Budget TRACK

Volume 10, Track 1-2, October 2014

IN THIS ISSUE

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Foreword

This edition of Budget Track focuses on the 'Issues before the 14th Finance Commission', which is due to submit its report to the Union Government this year. The Finance Commission of India, a Constitutional body constituted every five years, facilitates the intergovernmental transfer of resources at the sub-national level of the government and plays an important role in determining the fiscal architecture of the country.

The past few years have witnessed specific changes in the Centre-State fiscal relations. This has been reflected in the composition, Terms of Reference and the recommendations of the Central Finance Commissions. As the 14th Finance Commission prepares to submit its report, there are a number of concerns that need to be brought forth, both before the Commission as well as before other stakeholders. This issue of Budget Track tries to capture some of the aspects related to the 14th Finance Commission.

This issue begins with a brief note demystifying the role and significance of the Finance Commission. In the first article, **Prabhat Patnaik** raises some critical issues about the role, functioning of the Finance Commission and the gradual diminution of this Constitutional body over the years. **Vinod Vyasulu**, in the next article, outlines some key concerns regarding the composition, the division of resources and the terms of reference of the 14th Finance Commission. Taking forward the concerns raised in the two previous articles, **Chirashree Das Gupta** questions the ideological base of the assumptions that underlie the Terms of Reference of the Finance Commission and raises some paradigmatic queries about its mandate.

The sharing of resources between the Centre and the States has since long been a subject of contention. **K. K. George** in the following article deliberates on some of the crucial matters regarding the 14th Finance Commission and the Centre-State fiscal relations in the context of the broader theme of economic governance and budget accountability. **Praveen Jha** and **Rohith Jyothish** discuss the role of the 14th Finance Commission towards expanding the fiscal policy space in India through increasing the tax-GDP ratio. **Sona Mitra** outlines the issues before the Commission in the context of the reduced fiscal autonomy of the States, leading to the inability of the State Governments to make long-term expenditure commitments, especially in the social sectors.

In the following piece, **Subrat Das** and **Saumya Shrivastava** discuss the key challenges pertaining to the acute shortage of human resources in the State Governments, especially in the development sectors, in the relatively backward States. **Ravi Duggal** illustrates the limitations of the arguments related to the 'lack of absorptive capacity' of the States, through a case study of a public healthcare system in Mumbai. **Jawed Alam Khan**, in the subsequent article, draws from the experience of a few states in India to highlight the issues before the 14th Finance Commission in the domain of fiscal decentralisation and finances for the local governments.

Jyotsna Goel enumerates the ways in which the Commission can promote the development of renewable energy in India, which is crucial for promoting clean energy and a sustainable growth trajectory for the country.

Transparency, accountability and public participation have been widely recognised as imperative for good governance. **Ravi Duggal** and **Anjali Garg**, in their article, make specific recommendations to the 14th Finance Commission for strengthening budget transparency and participation in India through the Pre-budget process. **Nilachala Acharya** discusses the issue of enhancing budget transparency further. He traces the recommendations of the previous Finance Commissions and the recent key developments in this domain; and stresses the need for allocating resources towards strengthening institutional mechanisms to ensure greater budget transparency in the country.

Rohith Jyothish and **Saumya Shrivastava** in a note summarise the key demands by the different states for the 14^{th} Finance Commission. A separate note by **Rohith Jyothish** captures the key commitments on fiscal federalism and taxation in the Election Manifestos of select political parties for the 16^{th} *Lok Sabha* elections.

Lastly, **Protiva Kundu** reviews some major budget and policy developments in the last few months in India as well as globally. She outlines some key legislations and policies in India and traces some important policy developments at global platforms, which have an impact on India.

We hope that this Special Issue of Budget Track, focusing on the different issues before the 14^{th} Finance Commission, would help facilitate a greater public understanding and encourage an informed discussion on the same. We may also add here that CBGA has submitted most of the policy asks captured here to the office of the 14^{th} Finance Commission earlier this year.

- Editorial Team

Significance of the Finance Commission

Sona Mitra*

The Finance Commission (FC) of India is a body established under *Article 280(3)* of the Indian Constitution by the President of India. It is formed once every five years to determine the financial relation as well as facilitate the intergovernmental transfer of resources between the national and the sub-national governments under the Finance Commission Act of 1951. The Act states the terms of qualification, appointment and disqualification, the term, eligibility and powers of the Finance Commission. As per the Constitution, the Commission is appointed every five years and consists of a chairman and four other members. Till date, thirteen FCs have submitted their reports. The FC and its recommendations over the years pertaining to the sharing of resources between centre, states and local bodies have played a major role in determining the federal fiscal architecture of the country.

The Indian State has often been viewed to be characteristically federal with certain 'unitary features'. It faces problems of vertical and horizontal imbalances between the centre and the states. Vertical imbalances occur due to the expenditure patterns of states which is often disproportionate to the states' source of revenue, a large part of which flows from the Centre. On the other hand, factors such as geographical location, historical backgrounds and differences in resource endowments are major reasons for horizontal imbalance within the states. Recognizing the importance of equalisation among states to bring in a parity of development across the regions, the Constitution made several provisions to bridge the gap in finances between the Centre and the States.

Some of the provisions include various Articles in the Constitution like Article 268, which facilitates levy of duties by the Centre but equips the states to collect and retain the same. Articles 269, 270, 275, 282 and 293 specify ways and means of sharing of resources between Union and States. And finally the Constitution also provides an institutional framework to facilitate Centre-State Transfers. Article 280 (3) of the Indian Constitution states:

- *The President will constitute a Finance Commission within two years from the commencement of the Constitution and thereafter at the end of every fifth year or earlier, as the deemed necessary by him/her, which shall include a chairman and four other members.*
- *Parliament may by law determine the requisite qualifications for appointment as members of the Commission and the procedure of selection.*
- *The Commission is constituted to make recommendations to the President about the distribution of the net proceeds of taxes between the Union and States and also the allocation of the same amongst the States themselves. It is also under the ambit of the Finance Commission to define the financial relations between the Union and the States. They also deal with devolution of non-plan revenue resources.*

The primary mandate of the FC as laid down by the Constitution can be explicitly stated as:

1. *Distribution of net proceeds of taxes between Centre and the States, to be divided as per their respective contributions to the taxes.*

2. *Determine factors governing Grants-in-Aid to the states and the magnitude of the same.*

3. *To make recommendations to President as to the measures needed to augment the Consolidated Fund of a State to supplement the resources of the panchayats and municipalities in the state on the basis of the recommendations made by the Finance Commission of the state.*

These functions form the core activities for the FC. Currently the recommendations of the 13th FC are being followed for centre-state resource sharing. The 14th FC, under the Chairmanship of Shri Y. V. Reddy, former RBI Chairman, is preparing its report to be submitted by the end of this year, recommending the method for sharing Central resources between the states for the period 2015-16 to 2019-20.

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The Diminution of the Finance Commission

Prabhat Patnaik*

The Finance Commission is one of the grandest institutions conjured up by the Indian Constitution. Its role is to overcome a basic anomaly in India's federal structure, arising from the fact that while the state governments have the responsibility of carrying out substantial development expenditure, the revenues at their command are meagre compared to those of the Centre. A Finance Commission therefore is constituted once every five years to decide on the magnitude of devolution of resources from the Centre to the states and their distribution across states.

The job of the Commission being of such great importance, and its position being one that overarches both the Centre and the states, the constitution of a Finance Commission should be front-page news. But that alas is not the case. The setting up of the Fourteenth Finance Commission scarcely attracted any notice. The reason for this diminution of the Finance Commission lies in the fact that the Central government has converted it virtually to a Departmental body entrusted with the task of imposing neo-liberal policies on unwilling state governments, by using, entirely illegally, the threat of withholding resources from them that are Constitutionally their due.

Of course even before the Finance Commissions were forced to become policemen for the Central government, their importance had got undermined. This was because the Centre had insisted on routinga large chunk of the total transfers it made to states through the non-FC route. The Planning Commission which is a mere Departmental body of the Central government, with no Constitutionally-sanctified position, was one route for such transfers, viz. in the form of Plan assistance; and in addition there were discretionary transfers made at the whim of the Central government. The transfers effected through the Constitutionally-sanctified body, the Finance Commission, accounted for only a fraction of the total transfers from the Centre to the states; and this of course enabled the Centre to indulge in "favouritism", rewarding "obedient" states and penalizing "inconvenient" ones.

But at least the plan assistance, no matter how small and despite being given at usurious interest rates (the term "assistance" was indeed a misnomer), allowed the state governments to decide on their own plan priorities. Of late, however, a new entity has emerged called Centrally Sponsored Schemes, through which not only does much of the Centre's devolution of plan resources to states take place, but which actually amount to interfering in states' plan priorities.

State governments have to share a part of the expenditure on Centrally-Sponsored Schemes, which have not been designed by them, and whose implementation itself is largely outside their control (often entrusted to independent bodies like the Sarva Shiksha Abhiyan, or the NRHM). States, when confronted with a CSS, are given a "take it or leave it" choice; and naturally since such Schemes entail some money coming from the Centre, there is pressure on them, given their straitened circumstances, to "take it". Their own plan resources therefore get partly diverted to Centrally Sponsored Schemes.

But that is not all. After some time, the Centre decides unilaterally to lower its share of contribution to the CSS. (This unilateralism is so brazen that in the case of SSA, the Centre went ahead with its proposed reduction in share despite a unanimous plea to the contrary by all the Chief Ministers at an NDC meet). For the continuation of the schemes therefore the state governments have to make proportionately more and more resources available. They are thus left holding schemes, over whose designing and inception they had no say whatsoever; and their own plan priorities and plan conceptions get subverted.

The NDC had decided long ago, in view of the state governments' unanimous demand to this effect, that CSSs should be handed over, together with funds, to the state governments. But nothing has come of this decision; on the contrary the scope of such schemes has got enlarged, and the resources they absorb have increased manifold. The fact that successive Finance Commissions have turned a blind eye to this travesty of the Constitution is one reason for their diminution of status. In addition, however, the Finance Commission itself has become a tool of the Central government.

The reasons for this are obvious. The Centre unilaterally decides on the membership of the Commissions. It is reasonable to expect that if a body is to adjudicate between the Centre and the states, then its composition should be decided not by one of the two parties unilaterally, but by both, through mutual agreement. There are plenty of institutions, such as the National Development Council, or the Inter-State Council, where both the Centre and the state governments are represented; these naturally should be the fora at which the composition of the FC should be decided. But despite the fact that this demand has been put forward by the Left parties and the Left-led governments for long, the membership of the FC to this day is decided entirely by the Centre, which naturally fills it with persons "acceptable" to it.

The Centre also unilaterally decides on the terms of reference of the FCs. Here again, the NDC or the ISC could be used to get an agreed set of terms of reference,

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but this has never happened. In fixing the terms of reference, the Centre also ensures that the FC, consisting of its handpicked persons as members, works on the Centre's agenda. The terms of reference of the Fourteenth Finance Commission for instance include assessing what progress the states have made in following the "road map for fiscal consolidation" suggested by the 13th FC and what "incentives" and "disincentives" should be used to make state governments conform to this "road map"; this in plain language means compelling the states, by withholding their resources, to practise fiscal austerity (and enact Fiscal Responsibility Legislation).

This obnoxious practice of withholding resources due to them from the states, unless they satisfied certain "conditionalities" (involving the adoption of neo-liberal measures) started with the Eleventh Finance Commission. The 11th FC asked for a "package" of measures, which included "reforms" of State Electricity Boards (involving "unbundling" and "trifurcation"), *to be adopted to the satisfaction of Central government personnel*, as a condition for a part of the devolved resources to be made available to them.

This was clearly un-Constitutional. The Constitution was explicit that the resources made available to states by the FC were to be made available *unconditionally*. This is not surprising since it visualized the possibility of different state governments being ruled by different political parties with different programmes, who were electorally chosen by the people; and if this choice was to have any meaning then these different state governments should be allowed to have their different trajectories of development. Since it was neither the Centre's nor the FC's job to tell them what development strategy to pursue, the resources being made available to them should be made available *unconditionally* so that they *could* pursue different trajectories. But the neo-liberal policy-makers decided to use the institution of the FC to ram their favoured measures down the throats of the state governments, no matter what the ideology that the political parties running these state governments subscribed to.

It must be said to the credit of Dr. Amaresh Bagchi, one of the members of the 11th FC, that he gave a dissenting note to the FC's report, protesting against this un-Constitutional step of the Commission. What is Constitutionally due to the states, he argued, must be given to them unconditionally. Even though this obnoxious and un-Constitutional practice has been followed by all subsequent Finance Commissions, no other member alas has had the courage or the conviction of Dr.Bagchi to voice a similar protest.

