the Central government and an attempt at increasing centralisation. The** Fifteenth Financial Commission Chairman, N. K. Singh**, discusses these and other emerging fiscal federal issues with** senior journalist, Puja Mehra**. Excerpts:

You are visiting various States these days. What are States telling you about fiscal federalism?

It is both the tradition and, if I may say so, an obligation to visit all the States before the Finance Commission firms up their recommendations. In pursuance of that the Commission has so far visited 20 out of 29 States. We have nine more to go but I can give you a fair feel of what some of the things the States have been saying. There are some commonalities. There are of course some state specific issues. Let me first share with you some of the commonalities and then one or two remarks on the specifics.

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One of the concerns of the States seems to be the uncertainties on the GST [Goods and Services Tax] and the fact that the 14 per cent [revenue growth] that has been guaranteed to cover the first two years of the Finance Commission's recommendations. What happens thereafter because so far the rates have not reached the fiscal resting point. There is a degree of volatility. Some States have experienced good buoyancy [on GST revenue]. Others have not given that if ST is a consumption-based tax. So, there is uncertainty in the minds of the States. There is also uncertainty on the minds of the Commission on the robustness of the data which we are receiving. We have to make projections on the likely revenue of each State individually by projecting [various sources of revenue]. GST is now the main source of revenue as far as the States are concerned. Most other Sources have got subsumed there. Leaving petroleum, electricity, alcohol and real estate, the bulk of it all has got captured in GST. So one is the uncertainties related to GST, the other is the uncertainties on the compensation regime [for the revenue shortfall given that the Union government guaranteed to States for the first five years after GST's introduction] after the expiry of the two years of the Commission's recommendation

Is it the weaknesses in the GST collection system or in the refunds mechanism that has introduced the element of uncertainty over the robustness of the data?

It's the latter. Particularly the amount of resources unallocated in the Integrated Goods and Services Tax (IGST). That remains a matter for some concern. Some States which are well-known for high growth rate - this has not really translated into GST figures. Others which will be automatically regarded as consuming States, such as Bihar or Uttar Pradesh, have also not made that kind of gain under GST which was initially expected. So the uncertainty related to the GST is one of the concerns the States have projected while giving their revenue projections for the period 2020-2025 to the Finance Commission.

Are the revenue projections showing 14 per cent revenue growth [The GST compensation law guarantees a revenue growth of 14 per cent on the FY16 base to States]?

It's falling short. Also don't forget in the data which we have so far, the buoyancy in the tax revenue given to us by the Ministry of Finance (Department of Revenue) suggests very robust buoyancy with regard to direct taxes but not such a great buoyancy with regard to the indirect taxes. This is also a matter for some concern.

If the economy is doing well then the indirect tax buoyancy should ideally reflect that growth. Is this projection on account of suspected tax leakages?

There are three things. One is exemptions are still there which are not inconsiderable. Second, there's been a lot of recalibration of rates. Third, of course, are leakages. Everybody tells me that it will be a while before technology really catches up. But the fact remains that the buoyancy data on the direct taxes are far more robust and satisfactory than the buoyancy figures on the indirect taxes. That plays in to the kind of projections which the Commission has to make.

The other issue that States do raise is the whole issue of cesses and surcharges being kept out of the divisible pool [of tax revenue collections to be shared between States and the Union government]. We know that this has nothing to do with the Commission because the Constitution leaves cesses and surcharges out of the Divisible Pool. We have assured the States that we will be getting legal opinion which we have on cesses and surcharges. Because currently they are clearly out of the divisible pool. So there is nothing very much the Commission can do.

The third issue is the classic one: Two big elephants in the room are, one, UDAY (Ujwal DISCOM Assurance Yojana) which has led to difficulties in compliance with the fiscal consolidation of roadmap many States both on debt and the fiscal deficit targets. UDAY is a kind of issue which they don't know how to grapple with. Then the second of course there is the Seventh Pay Commission. Pay commissions have so far been coming once in 10 years. This is the Finance Commission which is going to take the brunt of that because the States are factoring its impact in their committed liabilities. This is unlike the previous Finance Commission when they had fully absorbed the Sixth Pay Commission's recommendations. These two are naturally in the calculus of the State governments' projections.

