Rethink the dynamics of India's fiscal federalism

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A 'holding together federation' with a built-in unitary bias, the Indian Constitution was the contextual product of centrifugal forces and fissiparous tendencies in the run-up to Independence. It has journeyed over 73 years with remarkable resilience. Even so, the emerging dynamics of India's fiscal federalism needs some rethinking. The paradigm shift from a planned economy to a market-mediated economic system, the transformation of a two-tier federation into a multi-tier fiscal system following the 73rd and 74th Constitutional Amendments, the abolition of the Planning Commission and its replacement with NITI Aayog, the passing of the Fiscal Responsibility and Budget Management (FRBM) Act, with all the States forced to fall in line, the Goods and Services (GST) Act with the GST Council holding the controlling lever, the extensive use of cess and surcharges which affect the size of the divisible pool and so on have altered the fiscal landscape with varying consequences on India's federalism. I raise just four issues.

One, India's intergovernmental transfer system should be decidedly more equity-oriented. Although the natural proclivity of any market-mediated growth process is to work in favour of the propertied class, the actual experience in India has been astounding. Chancel and Piketty (2019) estimate that the top 1% earners in India captured less than 21% of the total income in the 1930s, but this was drastically reduced to 6% in the early 1980s and then rose to 22% during the liberalisation era. To be sure, the tax exemptions, tax concessions and other revenues forgone in recent times disproportionately favoured the rich and have reduced the size of the divisible pool.

Equity as concern for 16th finance body

My study on the convergence trajectory of per capita income (PCI) of 16 major States from 1970-71 through 2020-21, based on *Economic and Political Weekly* Research Foundation (EPWRF) data, shows an increasingly divergent trend, where the standard deviation value of log PCI has increased to 0.231 in 2020-2021 from 0.186 in 1991-1992, registering a compound annual growth rate (CAGR) of 0.72%. On the other hand, following United Nations Development Programme methodology, Oommen and Parma (in a forthcoming paper in the *EPW*) argue that the Human Development Index (HDI) across 15 States shows a convergence during the post-reform period. The standard deviation value of HDI is reduced to 0.268 in 2018 from 0.611 in 1991. Instructively the disaggregated picture since 2005 that spans FRBM legislations shows a declining rate of convergence with a high CAGR of minus 2.85%. Indeed, equity should be the overarching concern of the 16th Finance Commission and that HDI could be considered as a strong candidate in the horizontal distribution of tax devolution. Second, there is a case for revisiting Article 246 and the Seventh Schedule for a denovo division of powers, functions and responsibilities for a variety of reasons.

> Beginning with the shift from a planned economy to a market-mediated economic system, there are a number of issues that have varying consequences on India's fiscal federalism which need review

First, India is no longer the one-party governance of post-Independence times. It has become a truly multi-party system. The nature of polity, society, technology, demographic structure and the development paradigm itself have significantly changed.

Second, under the changing dispensation, several pieces of central legislation such as the Mahatma Gandhi National Rural Employment Guarantee Act 2005, the Right of Children to Free and Compulsory Education Act 2009, the National Food Security Act 2013 and many others impose an extra burden on the States. The Tamil Nadu Chief Minister recently raised the issue of shifting education from the Concurrent List to the State List.

Third, at the time of constitution-making, we never asked the pertinent question of who should do what and who should tax what? We borrowed copiously from the Government of India Act 1935 and failed to apply the subsidiarity principle, *viz.*, that whatever could be done best at a particular level should be done at that level and not at a higher level, in the division of functions and finance. Although the 73rd and 74th Constitutional Amendments provided an opportunity to re-examine the issue, nothing was done. In fact, more confusion was added with the introduction of Schedule XI and Schedule XII, which, respectively, list out the subject matter for the panchayat raj institutions and municipalities by simply lifting items from the State list and Concurrent list. They lack operational meaning unless they are broken down into activities and sub-activities, as Kerala and a few others have done. Again, the retention of the irrelevant item No. 5 in the State list is an affront on the third tier. A new local list that will map out the functional and financial responsibilities of the panchayat raj institutions and municipalities is but inevitable.

A respectable place for the third tier

Fourth, the persistent failure to place the third tier properly on the fiscal federal map of India is a serious issue. The absence of a uniform financial reporting system (standard budgeting rules for all tiers, introduction of the accrual-based accounting system long recommended and so on) comprising all levels of government is a major deficit which the coming Union Finance Commission may be required to address. Although the Constitution refers to the third tier as 'institutions of self-government', policymakers, experts and even the UFCs generally refer to them as 'local bodies' and have not given the respect and the handholding they deserve. The failure in building the local democratic base of India, which has over 3.2 million elected representatives, and 2.5 lakh rural and urban local governments, is an enigma. is well-recognised that the prime objective of our federation with deep heterogeneity is to provide basic services of standard quality to every citizen irrespective of her choice of residence and they have a critical role to play. Will the terms of reference of the next Commission consider this?

Review off-Budget borrowing

Fifth, there is a great need to review the off-Budget borrowing practices of both the Union and the States. Off-Budget borrowings mean all borrowings not provided for in the Budget but whose repayment liabilities fall on the Budget. They are generally unscrutinised and unreported. That all income and expenditure transactions should fall under some Budget head or other is a universal principle. State public sector undertakings and special purpose vehicles raise resources from the markets, but their servicing burden often falls on the State government. In cases where the government is the ultimate guarantor, the burden of repaying the debt also falls on the State.