The Twelfth Finance Commission made the provision of debt relief conditional upon states passing Fiscal responsibility Legislation which would provide for an elimination of revenue deficits and limit fiscal deficit to 3 percent of the Gross State Domestic Product. This was not just un-Constitutional and undemocratic, making the provision of assistance to a popularly elected government conditional upon the pursuit of *specific and uniform* policies which had no Constitutional sanction; but it was as silly in its content, as it was shallow in its analysis of the causes of state indebtedness.

Through the decade of the nineties states taken as a whole were better at mobilizing revenue than the Centre: while the ratio of the Centre's tax revenue to GDP came down over the decade, that of the states taken together did not. And yet the states taken together had a worsening debt situation over the decade. A major reason for this lay in the exorbitant rates of interest charged by the Centre on the loans, including Plan assistance, it made available to states. These rates in many instances exceeded in real terms the rate of growth state GSDP, which is a sure recipe for falling into a debt-trap. Having virtually pushed the states into a debt trap the Centre then used the FC to get them to pass "Fiscal Responsibility Legislation"!

And the absurdity of such legislation lies in the fact that a lot of development expenditures undertaken by state governments, such as salaries of teachers in government and "aided" schools, salaries of doctors and costs of medicine in government hospitals, plan transfers to local bodies, are counted as revenue expenditure. Zero revenue deficit therefore would mean cutting many of these expenditures, which impinge on the lives of the common people. In short, the idea that revenue expenditure is non-developmental, which underlies the prescription for zero revenue deficit, is fundamentally wrong.

The Thirteenth Finance Commission continued with this undemocratic neo-liberal orthodoxy, through its imposition of a "road map for fiscal consolidation". The case of Tripura illustrates its absurdity. Every state, irrespective of its size and GSDP, has to have a certain minimal administrative structure in absolute terms. When salaries of state government personnel have to increase in the wake of Central pay increases, as a fall-out of Central Pay Commission recommendations, a small state has to bear a heavier burden. Instead of taking this fact into account, the 13th FC used arbitrary "norms" for administrative expenditure, on the basis of which it *penalized* states like Tripura for no fault of theirs. Instead of acting as a Constitutional body, the FC had acted as neo-liberal *vigilante* at the behest of the Centre.

The fact that successive FCs have acted in this manner is what explains the current diminished status of this Constitutional body of grand conception.

The 14th Finance Commission: With what porpoise?

Vinod Vyasulu*

'They were obliged to have him with them,' the Mock Turtle said: 'no wise fish would go anywhere without a porpoise.'

'Wouldn't it really?' said Alice in a tone of great surprise.

'Of course not,' said the Mock Turtle: 'why, if a fish came to **me**, *and told me he was going a journey, I should say "With what porpoise?"'*

—Lewis Carroll: Alice in Wonderland

1

The Finance Commission (FC) is a constitutional mechanism for the sharing of funds in India's federal structure. The collection of income and excise and other taxes is the responsibility of the Union of India, while sales and other indirect taxes are collected by the State governments. Since the largest generators of revenue are with the Union and the biggest responsibility for providing social services are with the states, a need for equitable sharing of revenues was felt, and has been institutionalised in the Finance Commission. It is set up every 5 years by the President, and makes recommendations on how the total revenues of the Indian State are to be shared between the Union government and the state governments. By convention, the Union government accepts the recommendations made by a FC in toto. This is an excellent practice. After the 73rd and 74thAmendments to the Constitution, a similar state level mechanism has also been put in place to share funds with local governments.

Over the years, the Union has begun transferring funds for 'central schemes' to the states. This is done through the Planning Commission, which is a think tank of the Government of India headed by the Prime Minister. These transfers have become so important in recent years, that a member of the Planning Commission is made a part time member of the FC to ensure 'co-ordination'. In the 14 FC, this position is held by Dr. Abhijit Sen, as Member of the Planning Commission.

The 14 FC has been set up, with Dr Y. Venugopal Reddy, former Governor of the Reserve Bank of India, a respected economist and civil servant, as Chairman.

There are some issues with the composition of this FC that merit discussion.
The composition of this FC seems to have deviated from the requirements of the law[2], for Section 3 requires that one member be selected from among those who '(*a*) *are, or have been, or are qualified to be appointed as Judges of a High Court*'. None of the members of the 14 FC seem to meet this criterion.

In recent years the FC has been made up of government economists, not politicians or judges. Before Dr. Kelkar, a former Finance Secretary, who chaired the 13 FC, the Chairman of the 12 FC was Dr. C Rangarajan, an eminent economist and a former Governor of the Reserve Bank of India. The Chair of the 11 FC was Professor A.M. Khusro, a former member of the Planning Commission and a well-known economist.

There has been a shift to a technocratic composition of the FC. This FC is a formidable collection of economic expertise and administrative wisdom. One wonders also if these economists have the political skills of negotiation and compromise, so essential in a federal institution. One further wonders whether economists who have been part of the decision making process in the Union government over many years will be able to approach the problems of fiscal federalism with any fresh insights.

2

What should go into the Divisible Pool?

There have been different definitions of the Divisible Pool over the years. Today, given that the Finance Minister has used cesses and surcharges in the budget, we ask:

Should surcharge on income tax remain out of it?

What about the dividends declared by public sector companies? What about the revenues from disinvestments in the public sector?

These have become very important in recent years. These are national assets created with funds that the Union of India could invest because the total amount given to the states, taken together, was kept small in order to facilitate capital investment in industrial enterprises. From 2 FC onwards, it has been taken for granted that the need of the Union for finds is of special importance because of the Mahalonobis Strategy of industrialisation which required the setting of large green field plants in the public sector. Today we have SAIL, BHEL, ONGC and so many more—and they are important in the Bombay Sensex weightage.

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[2] **THE FINANCE COMMISSION (MISCELLANEOUS PROVISIONS) ACT, 1951.** http://fincomindia.nic.in/ShowContent.aspx?uid1=2&uid2=3&uid3=0&uid4=0.

Now that shares from these enterprises are being sold on the market, should not a part of the proceeds go to the states via the divisible pool? After all, *the states have willingly foregone revenues for many years in order to make this investment possible in national interest*. Now that national interest seems to lie in disinvesting from these enterprises, should not the states get their fair share? This is a matter the 14 FC should examine.

Should not these proceeds be used for capital investments, as they are capital receipts, and not for current consumption by the Union?

3

What should be *the formula for the vertical devolution* of funds between the Union of India and the states taken together?

From the 2 FC onwards, there has been a pronounced bias towards a larger share for the Union of India, than the States, than was warranted by the responsibilities in the 7th Schedule. This was then agreed upon by the states taken together.

The last public sector unit that was established by the government of India was NALCO in 1980. Since then the economy has moved in a different direction. The nature of vertical devolution has however continued. From funds that were no longer being invested in new Greenfield public sector plants by the GOI, the Union of India has introduced a series of central schemes across a number of sectors that come directly into the State list as given in the 7th Schedule. This has also brought the Planning Commission into the picture as arbiter of funds being transferred to the states—a situation not envisaged in the Constitution.

There have been many reports that have raised related issues—how the central schemes distort state priorities; how they deflect state funds via the sharing formula; how central schemes deny the states the flexibility they need to meet their responsibilities because of the guidelines' in central schemes; and finally of the tremendous inefficiency with which these schemes are implemented.

Since new public sector plants are not being set up now, should not this base for sharing, which gave the majority of funds in the divisible pool to the Union, be re-examined? Should not vertical devolution be on the basis of the 7th Schedule and the lists of responsibilities of each sphere of government? This is an important matter that the FC should examine afresh, not just tinker with small arbitrary percentages.

There have been demands that the distinction between Plan and Non-Plan funds be given up. This is a complex matter that brings the role—even existence of the Planning Commission as it now is—into question. The members from the Planning Commission may face a conflict of interest here. He could consider excusing himself from the discussion on this matter.

There is therefore a case for a re-examination of the basis for a vertical devolution of funds in the divisible pool. The Union's needs can be estimated for meeting its constitutional responsibilities, and the balance can be passed on to the states for their developmental and other needs. The Union's share of the divisible pool can also include an amount that is meant for transfer to local governments. Given the constitutional objection raised by the Chief Minister of Tamil Nadu to direct Union-local body transfers via direct benefit transfers, this is also a matter for the 14 FC to consider.

For unexpected events, like earthquakes, the states can come to aid of each other via a constitutional agency like the Inter State Council (ISC)—which should be set up in a way different from the current ISC. It is a matter that merits separate detailed discussion.

4

The horizontal devolution across the states also merits a fresh look. However, this is a matter that can be examined by later FCs; the issues raised above are of a fundamental nature and too much should not be done in one FC period. However the nature of State-local body relationships and conditions under which Union funds can beor not be devolved would also be important, given the uneven condition of federal deepening in India.

5

The size of the revenues available is estimated by the FC, and the shares of the Union and states are given in a percentage. When the Union fails to collect sufficient taxes, and the divisible pool is smaller than that estimated by the FC, the states suffer an automatic shrinkage in the funds available to them, for no fault of their own. This is unfair. The inefficiency of the Union should not be passed on to the states. If the Union fails in collecting sufficient revenue, it should bear the consequences of the shortfall. The recommendations for sharing the divisible pool should therefore be given in terms of both a percentage, and an absolute number based on the FC's estimations, with the proviso that the states get whichever is larger. This will give the Union an incentive to collect taxes efficiently.

6

The TORs of the 14 FC include, surprisingly, items that are really of a municipal nature: 'the need for insulating the pricing of public utility services like drinking water, irrigation, power and public transport from policy fluctuations through statutory provisions'.

These do not come under the constitutional responsibility of the FC, but are additional items that have been referred to it by the Union government. In seeking statutory means to insulate fluctuations in prices of public utilities via legal means, is not the Union government trying to limit the political freedom of the succeeding government to make policy changes? Is this not a misuse of the healthy convention that recommendations of the

Union Finance Commission are accepted in toto? This is, perhaps, unethical.

Another TOR has to do with long terms issues and is not really a fiscal matter: 'the need to balance management of ecology, environment and climate change consistent with sustainable economic development'. How is the sharing of revenues between the Union and the states related to climate change, which is a long term ecological issue of a global nature? Is the Union arrogating to itself responsibility for mitigating climate change in 5 years through some expenditure that the FC may enable at the expense of the states?

There is also a reference to the proposed Goods and Services Tax: 'the impact of the proposed Goods and Services Tax on the finances of Centre and states and the mechanism for compensation in case of any revenue loss.' This would require a constitutional amendment as it would take away the power to tax goods that is currently with the states. That *this would drastically change the federal nature of our Constitution* does not seem to have occurred to the Union of India, which thinks it can buy off the states with 'compensation for revenue loss'. But taking away this power would reduce state governments from being '*governments'to mere agents* of the Union; and this may well go against what has been called the 'basic structure of the Constitution' which includes its federal nature. This is a matter that has consequences far beyond the sharing of revenues between Union and states for 5 years and should not be casually dealt with by anyone; and I argue, certainly not a Finance Commission with a mandate of recommendations for 5 years.

In my own view, the FC should refuse to consider such items. It is within its powers to do so. As Lewis Carroll so succinctly wrote in Alice in Wonderland:

"You can really have no notion how delightful it will be

When they take us up and throw us, with the lobsters, out to sea!"

But the snail replied "Too far, too far!" and gave a look askance—

Said he thanked the whiting kindly, but he would not join the dance.

Would not, could not, would not, could not, would not join the dance.

Would not, could not, would not, could not, could not join the dance.

Paradigmatic Questions about the Mandate of the Fourteenth Finance Commission

Chirashree Das Gupta*

The debates on the mandates of Finance Commission(s) show a welcome de-mystification of the techno-managerial approach to the question. However, the dominant trend in addressing this question has been to find ways in which concerns around social disparity can be 'plugged in' to the existing devolution exercise. But such exercises of plugging in social categories into a pre-determined policy paradigm overlook the paradigm within which the TOR of the Finance Commission (FC) in ensconced. It is a paradigm based on an ideology of fiscal conservatism and a methodological dichotomy between equity and efficiency arrived at through tenuous assumptions, not to mention questionable political priorities. Unless, the debate is opened up to question these bases, aspirations of social justice in FC devolutions will remain a chimera.

Ideological Basis

The eroding role of Finance Commissions as 'neutral arbiter', despite constitutional provisions has been of increasing concern leading to the argument that FC TORs should remain confined to its basic constitutional mandate.But even if the FC mandates had remained confined to the constitutional scope, the question of the role of ideology in defining its methodological approach remains central. The conflict between inflation-targeting macroeconomic strategy and 'development' goals has largely defined the ideological landscape of policymaking in India in the recent decades. In keeping with that, inflation-targeting and fiscal conservatism have been at the core of the devolution principles suggested by FCs since the 1990s.

Differentiating between equity and equality, the neoliberal public policy paradigm has grappled with two questions: first, is it possible to have "equity" and "equality" in a system that prioritises efficiency in resource management over social justice, and second, is horizontal equity the most widely accepted principle of equity. Another set of contentions have derived from concerns around redistribution andthe undermining of the equity principle since the Tenth FC. The discarding of emphasis on redistribution has been accompanied by a shift towards fiscal conservatism. This tendency has been entrenching itself precisely at a time when sectoral, social and regional disparity has been widening.