Then some State-specific issues. Take the case of Punjab. The big issue for them is vulnerability of Punjab in multiple ways. It's a border State and therefore there are geopolitical considerations. There have been long years of militancy. Currently, militancy may be in the background but there is the drug menace that affects the youth and the education system. Connected with is a legacy debt of Rs. 31,000 crore. The unsettled dues with the Food Corporation of India (FCI) — both the interest and the principal. Their view is that we are not getting a level playing treatment with FCI with respect to its own agents. They argues that they are only collecting for FCI. In case of FCI agents they get somewhat more favourable treatment than State appointetd agents gets. There differences are arising out of transport charges, gunny bags, storage etc. The time taken from the receipt of the food grains to the payments are part of the same problem.

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Then West Bengal equally has a major concern on what is delivered as legacy debt. According to them, the previous government had contracted large borrowings, interest on which the present government has to pay. West Bengal government argue that their has not contracted these borrowings. The fact that governments are in perpetuity and the successor must pay and bear the cross of all predecessors is embedded in our parliamentary system. There's nothing you can do about it. But the fact remains that this is painful. As a Finance Commission when you look at the fiscal position of each State this will be no doubt reflected and captured in the data. Let us see to what extent the Commission can address up these issues.

Are you hearing anything from the States on the vacuum created by the abolition of the Planning Commission, and the erstwhile plan allocations to States by it?

Not a vacuum as such. But the fact that they reckon the financial losses that they have had to suffer since some devolutions and some resources which they used to get when the Planning Commission do not exist anymore. These included normal plan assistance and some specific ones like backward region grants, adding up to a substantial amount. All that of course came out of the Gross Budgetary Support which used to be given for Plan devolutions by the central budget year after year. But it is the loss of resources they now encounter on account of the Planning Commission not being there. But as a counter factual to that devolutions to the state where very substantial increase from 32 to 42 per cent which enlarge their fiscal space and also these were unconditional resource. There's a very steep rise in the devolution. That was given reckoning with the fact that they would lose the resources which came from an institution that no longer exists. Besides it was a significant movement towards unconditional devolutions.

Now that the Planning Commission doesn't exist, it is expected that you will have to take a holistic look at all resources, both Plan and non-Plan.

I think when you use the word vacuum it is in a broader context. That context is the fact that up to the Fourth or the Fifth Finance Commission it was repeatedly said that the existence of the Planning Commission stymied the work of the Finance Commission because they could not look into the devolution allocation of the Plan resources. Increasingly, the Finance Commission got pushed into concentrating on the Non-Plan instead of the Plan expenditure. In fact in order to address this prevarication of the Finance Commission after the fifth or sixth finance commission, the Terms of Reference were so crafted that they were advised to leave out the Plan part of it and concentrate on the non-Plan. Now that the Planning Commission doesn't exist and the distinction between the Plan and non-Plan (allocations) has also gone, it is expected that we will have to take a holistic look at all resources, both Plan and non-Plan. We are still deliberating specifically to look into the *inter se* and inter sectoral allocation of the vertical devolutions. This is a matter which is still being deliberated. Fact remains there is no way we can absolve ourselves of the obligation to look at the resources on the whole — both vertical and horizontal.

The Planning Commission has not survived but the Centrally Sponsored Schemes (CSSs) have. Entitlement-based schemes launched by the Centre tend to come with fiscal obligations for States. Would you like to address this issue of fiscal federalism?

There are three things. First and foremost, if you look at the Constitution, it does not talk of any Centrally Sponsored Schemes. The Constitution has only what is classically known as the Seventh Schedule. That demarcates the functions for central government, for States and the Concurrent List [the Union, State and Concurrent Lists]. Right from the first Five Year Plan itself, some projects of national importance were taken up by the central government. Such as the Bhakra Nangal project and Damodar valley corporation. Large projects were taken up where both the States and the central government contributed to their funding. That tendency got somewhat amplified in every Plan thereafter.