The central government that should set good examples is probably more guilty of off-Budget borrowing than the States. Although the States are disciplined through Article 293(3) by the Union and through the FRBM Act, the Union often escapes such controls. The liberal utilisation of the National Small Saving Fund (NSSF) for extra-budgetary financing of central public sector undertakings and central ministries by way of loans is not reflected in the Union fiscal deficits. This is because only the Consolidated Fund of India balance is considered for calculating fiscal deficit, and items in public accounts such as the NSSF are kept out. While the borrowing space of States is restricted, the Union escapes such discipline. There is also a huge area of special banking arrangements using public sector banks to facilitate cash and credit flow outside the budgetary appropriations to help various agencies involved in quasi-fiscal operations with the government. Transparency guarantees and public accountability demand that the Union, States and local governments come clean and bring all extra-budgetary transactions to the public domain.

In sum, the dynamics of the emerging fiscal federalism of India entails significant rethinking especially in the context of the 16th Finance Commission.

Cleantech, for an inclusive green future in India

In his address to the nation on Independence Day this year, Prime Minister Narendra Modi talked about India showing the world how to combat climate change. India's experience has shown that climate action is only effective and embraced at scale if it aligns with the development aspirations of millions and contributes to economic growth.

The green economy paradigm provides an optimistic pathway to align development and environmental outcomes. For instance, building a solar park or an electric vehicle charging station helps expand the much-needed infrastructure in a developing economy while furthering climate action. Similarly, reviving millets helps improve farm incomes in rain-fed areas while making our agriculture climate resilient. But how do we take this green economy paradigm to the heart of our development needs in the form of youth looking for jobs, women seeking income opportunities, or farmers waiting to diversify their incomes?

Initiatives in the hinterlands

In recent years, different initiatives have taken the green economy approach to the hinterlands of India by enabling access to cleantech solutions for livelihoods among the rural population. For instance, solar dryers converting throwaway tomatoes into sun-dried ones in Andhra Pradesh, biomass-powered cold storages helping farmers in Maharashtra selling lemons make a gain that is three to five times that of the original price, or solar silk reeling machines reducing drudgery for thigh-reelers and doubling their income in Odisha are some of the 50,000-plus examples of how cleantech solutions are already contributing to the jobs and incomes of rural women and men.

But this silent revolution that is underway from Rajasthan to Nagaland and Kashmir to Tamil Nadu now needs a structural boost. India's rural economy that comprises 120 million farmers and 34 million microenterprises often struggles with unreliable electricity access and a dependence on expensive and imported diesel. These cleantech solutions that are powered by renewable energy can help India reduce its diesel imports, avoid the loss of perishable food and enhance rural livelihood opportunities while posing an investment opportunity worth $50 billion for investors and financiers.

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Cleantech can deliver on development and climate action in the country's rural areas

Research at the Council on Energy, Environment and Water (CEEW) shows that just 12 such cleantech solutions (varying from solar pumps to cold storages to *charkhas* and looms) have the potential to impact at least 37 million livelihoods or about 16% of our rural population. There needs to be a three-fold approach to traverse this journey from 50,000-plus to tens of millions.

Steps to scale up

First, leverage existing government programmes supporting livelihoods. For instance, the Pradhan Mantri MUDRA Yojana that extends collateral-free loans for microenterprises can be used to enable the adoption of cleantech solutions. Similarly, the Pradhan Mantri Formalisation of Micro food processing Enterprises (PM-FME) scheme that supports the adoption of technology among micro food enterprises can be used to unlock support for solutions such as a solar dryer, an energy-efficient multipurpose food processor or a solar grain mill.

Likewise, the Pradhan Mantri Matsya Sampada Yojana can be leveraged towards adopting solar refrigerators and dryers for fishing communities. Finally, the Agriculture Infrastructure Fund, which has only seen a 15% fund utilisation against a target of ₹1,00,000 crore, can support the adoption of biomass-powered cold storage and beyond.

Second, enable large-scale financing of cleantech solutions. It requires supporting bankers' capacity on credit assessment for cleantech because they have not come across such solutions and the associated cash flows before to make an informed assessment. We also need to hedge their risks in the initial stages of the market through partial guarantees. Moreover, active engagement with financiers is important to structure loan products that are aligned with the cash flow scenarios of users. Adopting some of these principles helped 'Powering Livelihoods', a CEEW-Villgro initiative, unlock 300-plus loans for cleantech solutions to women, self help groups, farmer producer organisations and individual microentrepreneurs in rural areas.

Third, enable multi-actor partnerships between technology innovators, manufacturers, distributors and service providers, financiers, and market-linkage players to enable an overall ecosystem. Cleantech manufacturers often need help bringing their products to customers. The challenges faced include low product awareness, high customer acquisition cost as users need to touch and feel these products before adoption, and low density of customers for such products in a given area. Users too, at times, struggle with limited after-sales service and market linkage of the final processed products.

We need a holistic ecosystem where distributors work with manufacturers to enable technology access at the last mile, service providers ensure after-sales services, and market-linkage players enable the connection to the market to create a thriving ecosystem for cleantech to impact rural livelihoods at scale. For instance, there are solar dyer companies that are not only deploying dryers but are also enabling financing for users to adopt the dryers and buying back the final produce from them to ensure market linkages.

India has massive ambitions for a clean and green future. By focusing on cleantech for livelihoods and jobs, especially in rural areas, we can make that green future inclusive.

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