In most of these debates with regard to Finance Commission transfers, disparity, narrowly understood as inter-state disparity, is a *ceteris paribus* condition. The expertise in the FC has been devoted to designing closest to optimal allocations in balancing the competing demands of low and high income states. In this exercise, the indicators of regional disparity which only quantify symptoms have been the basis of the formula for horizontal devolution. Yet, the political expectations around FC transfers are towards reversing trends in widening disparity and thus addressing the cause of widening social, sectoral and regional disparity both within and across states.

The Constitutional mandate demands that the FC be able to raise itself above dominant economic ideology.The emphasis on equalisation demands a break from the *ceteris paribus* assumptions of not just the equity/efficiency paradigm but also a departure from the methodological approach of conceptualizing social disparity as an *ahistorical* given. It also requires a break with economic orthodoxy that is averse to high levels of public expenditure.

Political Priorities

There is an emphasis in the FFC mandate seeking recommendations on ways to increase tax-GDP ratios. The TOR also recognises non-salary and non-wage revenue expenditure as an important component of maintenance of capital assets. However, the emphasis on only the 'plan' component of such expenditure misses the point that revenue expenditure is important in the maintenance and upkeep of existing assets and infrastructure in resource constrained economies which entails emphasis on non-plan revenue expenditure.

The Commission has been asked to review the fiscal consolidation roadmap that had been suggested by the 13th FC and has been given the room to 'suggest measures for maintaining a stable and sustainable fiscal environment consistent with equitable growth including suggestions to amend the Fiscal Responsibility Budget Management (FRBM) Act currently in force'. This demonstrates recognition that the FRBM Act needs to be reconsidered both in the light of sustainability and relevance for state-level fiscal policy. However, it still indicates a fear of the fiscal deficit which derives from overtly ideological fiscal conservatism and has very little to do with the principles of economic theory. This has been pointed out by many experts since the tenure of the 12th FC when the question of the fiscal deficit gained ascendancy. There are two sets of arguments here. Some experts contend that while containing the fiscal deficit is important, there is no need to specify targets for both revenue and fiscal deficits. Others argue that the basis of FRBM Act itself is unnecessary as containing the fiscal deficit is not an economic priority for countries like India, where unutilized capacities entail a demand generating role to the fiscal deficit, without necessarily aggravating

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inflation. In fact, the experience of the Indian economy in the period of the 13th FC shows that bringing down the fiscal deficit (which most states have done) has very little correlation with inflation levels (which have risen in the same period).

The Commission has been given the room to suggest how much subsidies are required for sustainable and inclusive growth. This reflects a shift in approach as subsidies are being considered as an unavoidable instrument for economic development as opposed to the earlier conservative wisdom of being a universal 'bad'. However, the fact that fiscal conservatism defined concerns like food and fuel subsidy levels and the FRBM has been institutionalized in the FFC's TOR demonstrates that the spread of the mandate is over-ridden by the neoliberal priorities of the government in power. If subsidies are indeed to be scrutinised on grounds of fiscal conservatism, then the revenue foregone due to various concessions and tax preferences to corporates in the form of rebates, which the Ministry of Finance has viewed as an 'indirect subsidy to preferred tax payers' needs to be scrutinised first and foremost. Studies have shown that such concessions are ten percent higher than the current fiscal deficit of the Union government.

There are further disconcerting features of the TOR in blurring the distinguishing lines between the political priorities of the Executive and the terms of reference of a statutory body like the Finance Commission. One such feature is the inclusion of defence expenditure priorities of the current government as a binding constraint on the revenue pool available for sharing with the states. One can envisage an alternate policy paradigm in which social expenditure needs would be a given as opposed to defence. This dangerous trend of treating India's burgeoning defence budget as sacrosanct, at a time when India has emerged as the world's single largest buyer of conventional weapons (accounting for 12 percent of global imports), needs to be countered both from concerns around militarisation and the question of social priorities.

Disinvestment in public sector enterprises is once again a narrow political priority of the current executive in keeping with its neoliberal preoccupations and is way beyond the constitutional mandate of the Finance Commission. There are strong arguments questioning the rationale for disinvestment of PSUs based on the demonstration of the proposition that replacing public investment with private investment does not necessarily lead to gains in economic efficiency.

Assumption that the Goods and Services Tax (GST) will be efficient and enforceable in a country like India, where production and consumption base is highly heterogeneous, has proved to be unworkable in the last few years. The rationale for GST makes the flawed assumption that all low production states are high consumption states. In reality, most low production states are also low consumption states and for such states GST may not necessarily entail much change in resource constraints.The entire GST exercise is being propagated on the basis of assumptions about the purported expansion of tax base of states due to implementation of VAT. However, there has been no comprehensive assessment of VAT impact by the previous FCs or the Union government.

The TOR is significant in its exclusion of the current state of the Indian economy and the global context. There is no mention of the global recession, the linkages between India and the global economy, the intense slowdown in manufacturing as a result of these linkages and the protracted crisis of agriculture in India which pre-dates the global crisis.

Lastly, ecological sustenance and environmental concerns are of primary importance and these should be central to the formulation of policy goals. However,a demand on the Finance Commission to address climate change is not necessarily in line with its constitutional mandate.

Thus the TOR leaves little room for the Fourteenth FC to keep itself free of the overriding political and ideological priorities of the government in power in the consideration of the methods by which it will decide on questions of resource mobilization and revenue sharing. The ends will obviously determine the means.

Fourteenth Finance Commission in the context of emerging Centre–State Fiscal Relations

K. K. George*

We are discussing the 14th Finance Commission (FC) and Centre-State fiscal relations in the context of the broad theme of Economic Governance and Budget Accountability. It therefore becomes necessary to start with the role played by Centre-State financial flows including the flows through the FCs in the budgets of the Central and State Governments.

Aggregate Centre-State (CS) transfers accounted for an average of 44 percent of the Union Government revenue during the first four years (2010-11 to 2013-14) of the award period of the 13th FC. They accounted for an average of 41 percent of the revenue of all States put together but the transfers effected through the FCs (statutory transfers) accounted for only 27 percent of the Union revenues and 26 percent of the States' revenue. About 37percent of the Central revenues coming to the States are routed through other agencies like the Planning Commission (PC) and the different Union ministries[1]. If we take only the grants from the Centre, statutory grants, i.e. grants effected through the Finance Commission accounted for only 16 percent of the total grants. These grants are effected by way of Normal Central Assistance (NCA), Additional Central Assistance (ACA), Centrally Sponsored Schemes (CSS), Special Packages etc. According to the Raghuram Rajan Committee report, FC's transfers in 2011-12 accounted for 54 percent of the Central transfers to States while plan transfers accounted for 46 percent. Of the plan transfers, only 3.8 percent was transferred through the criteria based NCA route.

From the above discussion, it comes out very clearly that the FCs, the only constitutional body meant for allocating Central funds to the States, has now become a pale shadow of its constitutional self. A major part of the blame has to be borne by the successive FCs themselves who became willing accomplices of the Central Government for eroding their own role. They seem to have been gradually forgetting to whom they are accountable. The FC under the Constitution is meant to be arbiters between the Central Government (CG) and the State Governments (SGs). It implies that they are accountable equally to the CGs and the SGs. Over the period, FCs has come to assume that they are accountable primarily to the CG which appoints them than to the SGs. The CG, a party to the arbitration has adopted a number of practices to debilitate the independent role of the FCs. They took upon the sole responsibility of appointing the Chairman and the members of the Commission without holding any consultation with the States, the other party affected by the arbitration proceedings though there is institutional machinery provided for consultation with the States in the Constitution viz the Inter-State Council. There is yet another body, the National Development Council (NDC), though not Constitutional one, which the Centre can consult, if they so decide.

The quality and independence of the Chairmen and other members of the successive FCs seem to be getting undermined. In the past, we used to have legal luminaries like K. Santhanam, (a member of the Constituent Assembly) and Dr. P. V. Rajamannar, (Chief Justice of Tamilnadu and the author of a Commission on Centre- State relations). Till the 9th FC, there used to be a judicial member in each Commission.That practice is now dispensed with. In the past there used to be Chairmen who had experience as both Chief Ministers of States and Cabinet ministers at the Centre (Y. B. Chavan and Brahmananda Reddy). There also used to be financial administrators familiar with the finances of State Governments (B. P. R.Vithal). There used to be independent economists who were familiar with both the Central and State finances like Prof. I. S. Gulati.

The composition of the recent FCs shows a definite tilt towards the Centre. The Chairman of the 13th FC was a former Finance Secretary of the Central Government who was also serving as adviser to the Finance Minister at the Centre. There was yet another member who was a former secretary of the Union Finance Ministry. In the name of better co-ordination between the FC and the PC, an economist from the PC came to be appointed as a member of recent Commissions. Above all, the other independent economists were also drawn from the charmed circle of Delhi, connected more with the Centre than with the States.

Pro Centre tilt of the Terms of Reference (ToR)

Binding the Commissions by ever increasing number of Terms of Reference (ToR) is a measure increasingly adopted by the Central Government which undermines the umpiring role of the FCs. The ToRs are framed without consulting the states. It is as though in addition to

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[1] Even the above figures are gross under estimates as the data used are based on RBI studies on State finances based on State budgets; these figures do not include Central transfers effected directly to local bodies and para-state agencies. Such transfers do not find a place in the budget documents of the State Governments.

appointing umpires of its choice the rules of the game are written by one of the teams in its favour each time. These ToRs are unnecessary as the Constitution itself has defined the ToR of the FCs. This body is to determine the allocation of Central revenues to be transferred to the States by way of sharing Central tax revenue and providing grants to the States "in need of assistance".

From the 11th FC onwards, following the 73rd and 74th Constitutional amendments, the FCs are asked to augment the Consolidated Fund of States to supplement the resources of the Panchayats and the Municipalities in the States on the basis of the recommendations made by the Finance Commissions of the States. Of course, the President can refer any other matter to the FCs "in the interests of sound finance" under Article 280. The Thirteenth and the Fourteenth Finance Commissions were asked to examine the needs of state to manage ecology, environment and climate change consistent with sustainable development. By no means can this ToR be treated as "any other matter in the interest of sound finance".

More and not less number has been added to the 14th FC's ToR. In addition to the Constitutional impropriety, ToRs of recent FCs are objectionable as they are loaded heavily in favour of the Central government. TheToRs give a detailed road map on how and in which direction the FCs should proceed, thus limiting the freedom and flexibility of this Constitutional body. Besides, given the fact that the FCs in India do not have a permanent secretariat to provide institutional memory, the FCs with short deadlines for submitting reports cannot do justice to the ever expanding ToRs.

Tax sharing: FC recommendations and actuals

The Pro-Centre tilt of the FCs brought about by their composition and the fetters imposed on them by the ToRs are reflected in the recommendations of the recent FCs. The 10th and 11th FCs fixed the States' share in total Central tax revenue at 29.5 per cent. The 12th FC had stepped up the States' share marginally to 30.5 per cent. The 13th FC raised the state's share only marginally, to 32 per cent. This is despite the strong plea made by all the States unanimously to raise their share substantially in view of their vastly expanding expenditure commitments in comparison with those of the Centre. What is more, the stipulated 32 per cent is not that of gross tax revenue but that of revenue after excluding Cesses and Surcharges and after deducting the cost of collection. Despite fixing the share of States in total Central Taxes by the 10th, 11th and the 12th Commissions at 29.5 and 30.5 percent, the actual share touched the stipulated shares only in one year (1997-98) during the entire 15-year period covered by their awards. The gap between the actual ratios and the stipulated ratios has been only widening in recent years as may be seen from column 2 of Table1.

The exclusion of Cesses and Surcharges from the shareable pool of Central Taxes and the increasing resort to these measures by the Central government may be part of the reason for the lower share of States in the Central tax revenue. According to the 12th FC's estimate, the share of Cesses and Surcharges were to increase to 12 per cent during their award period. The 13th FC had noted that the actual shares devolved to states as per the Finance Accounts have been less than the percentages recommended by the Finance Commissions. The Commission found that the actual shares devolved to states in 2005-06, 2006-07 and 2007-08, the first three years of 12th FC award for which Finance Accounts were then available amounted to, 29.36, 28.95 and 29.6 percent of the net sharable tax revenue of the Centre. They also suggested that "there is need for more transparency in the current procedure to avoid any inconsistency between the amount released to states in any year and the respective percentage shares in net central taxes recommended by Finance Commission for that year". It becomes necessary that the 14th FC revisits the amounts actually allotted to the States once the audited accounts are available.

The Commission should make it a point to compensate the States for shortfalls if any from the budget estimates of transfers based on FCs recommended share.