I see an inherent conflict between the original Seventh Schedule and the use of Article 282 to initiate a large number of Centrally Sponsored Schemes.

There is an inherent conflict between the Seventh Schedule of the Constitution and the use, or if I may use the word, misuse of Article 282 of the Constitution. Article 282 does not come under the financial provisions of the Constitution. It comes under the category of something called the miscellaneous provisions. It was to be used under exceptional circumstances. But exception became the rule and Centrally Sponsored Schemes proliferated under Article 282. Why? Because that was the only way they could be implemented without necessarily transferring the subject from the State List to the Concurrent List or having a separate entitlement based legislation passed by Parliament. So I see an inherent dichotomy and conflict between original Seventh Schedule of the Constitution and the use of Article 282 to initiate large number of Centrally Sponsored Schemes. There is an added complication which is that on a number of subjects, there were also stand-alone entitlement legislations. For instance, the Right to Food legislation. Or the MNREGA [Mahatma Gandhi National Rural Employment Guarantee Act] for the Right to Employment, the Right to Education. So you also have got obligations to which Parliament has given approval. So what do you do now? You have a drawing board which has not been complicated by this government but which if has historically inherited. It’s a complicated picture. You have a number of Centrally Sponsored Schemes. What do you do with them?

Earlier the life cycle for every Centrally Sponsored Scheme was co-terminus with the life cycle of every Five Year Plan. Now Five Year Plans have been abolished. Every Scheme used to be reviewed with the mid-term review of the Plan. Two years ago, therefore, with the abolition of the Planning Commission, it was decided that the life cycle of every CSS will be co-terminus with the life cycle of every Finance commission. Therefore this year will be the last year of the existing CSSs, till we move into the next cycle, therefore they need to be reviewed or restructured in whatever form. So there is this whole myriad of CSSs on which a view has to be taken by the central government on what recommendations it wishes to make to the Finance Commission.

Why I say central government because when we make the allocation of revenues—the vertical allocation that is which means out of the total revenues that can be divided, which is the gross revenue. From the gross revenue take out the cost of collection, as certified by the CAG, then take out the cesses and surcharges, then take out non-tax revenue to get the net revenue collections. Then from the net sum decide what will be the vertical split between central government and the States. Vertical means how much will be retained by the central government and what will go to the States. Out of the proportion left for the central government, all expenditure on CSSs, on the Third tier, and Disaster Management, is also borne by the central government. So it is for them to decide what and how much and which components of the CSSs they would like to include in their submission to the Finance Commission and the kind expenditures needed to finance these schemes.

The States come up with a mixed picture. Some States have come forward and said that they are not particularly interested in these CSSs but they can't give them up because money comes through these schemes. So that is like becoming an aphrodisiac where you get hooked on to the money. You continue to carry on without assessing its real value. Many States have said that they should not only be constricted but whatever resources become available may be a bouquet of schemes whithin a resource envelop for them to choose the schemes considered most have fiscal. They have also said that those that the central government wants to take, let them fund these fully and why do they want states to contribute? But that will mean a very drastic change. The issue of CSSs remains a very complex issue.

The Terms of Reference (ToR) of the Fifteenth Finance Commission has stroked a controversy where even the Fourteenth Finance Commission Chairman Y. V. Reddy has called some of its elements unprecedented as they render the constitutional body an instrument of policy of the Union government, a development that strongly signals a shift towards centralisation, a reversal of the trend seen in recent decades. What is your view?

Every Finance Commission is asked by the President in the Terms of Reference of its Notification to look at some thing or the other. This is not unique to this Commission. May be in the articulation some of them have been spelt out in some greater details than is normal. We have been asked to consider incentivising and looking at the track record of implementing some programmes which have been listed in the ToR. We will, therefore, have to addressbut not necessarily accepted what is confirmed in the ToR. The Niti Aayog has made a presentation to us raising some of these things which also we will consider. There are also health, education and power sector related issues. It’s a question of incentives. And on rewards vs incentives there is always a dichotomy. Is it for past achievements?. Or is it a bait forimprovement in future? That’s a call conceptually the commission has to take.