The 13th FC did not take any measure to arrest the increasing tendency of the Central government to keep a good portion of Central tax revenue out of the reach of the State governments. In fact, they have assumed the high ratio of 14.9 per cent for cost of collection and Cesses and Surcharges during the five years from 2010-11, the period of their award, in their forecast of Central revenue. All that the Commission could do was to exhort the Central Government that they should review the levy of Cesses and Surcharges with a view to reducing their share in its gross tax revenue. It is important that the 14thFC take a closer look at the surcharges. The 14th Commission should suggest that at least those surcharges which are continuing after two years must be added to the divisible pool of the Centre.

Indicative ceilings

The practice of giving indicative ceiling of the aggregate revenue transfers to States (Tax share + all grants including plan and non-plan grants) from the Centre's gross revenue started with the 11th FC. The reasons for placing such indicative ceilings are not made clear by the Commissions. Such ceilings are not warranted either by the Constitution or the ToRs of the Commissions. The 13th Commission fixed the States' share at 39.5 per cent, an increase of just 1.5 per cent from the share stipulated by the 12th Commission. There was a huge shortfall from the ceiling during the first year of their award period. The ceiling has been crossed during the last three years possibly due to the proliferation of CSS and resorting to the ACA route.

Central deficits and tax collections: FC's estimates and actuals

The Finance Commissions had been wielding a big stick for disciplining the States by limiting the volume of grants just enough to meet their deficits in their normative non-plan revenue accounts. There are other carrots and sticks reserved exclusively for the states in case they do not stick to the road map for fiscal consolidation fixed by the Commissions. But no such stick is used, for the Central government when there are deviations, from the 13th FC, or its predecessors. Such deviations from stipulated deficits are given in Table 2. Increase in budget deficits of the Centre leads to inflationary pressures, interest rate hike and other macro-economic consequences which affect the States' budgets hard. There is a strong case for the States to be compensated for these consequences by sharing the deficits or (the additional borrowings to cover the deficits) in excess of what is stipulated by the FC. Such an argument was made by (Gulati and George, 1988)[a].

Reasons for variations – increasing tax expenditures

The increase in deficits is partly on account of the shortfall in tax revenue mobilisation of the Centre. This shortfall in turn is partly on account of the large volume of revenue foregone by the Centre. The revenue foregone in relation to GDP and total tax revenue collected has been substantial as may be seen from Table 3.

It is not that we are arguing against a total ban on tax exemptions . What is being suggested here is that the Finance Commission should take an independent look at the tax breaks to see whether and to what extent these tax breaks can be justified from the point of view of incentives or equity. We suggest that the 14th Finance Commission should stipulate a limit for the taxes foregone at three percent of the GDP or 25 percent of the gross tax collections, whichever is lower.

How much the States should get from the Centre

Almost all the states had been arguing for raising the states' share in Centre's gross tax revenue from the present 32 per cent to 50 per cent. We also consider that there is scope for substantially raising the share of states in Central taxes. Firstly, the economic reforms in the country followed since 1991 provided for privatisation, public private participation and foreign participation. Economic services are more amenable than social services, for privatisation, public private participation and foreign participation. Most of the key economic services are in the domain of the Central government, whereas, most of the social services are in the states' domain. There is more likelihood of market failures and imperfections in social services than in economic services. In view of the public good character of social services, the scope for privatisation and the public private participation is limited as compared to economic services.

Secondly, too much funds left with the Centre tempts it to make inroads into States' subjects through the fiscal backdoor. (Gulati and George, 1988)[b]. The proliferation of Centrally Sponsored Schemes (CSS), Additional Central Assistance and special packages are the means for the backdoor entry into the States' Constitutional domain. In several meetings of the National Development Council (NDC), the states had been arguing for limiting transfers under CSS. But the number of CSS and their outlays has been going up rather steeply. Recently the Chaturvedi Committee had recommended a reduction in the number and outlays on CSS. While the number of schemes seem to have come down by mergers there appears to be no corresponding decrease in outlays.

The need for a second look at the committed expenditure of the Central Government

According to ToR3 (ii), the 14th Commission shall have regard to the demands on the resources of the Central Government, in particular, on account of the expenditure on civil administration, defence, internal and border security, debt-servicing and other committed expenditure and liabilities. Since defence, internal and border security are sensitive subjects, we are not venturing to suggest any reduction in expenditure on these heads. However, we would suggest to the Commission to explore independently whether there is any scope for ensuring defence, internal and border security in a more cost effective way. As for expenditure on civil administration of the Central Government, in our view, there is considerable scope for reduction as most of the functions are passed on to private and global participants. Besides, if the Commission decides to reduce the CSS and special packages to individual states, the scope for reduction in the Centre's expenditure on civil administration will be enhanced substantially.

Horizontal inequity and the Non-Plan Revenue Surpluses of States

Our discussion so far shows that the record of FCs in bringing about vertical equity had not been very commendable. It appears out that their record in bringing about horizontal equity too has been less than commendable. Given the large disparities among the states, it is not just enough that the FCs bring about some progressivity in their aggregate transfers. If the Commissions have to make even a small dent to the problem of disparities, they will have to provide for progressivity in the non-plan revenue surpluses. The influence of the Finance Commission in determining the size of the States' plan is not often appreciated. It is the balance in the non-plan revenue account (balance in current account) provided by the FCs which determines *inter alia* the size of the plan. What is also not realised is that it is the policy of the Finance Commission with regard to tax sharing and grants, that to a large extent determines this surplus in the non-plan account.The per-capita non plan revenue surpluses of states under the award of the 13th FC and the per-capita plan expenditure during the first three years of the Commission's award period is given in Table 4. The table shows that some of the backward states like Bihar, Orissa, Uttar Pradesh, Rajasthan and West Bengal had been left with very limited non plan surpluses, while the counterparts like Goa, Haryana, Karnataka and Gujarat are flush with such funds. The implication is that the less developed states start with a major handicap with respect to their 12th plan financing. This is reflected in the per-capita plan outlays of these States.

Annexure

Table 1

Fiscal Transfers from Centre to States (Figures in percentages)

Year	Ratio of Tax Share of States to Gross Tax Revenue of Centre	Ratio of Total Revenue Transfers to Gross Revenue of Centre
2005-06	25.78	35.10
2006-07	25.73	36.14
2007-08	25.59	34.72
2008-09	26.46	37.97
2009-10	26.39	38.59
2010-11	27.81	38.00
2011-12	28.87	43.89
2012-13*	28.53	48.03
2013-14+	28.02	45.28

* Revised Estimates
+Budget Estimates
Source:
1. EPW Research Foundation, “Finances of Government of India”, Economic and Political Weekly (EPW), Different Issues.
2. RBI Bulletin, Union Budget- Review and Assessment various years
3. Figures of 2006-07 are revised estimates from RBI Union Budget Review and Assessment 2007-08.

Table 2
Gross Fiscal Deficits, Revenue Deficits and Tax revenue of the Centre as ratio to GDP

13th Finance Commission's - Estimates and Actuals

Year	Fiscal deficit		Revenue Deficit		Gross tax revenue	
	Estimate	Actual	Estimate	Actual	Assesment	Actuals
2010-11	5.7	4.9	3.2	3.3	11.4	10.2
2011-12	4.8	5.7	2.3	4.4	11.8	10.1
2012-13 (R.E.)	4.2	5.2	1.2	3.9	12.2	10.4
2013-14 (B.E)	3	4.8	0	3.3	12.7	10.6

Source: For Estimates, Report of the 13th Finance Commission; For Actuals, Union Budget documents

Table 3
Revenue foregone by the Centre as a Percentage of GDP/tax revenue collected(Figures in Percentage)

Year	as % of GDP					as % of tax revenue collected
	Corporate income tax	Personal income tax	Excise	Customs	Total	Percentage to total tax revenue
2010-11	0.8	0.5	2.5	2.3	6	58.42
2011-12	0.7	0.4	2.2	2.6	5.9	60.01
2012-13	0.7	0.5	2.1	2.5	5.7	55.26

Source: Compiled by Centre for Budget and Government Accountability (March 2013) New Delhi

Table 4					
Non-plan Revenue Surpluses@ and the Plan Outlays of States					
States	Post-Tax Transfers Devolution Non-Plan Revenue Surplus (+) / Deficit (-) (Rs. crores)	Total Grants in Aid (Rs. crores)	Total Non-Plan revenue Surplus /Deficit after all Statutory Transfers (Rs. crores)	Per-capita Non-Plan Revenue Surpluses (Rs.)	Per-capita Plan Outlays
	1	2	3 (1+2)	4	5
Andhra Pradesh	116092	13532.3	129624.3	15310	20458
Bihar	69177	14602.8	83779.8	8071	9038
Chhattisgarh	42796	6175.5	48971.5	19174	32807
Goa	8462	516.2	8978.2	61591	105987
Gujarat	120339	9682.9	130021.9	21533	29478
Haryana	109652	4270.8	113922.8	44935	35782
Jharkhand	34140	7238.4	41378.4	12552	16553
Karnataka	146665	11601.4	158266.4	25890	25882
Kerala	17113	6371.5	23484.5	7034	15889
Madhya Pradesh	85456	13324.5	98780.5	13607	14532
Maharashtra	189862	16302.8	206164.8	18346	18280
Orissa	41032	9658.8	50690.8	12084	14065
Punjab	20828	5540.3	26368.3	9518	18257
Rajasthan	78157	12949.8	91106.8	13277	18301
Tamil Nadu	117939	11366.9	129305.9	17925	15074
Uttar Pradesh	201782	26742.9	228524.9	11450	9937
West Bengal	49385	12638.7	62023.7	6790	10555
All States *	1450802	258581	1709383	14125	

* All States include special category States also.
@ after all Statutory Transfers by the 13FC
Source: 1.Report of the 13th Finance Commission 2010-15
2. Plan Outlay figures from RBI State Finances
Note: Population figures of 2011 Census are used for per capita calculations.

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a) "Centre-State Resource Transfers, 1951-84" in Essays In Federal Financial Relations, Centre for Development Studies, Trivandrum, 1988.
b) "Central Inroads Into State Subjects",ibid

How Many Miles Before We Get the Fiscal Policy Space Right?

Praveen Jha and Rohith Jyothish*

Despite high growth for over four decades, persistent and pervasive development deficits like hunger, malnutrition, poverty, lack of drinking water supply and inadequate sanitation facilities have continued to plague India. In such a scenario, the role of the state assumes centre-stage in all policy dialogues.

Need for Expanding the Fiscal Policy Space in India through a Higher Tax-GDP Ratio

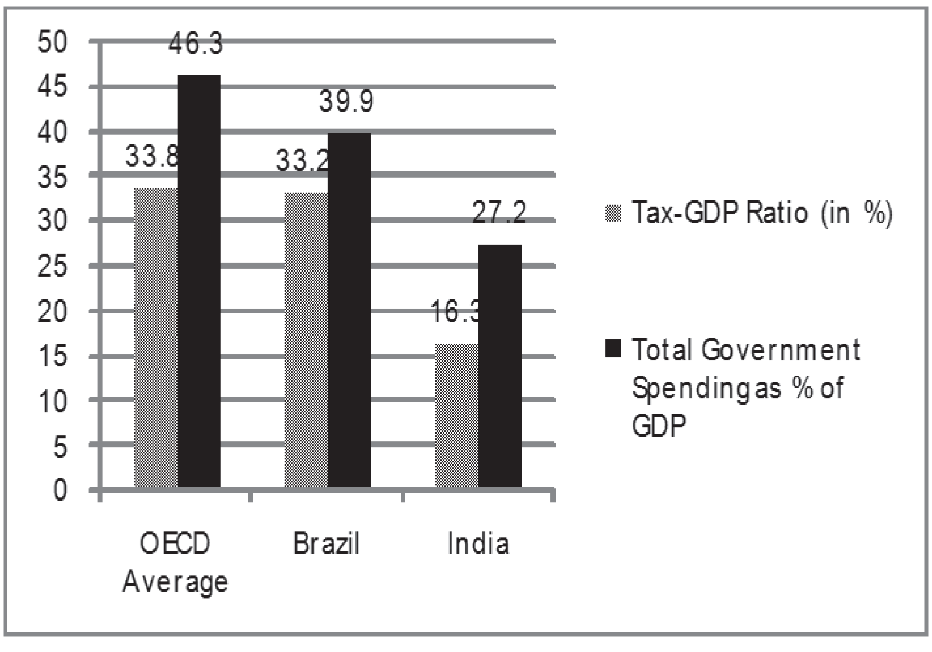
With regard to the total magnitude of government spending in India as compared to the size of the country's economy, we need to recognize that the same has been much higher in most of the developed countries as well as in some of the other developing countries like Brazil and South Africa. For instance, for the year 2010, total government spending as a proportion of the country's Gross Domestic Product (GDP) was 27.2 percent for India, while it was a much higher 39.9 percent for Brazil and 46.3 percent for the Organisation of Economic Co-operation and Development (OECD) countries on an average (*see Chart 1*).

A comparison of total government expenditure to GDP ratios across the BRICSAM countries (*presented in Table 1a and 1b*) indicates that China, South Africa, Mexico and Brazil have expanded their fiscal policy space over the decade from 2001 to 2012, while that has not happened in India. Also, a comparison of per capita government revenues and expenditures (in purchasing power parity US dollars and at current prices) in India, other BRICS Countries and OECD Average (*presented in Table 2*) shows that that the level of per capita government expenditure in India is far short of the OECD average, Russia, Brazil, South Africa and even China. It seems the level of per capita government spending in China has improved considerably during 2001 to 2011, as a result of which the gap between China and India in this regard has widened over the last decade.

In passing, we may also note that figures for China may as well be an underestimate as substantial expenditure is by local governments.

When the quantum of government spending is higher (as a proportion of the GDP of the country), the government does get a larger fiscal policy space; this allows the government to carry out substantive public provisioning of essential services (like, education, health, drinking water and sanitation etc.) and other development interventions for the people. The limited fiscal policy space in India has led to low magnitudes of government spending on a range of social sectors where the vulnerable sections of the country's population are likely to be dependent significantly on public provisioning. As a result of inadequacy of budgetary resources, public provisioning in social sectors and social security programmes in India seem to have suffered from the problems of inadequate coverage and unsatisfactory quality. The path of fiscal consolidation followed in India over the last decade has not allowed much space for expansionary fiscal policies; however, the low tax-GDP ratio in India could be improved in order to acquire larger space to increase public expenditure on development sectors. The overall magnitude of public resources available to the government in India has

Chart 1 A Comparison of Tax-GDP Ratio and Total Government Spending as Percent of GDP: India, Brazil and OECD Average (as of 2010)



Source: Compiled by CBGA from (i) IMF (2014), "World Economic Outlook - Recovery Strengthens, Remains Uneven", April 2014 (ii) OECD (2014), OECD Fact book 2014: Economic, Environmental and Social Statistics, OECD Publishing (iii) Government of India (2013), "Indian Public Finance Statistics 2012-13", Ministry of Finance.

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been inadequate in comparison to several other countries, mainly owing to the low magnitude of tax revenue collected in the country; at around 17 percent of the GDP, India's tax-GDP ratio constrains the fiscal policy space available to the government.

Within India's total tax revenue, two-thirds come from indirect taxes and only one-third comes from direct taxes (*please see Table 3*), which makes it more regressive compared to that of many other countries (that collect a much higher proportion of tax revenue from direct taxes). India's direct tax revenue as a proportion of total tax revenue at 37.7 percent (for the year 2010-11) is far below the G20 average of almost 50 percent. Even developing countries such as South Africa (57.5 percent), Indonesia (55.85 percent) and Russia (41.3 percent) have a more progressive tax structure. Property related taxes (which include tax on wealth, tax on immovable property and estate, inheritance and gift tax) constitutes only 0.40 percent of total tax revenue of the country as opposed to 4.85 percent for the BRICS average and 7.60 percent for G20 average. Hence, there is a need for exploring the possibility of stepping up revenue collected from property related taxes in India.

In this context, we should also note that the recent Union Budgets have not incorporated any strong proposal towards reducing the significant amount of tax revenue forgone due to the plethora of exemptions in the central tax system (*please see Table 4*). Even the proposed transition to Goods and Services Tax and Direct Taxes Code would bring in stability

Table 1 Expenditure and Revenue to GDP Ratios for BRICSAM Countries

a. Expenditure-GDP Ratio (in %)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Brazil	36.1	39.2	39.0	36.1	37.7	38.0	38.4	38.3	38.1	39.9	39.2	40.4
Russia	33.7	36.3	34.9	31.7	32.8	31.1	33.1	34.3	41.4	38.0	35.9	37.5
India	26.8	27.5	28.5	27.2	26.2	26.5	26.4	29.7	28.3	27.2	26.7	26.9
China	17.9	18.9	18.6	18.1	18.6	18.9	18.9	20.4	23.2	22.8	23.9	24.8
South Africa	25.9	25.8	26.5	26.5	26.9	28.2	28.4	30.1	33.0	32.4	31.9	32.6
Mexico	21.2	22.1	22.5	20.3	21.7	22.6	22.8	25.6	27.2	26.7	26.3	27.2

Note: Total expenditure consists of total expense and the net acquisition of non-financial assets. Apart from being on an accrual basis, total expenditure differs from the GFSM 1986 definition of total expenditure in the sense that it also takes the disposals of nonfinancial assets into account.

Source: Compiled by CBGA from International Monetary Fund, World Economic Outlook Database, April 2014

b. Revenue- GDP Ratio (in %)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Brazil	33.5	34.7	33.8	33.2	34.1	34.4	35.6	36.7	34.8	37.1	36.6	37.7
Russia	36.9	37.0	36.4	36.6	41.0	39.5	39.9	39.2	35.0	34.6	37.5	37.9
India	16.9	17.7	18.2	18.9	19.1	20.3	22.0	19.7	18.5	18.8	18.7	19.5
China	15.1	15.9	16.2	16.6	17.2	18.2	19.8	19.7	20.2	21.3	22.6	22.6
South Africa	24.7	24.7	24.6	25.3	26.5	28.9	29.7	29.6	28.1	27.5	27.9	28.3
Mexico	18.2	18.8	20.2	19.1	20.4	21.6	21.7	24.7	22.1	22.4	22.9	23.5

Note: Revenue consists of taxes, social contributions, grants receivable, and other revenue. Revenue increases government's net worth, which is the difference between its assets and liabilities. Transactions that merely change the composition of the balance sheet do not change the net worth position, for example, proceeds from sales of nonfinancial and financial assets or incurrence of liabilities.
Source: Compiled by CBGA from International Monetary Fund, World Economic Outlook Database, April 2014

Table 2 Per Capita Government Revenues and Expenditures: India, Other BRICS Countries and OECD Average

	General Government Revenues Per Capita (in US dollars, at current prices and PPPs)		General Government Expenditures Per Capita (in US dollars, at current prices and PPPs)	
	2001	2011	2001	2011
OECD Average	10751	15419	10716	16548
Russia	3341	7706	3395	7917
Brazil	2450	4272	2638	4564
South Africa	1704	3098	1784	3537
China	395	1897	469	2004
India	274	688	422	997

Source: Compiled by CBGA from OECD (2014), "General government expenditures and revenues per capita", in OECD Factbook 2014: Economic, Environmental and Social Statistics, OECD Publishing. (http://dx.doi.org/10.1787/factbook-2014-87-en)

in the tax laws as demanded for by the private investors but they might not help the government much in stepping up the country's tax-GDP ratio.

Hence, the Fourteenth Finance Commission should consider giving policy directions towards expanding the fiscal policy space in India, mainly through a higher tax-GDP ratio, focusing specifically on stepping up the direct tax to GDP ratio for the country over the next five years.

Table 3 Magnitude of Total Tax Revenue in India as % of GDP

	Direct Tax as % of GDP	Indirect Tax as % of GDP	Total Tax Revenue as % of GDP
1990-91	2.09	12.87	14.96
2000-01	3.31	10.77	14.08
2004-05	4.23	11.02	15.25
2005-06	4.54	11.37	15.91
2006-07	5.39	11.77	17.15
2007-08	6.39	11.06	17.45
2008-09	5.83	10.43	16.26
2009-10	5.82	9.63	15.45
2010-11	5.78	10.53	16.31
2011-12	5.57	10.73	16.29
2012-13 (RE)	5.73	11.49	17.22
2013-14 (BE)	5.97	11.9	17.87

Note: RE refers to Revised Estimates; BE refers to Budget Estimates; these figures can change in the Actuals.
Source: Compiled by CBGA from the data given in Government of India (2014), "Indian Public Finance Statistics 2013-14", Ministry of Finance.

Recommendations

There are certain measures that the State can take to enhance the tax-GDP ratio:

- Compared with other G20 countries, India has a very narrow tax base and a regressive tax structure. The contribution of Direct Taxes to total tax revenue and of Property Taxes within Direct Taxes is low too. Better property taxation which includes tax on wealth, on immovable property and estate, Inheritance and Gift Tax can raise significant revenues.

- Staff shortages across various agencies (such as CBDT, CBEC and ED) that are involved in tax collection and administration has been estimated to be around 30,000. Strengthening the tax administrative apparatus will ensure better compliance.

- As per the Union Budget 2014-15, tax exemptions/concessions/incentives/ deductions were at 5.0 percent of GDP in 2013-14. Although some of them are justified, there is a need to review of these clauses to understand which of them have sound economic and social rationale and which do

Table 4 Estimated Figures for Revenue Foregone due to Exemptions in the Central Tax System

Revenue foregone as % of GDP	Corporate Income Tax	Personal Income Tax	Excise Duty	Customs Duty	Total	Less Export Credit related	Grand Total (Total-Export Credit Related)
2005-06	0.9	0.4	1.8	3.5	6.6	1.0	5.6
2006-07	1.2	0.4	2.3	2.9	6.7	1.3	5.5
2007-08	1.2	0.8	1.8	3.1	6.8	1.1	5.7
2008-09	1.2	0.7	2.3	4.0	8.2	0.8	7.4
2009-10	1.1	0.7	2.6	3.0	7.4	-	7.4
2010-11	0.8	0.5	2.5	2.3	6.0	-	6.0
2012-13	0.7	0.3	2.1	2.5	5.6	-	5.6
2013-14 (projected)	0.7	0.4	1.7	2.3	5.0	-	5.0

Note: (1) 2005-06 figures are Provisional

(2) 2006-07 Figures are Estimated

(3) For 2005-06 and 2006-07, Cooperative Sector exemptions figures are also available. However, this has not been included for comparability of four categories of exemptions, namely Corporate Income Tax (CIT), personal Income Tax (PIT), Excise Duty and Customs Duty for all years.

(4) Since 2009-10, Export Credit Related items are adjusted against the Custom Duty Exemptions figures, and adjusted data are provided under the heading 'Customs Duty'. Hence, since then separate data for 'Less Export Credit related' are not available.

(5) The ratios to GDP at current market prices (CMP) are based on the Central Statistics Office's (CSO) National Accounts 2004-5 series

Source: Statement of Revenue forgone, Union Budget 2005-06 to 2014-15 (July 2014), Govt. of India.

not. This could augment the revenue mobilization.

- A comprehensive review of all Double Taxation Avoidance Treaties (DTATs) to curb round tripping of black money, enhance financial transparency and increase revenue mobilization.

- Tax amount raised but not realized was Rs. 4,92,637 crore at the end of financial year 2012-13. Out of this, Rs. 82,360 crore were not under dispute, while Rs. 4,10,277 crore were under dispute. Tax arrears related to corporate taxes amounted to Rs. 1,52,456 crore and other income taxes to Rs. 2,61,430 crore. The Supreme Court had effectively slammed the Union Finance and Law ministries in 2012 about the laxity in filing appeals by the government's litigation machinery. Under these circumstances it is imperative that the government addresses this.

Reduced Fiscal Autonomy in States

Sona Mitra*

Intergovernmental transfer of resources between national and sub-national governments has been a contentious issue in the domain of India's fiscal architecture. To facilitate the mechanism of such transfers, the Constitution provides for an institution, the Finance Commission (FC), in the Article 280 (3). The FC is formed once every five years, and, currently the 14th FC has taken charge with its Terms of Reference in the public domain.The Indian Constitution is characteristically federal with certain 'unitary features'; however, the last two decades have witnessed a reversed tendency of accentuated powers with the Centre and reduced fiscal autonomy, along with a roadmap of stringent fiscal consolidation, at the sub-national level. Growing role of the Planning Commission, rise in the number of Centrally Sponsored Schemes and transfer of resources to States tied to the broad / specific objectives of the Central Ministries have been the basis for regular criticism of the Central Government. In such a backdrop, the Finance Commission has been looked upon by the States as the main source of untied transfers comprising the States' share in central taxes and statutory Grants-in-aid.

Reduced Fiscal Autonomy at the Sub-National Level

The Terms of Reference (TOR) of the 14th FC, in tandem with the previous Commissions, includes the three clauses adhering to its Constitutional mandate of making recommendations, which are:

a) Extent of vertical and horizontal distribution (between the Union and the States) of net proceeds of taxes,

Table 1: Allocation of Grants by Finance Commissions for Non-Core Functions

Finance Commission	Heads of Non -Core Function	Amount (in Rs. Crore)	Total Non-Core Function Allocation (in Rs. Crore)	Non-Core Function Allocation as % of Total Grants (FC + PC$) to States
10th (1995-96 to 1999-2000)	Upgradation	1362.5	2608.5	2.15
	Special problems	1246.0		
11th(2000-01 to 2004-05)	Upgradation	3843.63	4972.63	2.12
	Special problems	1129		
12th(2005-06 to 2009-10)	Health	5887.08	44783.73	7.77
	Maintenance of Education	10171.65		
	Maintenance of roads and bridges	15000		
	Maintenance of Buildings	5000		
	Conservation of forest	1000		
	Heritage Conservation	625		
	State specific needs	7100		
13th(2010-11 to 2014-15)	Fiscal Performance Incentive	1500	102889	13.39*
	Elementary Education	24068		
	Improvement in Performance of Specific Union Governance Initiatives	9446		
	Environment related	10000		
	Maintenance of roads and bridges	19930		
	State-specific needs	27945		
	Renewable energy	5000		
	Reducing IMR	5000		

Source: Calculated by CBGA based on different Finance Commission reports
*Percentage calculated against grants between 2010-11 and 2013-14, $ Planning Commission

* Sona Mitra works with the Centre for Budget and Governance Accountability (CBGA), New Delhi

b) Principles which should govern the grants-in-aid of revenue of the States out of the Consolidated Fund of India, and

c) Measures needed to augment the Consolidated Funds of the States to supplement the resources of the local bodies.