Are you seeing it, as many people are, as an encroachment into the space that essential is of the States?

I have dealt with that extensively that CSSs are an issue coming under Article 282. But that is the original sin, if I may say so it was first committed in the First Five Year Plan itself. You have lived in a sinful state and trying to wash away all the sins of the past in one go can never easy.

So you are not committing that the Fifteenth Finance Commission recommendations will address the "original sin"?

Let me put it this way, I am certainly expecting that in the submission or the memorandum the central government gives. They will address these issues. Because it is their resources which are being tied down and being deployed. I explained that it is out of the kitty of the vertical of the central government that the expenditure currently in the CSSs is incurred ... Guess what it is ... how much do you think annually the central government spends on the CSSs? It is about Rs. 3.5 lakh crore annually. So it is for them to consider how they wish to take it forward or if they want to restructure or drop some. Once their submission comes we will have an even handed approach.

Do you think this Rs. 3.5 lakh crore can be converted into cash transfers of the kind the income support schemes being promised by political parties in their manifestos? Do you think this is the money the Congress party is banking on to finance its NYAY income support scheme?

I don't know whether they can or they cannot. First they have to make their submission by way of a memorandum on behalf of the Central Government. I cannot prejudge the final submissions of the central government.

Is it time to set up a conflict resolution mechanism for fiscal federal issues between States and the centre?

There is one already in the Constitution. The Inter-State Council that no doubt came after the Sarkaria Commission, not part of the original Constitution. But purpose of this is to bring about greater coherence not necessarily for conflict resolution but for a greater congruence and coordination between centre and States. We are experimenting with new mechanisms which harmoniously work such as the GST Council. It has never voted. It works consensually. And that also on a contentious issue like taxation. It is possible to conceive of similar mechanisms if the GST Council has worked well in other areas.

Dr. Haseeb Drabu, former Finance Minister of the State of Jammu & Kashmir, has pointed out that there needs to be greater coordination between the GST Council and the Finance Commission. Do you agree?

There should be a mechanism by which the two constitutional bodies can coordinate because both are grappling with resources that are such an important and integral part of the revenues of the State governments and the central government, However the GST Council is primarily a political institution while the Finance Commission is not a political entity. But there should be ways and modalities in which both institutions can work in tandem to ensure there are multiplier benefits of a higher growth trajectory.

Will that need the Finance Commission to be continuously functional of course subject to being reconstituted every five years?

The only obligation the Constitution places is that the Finance Commission has to be reconstituted every five years. It doesn't talk about whether it should be continuous or not continuous. One thing is clear to me visiting 20-plus States that there has to be some scope of recalibration. There is what I call the tyranny of the Finance Commission. Once its recommendations, are accepted by the President and matter placed before parliament, the matter is sealed for five years. And then there is no possibility of revisiting the reward, or recalculating to emerging contingencies until the next Commission is a appointed.

If you read the Finance Commission Act, it says the Finance Commission will work as a civil court. It has all the powers of a civil court. That's why I am using the word submission very consciously. Not to establish any hierarchy. The commission will have 30 submissions by way of memorandum. One by the central government and one each by the 29 states. We have to take a judicial view. We can seek the production of any document. And compel the attendance of any entity. In that sense we have to function like a quasi judicial body within the parameters of its constitutional obligations. This is different from the GST Council which is primarily a political body. Its membership comprises of Finance Minister of all states headed by the Union Finanec Minister.

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[**Puja Mehra** is a Delhi-based journalist. She won the Ramnath Goenka Excellence in Journalism Award in 2008 and 2009 for her stories on the impact of the Lehman Brothers' collapse-triggered financial meltdown and the subsequent global economic downturn on the Indian economy. She was formerly a Senior Deputy Editor at *The Hindu*. Her first book, *The Lost Decade (2008-18): How India's Growth Story Devolved Into Growth Without a Story*, has been published by Penguin Random House. She can be contacted at puja.mehra@gmail.com].