While the above recommendations constitute the core mandate of the FC, other items have also been included in the TORs of previous Commissions pertaining to State specific needs. The point of concern with successive FCs, specifically since the 12th FC, has been related to the nature of devolution of grants-in-aid under specific heads.

The grants-in-aid, which are over and above the FC recommendation of sharing a specific proportion of the divisible pool of central taxes with States, have also been perceived by the States as untied resources. However, in the recommendations of the FCs over the last decade, grants for core-mandate (or core functions) have been replaced by grants for certain non-core functions. The *upgradation* grant received by States through FC since the 7th FC has been one of the non-core function grants. The *upgradation* grants were also allocated by specific sectoral requirements of States. The 10th FC introduced the *special problems grant* in addition to the *upgradation* grant. In the 12th and 13th FCs, the heads for non-core function grants to states have become more specific (Table1 on page 20). The *upgradation* devolution does not feature; instead there are newer heads of non-core function grants, which show an increasing share in total grants to States.

Increasing 'Non-core mandate' Issues reflected in TOR of 14th FC

In this context it is important to note that the TOR of the 14th FC also sought recommendations on 'any other matter referred to the Commission by the President of India'. So long as the 'other items' pertain to the issue of maintaining a sustainable fiscal environment, it is apt for the 14th FC. However, a list of 11 'consideration items' have been included in the TOR of the 14th FC, some of which do not seem to be strictly related to the interests of sound finances of the Union or the States. These include issues such as,

i) The level of subsidies that are required, having regard to the need for sustainable and inclusive growth, and equitable sharing of subsidies between the Union Government and State Governments;

ii) The need for insulating the pricing of public utility services like drinking water, irrigation, power and public transport from policy fluctuations through statutory provisions;

iii) The need for making the public sector enterprises competitive and market oriented; listing and disinvestment; and relinquishing of non-priority enterprises; and

iv) The need to balance management of ecology, environment and climate change consistent with sustainable economic development.

These inclusions appear to be motivated by the requirements to provide a governmental position on the ongoing debates on subsidies, cost recovery, environmental misuse and disinvestment rather than by the requirements of the Constitutional mandate for the Finance Commission and, therefore, constitute the 'non-core mandate' for the 14th FC. Thus, it remains up to the 14th FC to decide whether or not to 'consider' these items for making recommendations in its report.

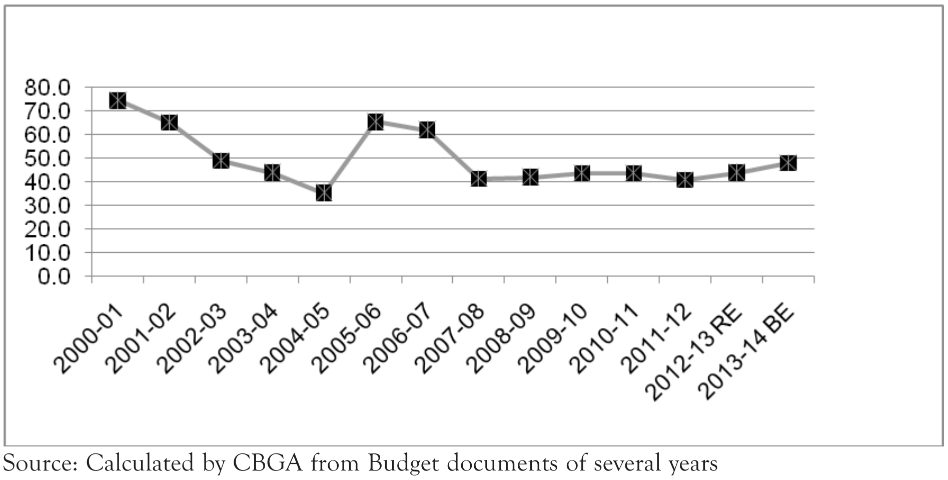
In the context of the 'non-core mandate' for the 14th FC, some of the issues confronting the State Governments have been dealt with effectively, in the recommendations made by the B. K. Chaturvedi Committee (of the Planning Commission, pertaining to restructuring of the Centrally Sponsored Schemes in the Twelfth Five Year Plan) and the Punchhi Commission. These have been supported by most States and the 14th FC could take a position on whether it endorses any of these recommendations.

Also, some of the 'non-core mandate' items for consideration of the 14th FC, such as, 'pricing of public utilities', could be best left to be dealt with by respective sectoral policymakers and regulators.

Tied versus Untied Transfer of Resources

The concern here is whether the nature of transfers made to the States are actually free from conditionalities. It is important to note that given an increase in the non-core function grants by the Finance Commission (FC), rising tendencies of centralization, have not been restricted only to transfers made by the Planning Commission. The broader trends in devolutions from Centre to States show that the ratio between Non-plan grants and Plan grants has declined substantially, indicating the increase in the tied nature

Chart 1: Ratio of Non-plan Grants to Plan Grants (in %)



Source: Calculated by CBGA from Budget documents of several years of fund transfers to States (Chart 1). The sudden peak reflected for 2005-06 in chart 1 is mainly due to the withdrawal of the loan component of Central Assistancefor State & UT Plans, which was recommended by the 12th FC. Despite such changes, the ratio shows a somewhat declining trend over subsequent years.

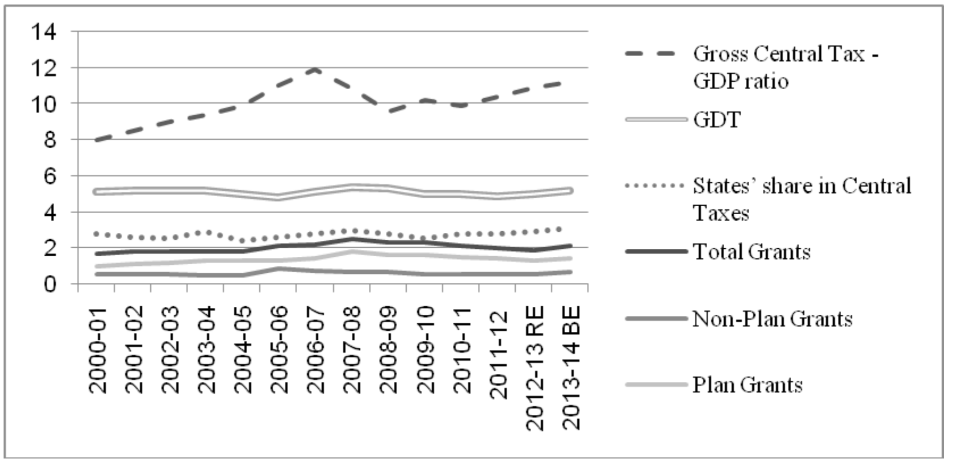
The trends of central transfers to States show that while total grants as a proportion of Gross Devolution and Transfers (GDT) have increased slightly over the last two decades, Non-plan grants as a proportion of both total grants as well as GDT shows stagnation. While Plan grants have been increasing during this period, the Non-plan grants, which form a major part of the untied transfers to States, have declined thus imposing restrictions on States in their expenditure decisions. The share of States in gross central tax revenue, which is devolved according to FC recommendations,has also followed the same pattern and does not show significant variations (Chart 2).

Similarly, when we look at GDT, total grants and non-plan grants to States as proportions of GDP, the trends do not exhibit much change (Chart 3). However, States' share in gross central taxes as percentage of GDP shows a marginal increase. That is also due to the increase in the total tax revenue, as is evident from the increased tax-GDP ratio (Chart 3). This stagnation in fund devolution to States as proportions to GDP has become a cause of concern especially over the last few years. Between 2005-06 and 2009-10, the rate of GDP growth in India has been in the range of moderate to high (7-8 percent per annum). It was expected that the gains from faster GDP growth and buoyancy of central taxes would trickle down to the States. But the transfers to States, as evident from the tables below, have belied such expectations. Added to these trends, Chart 3 also shows an increase in the share of plan transfers to States as percentage of GDP, thus corroborating the argument of increased conditionalities on resources transferred to the States.

Given this caveat, one of the major challenges confronting the 14thFC would be to address the need for increasing untied transfers to the States so that they have greater autonomy in their spending decisions. Meanwhile, curbing States' power in order to maintain fiscal discipline has resulted in a number of problems for the States, as the State governments have refrained from making any long-term expenditure commitments, especially in social service departments, in order to maintain fiscal discipline. Apart from other problems, a major consequence of such disciplining has resulted in the problem of shortage of staff in the regular cadres of several State Government departments (this issue has been discussed separately in another article in this issue of Budget Track. This article limits itself to a mere mention of the problem).

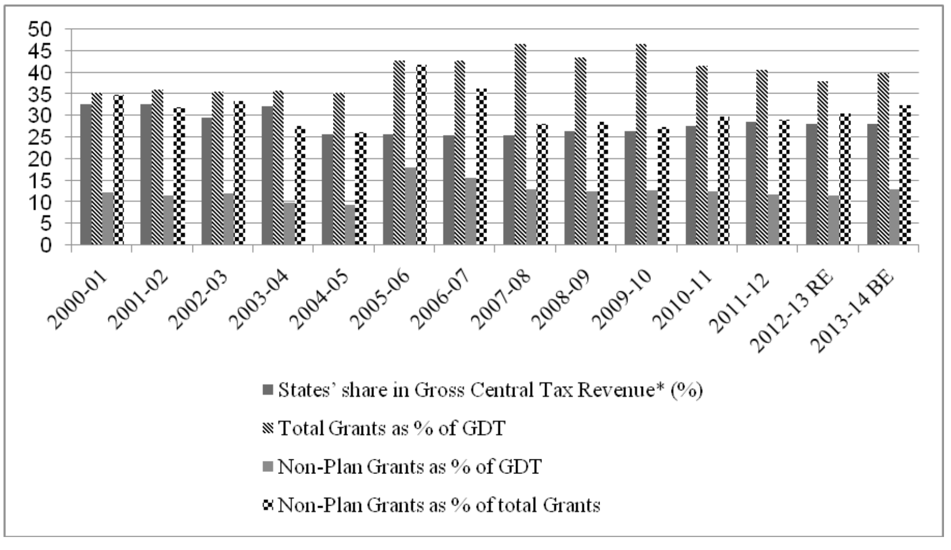
However, such tendencies are in tandem with the kind of 'fiscal consolidation' strategies that the State Governments have followed over the last decade. In their attempt to eliminate the Revenue

Chart 3: Transfers to States as Percentage of GDP



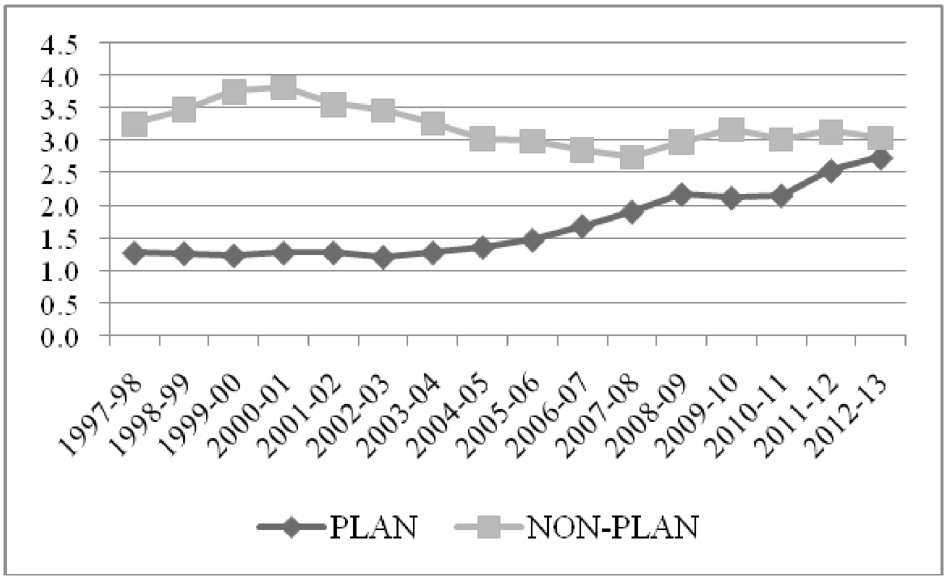
Source: calculated by CBGA from Budget documents, RBI Finance Accounts and NAS estimates of several years

Chart 2: Centre-state Resource Transfers: 2000-01 to 2013-14



* Gross Central Tax Revenue, inclusive of collections from Cesses, Surcharges, and taxes collected by UTs
Source: Calculated by CBGA from Union Budget documents and RBI's "State Finances", several years

Chart 4: Plan and Non-Plan Expenditure in Social Services as Percentage of GDP



Source: calculated by CBGA from Budget documents, RBI Finance Accounts and NAS estimates of several years

Deficit, many States seem to have checked their Non-Plan spending, particularly in Social Services. This is also evident if we look at the Non-Plan expenditure patterns on Social Service as percentage of GDP (Chart 4). The chart below clearly illustrates that between 2000 and 2007, Non-plan expenditure on Social Services experienced a sharp decline. The two peaks, prior to 2000 and post 2007 are due to the impact of the 5th and 6th Pay Commissions respectively, which increased the salary component of the Non-Plan expenditure in Social Services. Freezing the recruitments in regular cadres of their departments for more than a decade now, and thus embarking upon a policy of fiscal consolidation via decreased salary/wage component of the Non-Plan expenditure has become an easy tool for most states to achieve the mandated targets of fiscal and revenue deficits.

The policies in the domain of Centre-State sharing of resources over the last one and half decades seem to have neglected the need for greater magnitudes of untied resources being transferred to State Governments.The transfers of resources tied to the conditionalities / objectives of the Centre (such as, those in the Central schemes, Additional Central Assistance for State Plans and Special Central Assistance for State Plans) have gone up. Such transfers essentially have an ad-hoc approach and do not enable the State Governments to increase, or even sustain the existing levels of long-term expenditure commitments. In this context, the Finance Commission is the only institution, which can address the problem of inability and/or unwillingness of the State Governments to make long-term expenditure commitments. It is thus expected that the recommendations of the14th FC would give sufficient attention to this problem and explore the possible remedies in the domain of sharing of untied resources with State Governments as well as provide incentives to the States to engage in long term commitments towards social sectors.

Erosion in Governance Capacity at the Sub-national Level

Subrat Das and Saumya Shrivastava*

A view which has been propagated the most in the last few years with regard to the public spending in India, is that under-utilisation and ineffective use of budgetary resources is the biggest challenge in this domain; not the inadequacy of budgetary resources for the social sectors. It is true that in many sectors, the available budgetary resources are not being utilized very well and some amount of resources are also remaining unspent in the schemes. However, research studies by Centre for Budget and Governance Accountability and other civil society organisations have shown that – staff shortages in different functions (programme management, finance and accounts, and most importantly service providers) are among the principal factors causing under-utilisation of budgetary resources in the social sector schemes. An important issue for the 14th Finance Commission is to address these key challenges pertaining to the acute shortage of human resources (HR) in the State Governments, especially in the development sectors, in the relatively backward States. The problem is rooted in the inadequacy of resources with the State Governments and their unwillingness to fill up the staff vacancies. It has been argued that shortage of staff, especially in the regular cadres of the State Government departments in sectors like education, health, water and sanitation, rural development and agriculture, among others, is one of the main factors affecting the coverage as well as quality of government interventions in these crucial sectors, across many States.

The available evidence indicates that India has only 1.6 government personnel for every 100 residents (including the personnel in the Union Government, Indian Railways, State Governments, Urban and Rural Local Governments and Public Sector Undertakings) as compared to much higher figures of 3.3 in South Africa, 3.9 in Mexico, 5.9 in Brazil, 7.2 in Germany, 10.1 in the UK and 10.6 government personnel for every 100 residents in Canada (*please see Table 1 below*).

Table 1 Public Sector Employment across select countries

Government Staff as percentage of population

Country	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Brazil	NA	NA	NA	5.3	5.3	5.6	5.7	5.8	5.9	NA
Canada	9.8	9.8	10.0	10.0	10.0	10.2	10.3	10.5	10.6	10.6
France	10.8	10.9	11.0	10.8	10.6	10.6	NA	NA	NA	NA
Germany	7.5	7.4	7.4	7.2	7.0	7.1	7.1	7.1	7.2	7.3
India	1.8	1.7	1.7	1.6	1.6	NA	NA	NA	NA	NA
Mexico	4.6	4.5	3.9	3.9	3.9	3.9	3.9	3.9	3.9	NA
Russia Federation	16.6	16.6	16.5	16.4	15.7	15.2	15.1	1.5	14.6	NA
South Africa	3.2	3.1	3.1	3.1	2.4	3.3	NA	NA	NA	NA
UK	9.5	9.6	9.9	10.0	10.1	10.0	9.8	9.7	10.1	10.0

Source: Compiled by CBGA from http://laborsta.ilo.org/STP/guest for data on Government Employees and http://databank.worldbank.org/ for data on Population

Notes: (1) The Public Sector is composed of a general government sector and a public corporation sector. This includes employment of general government sector as defined by the System of National Accounts (1993) plus employment of publicly owned enterprises and companies, resident and operating at Central, State (or regional) and local levels of government.

(2) The general government sector is the total employment of all government units, social security funds and non-market Non Profit Institutions (NPIs).

(3) The employment of publicly owned enterprises and companies is the employment of all units producing goods or services for the market and which are mainly owned / or controlled by government units.

(4) Total population is based on the de-facto definition of population, which counts all residents regardless of legal status or citizenship—except for refugees not permanently settled in the country of asylum, who are generally considered part of the population of their country of origin. The values shown are mid-year estimates

* Subrat Das and Saumya Shrivastava work with the Centre for Budget and Governance Accountability (CBGA), New Delhi.

If we exclude the personnel under the Union Government and central PSUs and look at government personnel for every 100 residents in various State Governments, we find that the figure varies from 0.9 in Gujarat to 1.5 in Kerala (*please see Tables 2 to 8 below*).

In terms of the shortage of government personnel at the sub-national level in India, the sectors that have been worst affected are mostly the development sectors, like, education, health, water and sanitation, rural development and agriculture, among others. It is important to note here that, in these development sectors, the total number of government personnel available at present includes a significant proportion of 'contractual' staff (hired on a contract basis for a few months or at the most a couple of years, who are usually less qualified and much less paid

Table 2 Number of Government Employees in Odisha

	2006-07	2009-10	2011-12
Total Government Staff Strength	467517	442294	464179
State Population in Absolute numbers	38887000*	40025000*	41974218
Government Employee Per 100 Persons	1.20	1.11	1.11

Source: Compiled by CBGA from Statement Presented along with the Annual State Budget under the Orissa Fiscal Responsibility & Budget Management Rules, 2005; various years
* Population Projections as per 'Population Projections for India And States 2001-2026', Report of the Technical Group on Population Projections Constituted by the National Commission on Population; May 2006

Table 3 Number of Government Employees in Kerala

	2011-12	2013-14
Total Government employees	49956	502557
State Population in 2011	33,406,061	
Government Employee Per 100 Persons	1.50	1.50

Source: Appendix I to the Detailed Budget Estimates of the Government of Kerala, Various Years And Census of India, 2011

Table 4 Number of Government Employees in Gujarat

	Previous Year 2011-12	Previous Year 2012-13 RE	Ensuing Year 2013-14 BE
Total Government Employees**	540145	539881	539881
State Population in 2011	60,439,692		
Government employee per 100 persons	0.894	0.893	0.893

Source : Statements Under The Gujarat Fiscal Responsibility Act, 2005; February 2013 Finance Department, Govt. of Gujarat and Census of India 2011, GoI
** Includes employees in Panchayats
*Includes employees in Government Departments, Aided Institutions, PSUs, Panchayats and Urban local bodies

Table 5 Number of Government Employees in Andhra Pradesh (As on 31st March 2012)

Total Government Employees	1176609
State Population in 2011	84,580,777
Government employee per 100 persons	**1.39**

Source: Statement of Fiscal Policy to be laid on the table of the A.P. State Legislature in March 2013 and Census of India 2011, GoI
*Includes employees in Government Departments, Aided Institutions, PSUs, Panchayats and Urban local bodies

Table 6 Number of Government Employees in Madhya Pradesh (As on 31st March 2012)

Total Government Employees	736313
State Population in 2011	72,626,809
Government employee per 100 persons	**1.01**

Source: FRBM Statement of Madhya Pradesh 2013-14; Finance Department, Govt. of Madhya Pradesh and Census of India 2011, GoI
*Includes employees in Government Departments, Aided Institutions, PSUs, Panchayats and Urban local bodies

Table 7 Number of Government Employees in Rajasthan

Number of government employees	PreviousYear 2011-12	Current Year 2011-12 RE
Total Government Employees	847000	887000
State Population in 2011	68548437.0	
Government employee per 100 persons	**1.24**	**1.29**

Source: FRBM Statement 2013-14, Department of Finance, Govt. of Rajasthan and Census of India 2011, GoI*
Includes employees in Government Departments, Aided Institutions, PSUs, Panchayats and Urban local bodies

Table 8 Number of Government Employees in Haryana

	Previous Year 2012-13 (Actual)	Current 2013-14 RE
Total Government Employees	402916	387227
State Population in 2011	25,351,462	
Government employees per 100 persons	**1.59**	**1.53**

Source: FRBM Statement 2014-15; Department of Finance, Govt. of Haryana and Census of India 2011, GoI
*Includes employees in Government Departments, Aided Institutions, PSUs, Panchayats and Urban local bodies

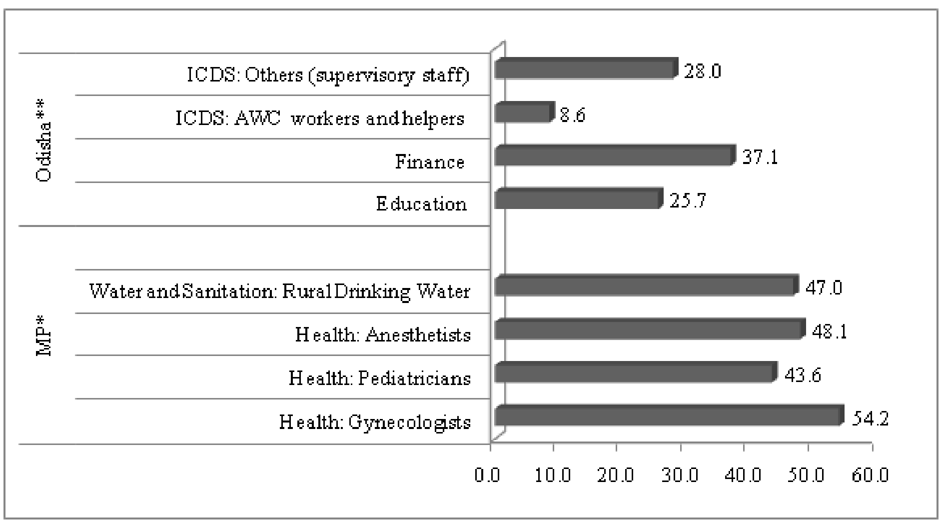
than those recruited as regular or permanent cadre employees).

The evidence compiled by some of the think tanks and civil society organisations indicate that the problem of staff shortage has grown into a crisis in governance of the country. For instance, several newspaper reports and micro-studies commissioned by government and independent organisations have pointed out that the shortages in quality human resources is one of the major challenges faced by the public delivery of services in India. Recently a report submitted by Public Health Foundation of India to the Ministry of Health and Family Welfare reported that, in the healthcare sector of the country, shortages of skilled / technical professionals are far greater compared to those of non-technical staff and that the overall shortage amounts to more than 64 lakhs in absolute numbers. Several newspaper reports have quoted the magnitude of shortage of health professionals in different states. Jharkhand reported a shortage of 7000 doctors and Maharashtra reported at least 60 percent vacancies in its health sector. Even the state of Kerala, where health indicators are comparable to the European standards, also reports almost 50 percent vacancies in the health department.

Similarly for education, several studies and news reports have pointed out major gaps in HR. Uttar Pradesh (UP) alone accounts for a shortage of 3 lakh school teachers, followed closely by Bihar at 2.6 lakh, West Bengal (WB) at 1 lakh and Rajasthan at 70,000. In Jharkhand almost two-thirds and in Odisha 57.7 percent of the sanctioned posts for primary school teachers are vacant. Information based on some civil society study reports and government documents, also indicate similar shortages of staff in different sectors in the relatively backward States (Chart 1).

It is important to note here that the problem of staff shortage is likely to be more acute in skilled / technical staff positions (including all three kinds of such staff, viz. programme managerial staff, finance and accounts staff, and skilled service providers) than the unskilled / support staff positions. Moreover, the extent of shortages is with reference to the numbers of posts sanctioned in different States, which are likely to be outdated in many cases.

Chart 1: Shortages of Staff in Madhya Pradesh (MP) and Odisha in Selected Sectors (in State Government Departments), 2012



Source: *Compiled from - Vikas Samvad (2012), Status of Maternal and Child Health Services in MP: A Situation Analysis, Bhopal, MP, ** Calculated from - Govt. of Odisha (2012), FRBM Special Statement, State Budget of Odisha for 2012-13 and information provided at www.icds.gov.in

The consequence of the problem of acute shortage of staff (in the government apparatus at subnational level) with regard to inadequate coverage and poor quality of government interventions in the development sectors in the country is not difficult to visualize, but another widespread manifestation of the same in the last decade has been the poor resource absorption (or fund utilization) capacity of States in the development programmes in many sectors.

Centre for Budget and Governance Accountability (CBGA)'s studies on some of the Plan schemes in the social sectors (in UP and Chhattisgarh) have revealed that shortage of staff has weakened the State Government apparatus in these sectors, which, as a result, has not been able to utilize effectively the Plan funds provided by the Centre in the flagship schemes. Shortage of staff is also one of the main reasons behind weak enforcement of several important central legislations (like, the PWDV Act, SC/ST Prevention of Atrocities Act etc.). The main cause for this problem of shortage of staff in the States seems to be rooted in the kind of 'fiscal consolidation' strategies that the State Governments have followed over the last decade. In their attempt to eliminate the Revenue Deficit in their budgets (and even show a Revenue Surplus, in some cases), many States seem to have checked their long-term expenditure commitments (particularly in development sectors) by freezing the recruitments in regular cadres of their departments for more than a decade now.

In order to address this serious challenge, the 14th FC needs to give clear policy directions to the states that they should not approch fiscal consolidation on the basis of compressing long-term, public expenditure commitments in development sectors.

The Political Economy of Absorptive Capacity – Case of the Health Sector

Ravi Duggal*

Resource distribution between Centre and States is determined by the provisions in the Constitution. The subjects are divided between the Centre and States, and post 73rd/74th Amendment, also further devolved to districts, municipalities and panchayats. There is a constant tussle between the Centre and States for a fair share of the resources and the mandate to determine this is given to the Finance Commission under Article 280. Each five years the Finance Commission defines the envelope of the share between the Centre and States as well as determines the broad parameters for sectoral allocations which states receive from the Centre's share (Article 275) through the Planning Commission and/or Centrally Sponsored Schemes. The Centre, under Article 282, can also give discretionary grants as per its own prerogative.

On the state's part they want a larger share in the overall envelope so that they can autonomously design their own policies and programs. At present, states feel constrained in terms of resources earmarked as their direct share from the national kitty. They get only about 32 percent directly as their own share and the remaining from the central pool. From the latter, the states get about half the share through policies and programs that is determined by the Centre mostly via the Planning Commission.

Politics of Fiscal Federalism

Being a federal country the states are perhaps right in their assertion that the share they get directly as their own resources is quite meagre and inadequate for them to plan boldly, especially for key social sector allocations like health, education, social welfare, rural development etc., which are all primarily state subjects. In reality, the states get only about one-third share of the revenues but share the burden of over two-thirds of the expenditure. This imbalance of spending with limited resource generation sources, since the Centre appropriates the main sources of revenues under its control, reduces state's capacity to develop on its own free will. Given this asymmetrical fiscal federalism, the politics within the states has been changing over time with regional parties becoming dominant and national parties increasingly becoming dependent on the regional parties in coalition governments. This political scenario is now exerting pressure on liberalizing the fiscal federalism towards a much larger share for states but such a demand for increased regional hegemony is often construed by the Centre as being "anti-national" and weakening the unified integrity of the Indian nation state.

The Centre's logic is that if states get a larger share directly or they are given more lucrative revenue raising options under their control there would be unhealthy rivalry amongst states leading to unnecessary conflicts which would be a burden for the Centre to manage. Further the huge regional imbalances of resources and capacities across different states, backwardness in development etc. may get exacerbated if the Centre has less control over distribution of resources. Also the states' fiscal management capacities are questioned given that their ability to manage existing resources is weak and an increased volume of resources may be beyond their "capacity to absorb".

The Quest for Fiscal Devolution

Politically the trend over the last two decades has been greater decentralization wherein more powers and subject devolution has moved from Centre to States and from States to the local governments. Representative governance has been devolved, administrative devolution has happened but there is strong reluctance by the Centre for fiscal devolution. As mentioned earlier politics and administration has regionalized and good governance is not possible without adequate control over fiscal resources. So the new battle-ground in Centre–State relations is going to be greater fiscal devolution and the task of the 14th and subsequent Finance Commission is going to be achieving a more acceptable balance in resource distribution both between Centre and States as well as across sectors, especially the share for social sectors like health, education, social security, employment guarantee, food security, social welfare, *dalit* and *adivasi* development etc., given that many of these entitlements are being legislated into rights.

During the UPA decade under the flagship programs such entitlements had increased and have raised demand expectations. Resource commitments by the Centre to these flagships have also seen an increase; but most of these programs being state subjects, one has not seen in most states any substantial increases in state budget commitments. While allocations may have increased, gross underspending happens, and for this the Centre blames the states for lack of absorptive capacity. Is this allegation by the Centre correct? The story is not as simple as it is made out to be. The political economy of absorptive capacity is quite devious. I will illustrate this through the example of the health sector.

Absorptive Capacity Issue – the case of the Health Sector

To begin with I want to give the example of how underfunding destroyed one of the best healthcare systems in India, the health services run by the Municipal Corporation of Greater Mumbai (MCGM). Right through the sixties, seventies and eighties between one-fourth and one-third of the MCGM core budget was committed to public health and healthcare services. Almost everyone in Mumbai, especially for hospital care, utilized these services even though there was overcrowding and waiting in long queues. At the turn of the nineties, under structural adjustment reform policies the MCGM too came under its impact and social sector expenditures were compressed and a declining trend emerged. From 25

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percent of its budget for healthcare in 1991 to 15 percent by 1996 and down to an abysmal 9 percent in 2014,[2] the public health services of MCGM were starved of resources resulting in crippling them.

The first impact was on consumables like medicines and diagnostic inputs for which prescriptions were provided to procure privately. Next was maintenance of facilities and equipment which created frustration amongst staff and patients. The consequence was that the middle class patients deserted the system and opted for the emergent health insurance option, often with employer support, for treatment in private hospitals. This was a tremendous loss to the public health system as the voice of the system that kept it on its heels was snuffed out. As though this was not enough, the MCGM introduced user fees from 1999 and this was the proverbial last straw that broke the camel's back. Next, a lot of the dedicated health professionals left, new recruitments stopped and the public health system, from a universal access system, became a system for the poor, and consequently it became a poor and underfinanced system.This is reflected in declining budget commitments over the last two decades and which is at its lowest today.

Why I have narrated the Mumbai story is because there is an important message in it for the Finance Commission to reflect upon - running any service delivery system requires a reasonable amount of resources which need to be costed properly. The failure to do so in India has wasted huge resources in the social sectors, especially health and education. Health centres and hospitals, schools and colleges are set up without proper determination of unit cost of these services for the population it is supposed to serve. Budget allocations are made in an *ad-hoc* manner and consequently they do not result in effective services and benefits that reach people. For instance according to WHO, to run a robust comprehensive primary health care system with adequate support of secondary and tertiary services, a country on average would need to invest about 5% of its GDP. In India's case we are still hovering around 1% of GDP despite the UPA's promise of upto 3% GDP commitment before the end of its term. Without such a volume of rationally allocated resources, the healthcare system will continue to remain a targeted and selective health system which would prevent any significant progress towards better health outcomes. The Finance Commission needs to consider this very seriously and push for budgetary allocations which have a rational cost basis. The absence of the latter is what brings to the fore the question about absorptive capacity.

To illustrate the problem of absorptive capacity let us look at how resources are allocated. A Primary Health Centre is set up, staff sanctions are made and most staff recruited, medicines, diagnostics etc. are provided. But if we look at allocations they are not adequate to meet the needs of the PHC which has to cater to 20,000 to 30,000 population. Studies for instance show that medicine requirement for outpatient care is Rs. 50 to 60 per capita per year whereas the average PHC gets only Rs. 8 to 10 per capita annually for medicines. Naturally this reduces credibility of the PHC and only the very poor come to it. So there is clearly underfunding in the PHC budget. Further because of the poor conditions of the PHCs, it is difficult to find doctors and nurses, the key professionals, to work at the PHC. So because sanctioned posts are not filled, there is underspending. The story for rural, district and teaching hospitals is the same – underfunded budgets, leading to loss of credibility, poor quality, frustration, sanctioned posts not filled up, leading to underspending. This underfunding and underspending viciousness is the root cause of poor service delivery and this can certainly not be termed as lack of absorptive capacity at the service delivery level.

The problem therefore is not the absorption capacity but the bureaucracy itself which does not have the capacity to plan and budget in a way that service delivery is appropriately structured and financed so it can meet the demands of the people. Further, the central and state bureaucracies are unwilling to let lose their control over the healthcare delivery system, despite a lot of talk about decentralization. They may allow decentralized planning through the panchayats and even provide some untied funds for the directuse by the latter, but they will never transfer fiscal, governance and management autonomy and control to units who directly provide services and have to face the direct flak of people day-in and day-out for inadequate and poor quality services. This is where the problem lies in resource allocation and use. Those who deliver care, who understand and know the situation and hence can plan and budget the resources, have no role in decision making and those who govern from the state and national capitals take all decisions without having a clue to what the ground realities are[3].

To conclude, the question of absorptive capacity is a convenient tool which the bureaucracy uses to circumvent real issues that are a cause of the underfinancing and underspending of social sector budgets. The lack of bottom up planning and budgeting that is based on expressed needs and demands of the community for which services are being provided, and the lack of decision-making power and autonomy to govern and manage the provider institutions are the main causes for poor service delivery. This needs to be remedied immediately if resources invested in public services have to realise the policy goals. The 14th Finance Commission must engage with these concerns and suggest mechanisms which will strengthen local capacities to take charge of fiscal management and determine their own budgetary requirements to fulfil demands of its communities.

[2] Budget documents of various years of the MCGM; also see DNA Mumbai edition 25-09-2013 Minimum Healthcare for Maximum City (pg 4) and Ravi Duggal: An increase in healthcare budget to 1991 levels is urgent need DNA 25-09-2013 (pg 4)

[3] Ravi Duggal: Sinking Flagships and Health Budgets in India, Economic and Political Weekly, Vol XLIV No 33, Aug 15 2009

Panchayat Finances: Issues before 14th Finance Commission

Jawed Alam Khan*

The 73rd Constitutional Amendment Act (CAA), legislated in 1992, has been a milestone in establishing the "Institutions of Local Self-Government" with the primary task of providing autonomy to the Panchayati Raj Institutions (PRIs) for preparing the local plans and projects related to economic development and social justice. Through the CAA, PRIs have been given more politically supported, appropriate platform for own resource mobilisation, decentralised planning and participatory budgeting. PRIs receive funds mainly from Centrally Sponsored Schemes (CSSs), State Plan Fund, and Grants-in-aid as per recommendations of the State Finance Commissions (SFCs) and Central Finance Commissions (CFC), and Own Source Revenue (OSR).

The own revenue collection of PRIs as a percent of Centre and State revenues combined has declined to 0.27 percent in 2007-08 from 0.33 percent in 1990-91. The data reflects that the PRIs are heavily dependent on the transfers from Centre and States. Looking at the finances of PRIs in states such as Uttar Pradesh and Rajasthan, the major sources of funds for the PRIs have been the CSSs; they receive grants from SFC and CFC, out of which CSS comprises the lion's share (roughly 75 percent of the total receipt). The OSR is almost negligible.

The CSS funds are essentially tied funds where PRIs do not have the discretion to decide their own expenditure priorities. In Kerala, however, major shares of funds to local bodies are received as Grants-in-aid from SFC, CFC and State Plan Funds. In Kerala nearly 40 percent of plan grants are transferred to local bodies as untied funds over which they have complete discretion. Further, it is also found that low revenue raising efforts by the PRIs are mainly due to less delegation of power to collect taxes, lack of revenue potential of taxes or fees assigned to them and inefficient tax administration for collection. There are also problems in defining and demarcating tax jurisdictions as per revenue generating potential.

Role of CFCs in augmenting the Finances of PRIs

One of the main objectives of CFC is to recommend measures to supplement the resources of the Panchayats and Municipalities by augmenting the consolidated funds of individual States, taking into account the recommendations of the respective SFCs. But CFCs were unable to adopt the SFC reports for its recommendation due to several problems such as lack of synchronisation in the award periods of the CFC and SFCs, non-availability and poor quality of SFC reports and lack of clarity with respect to assignment of power, authority and responsibilities to local governments. The funds from CFC are being utilised by the local bodies for maintenance of core civic services such as lighting, water supply and sanitation etc. and can't be used for wages and salaries by PRIs.

Many State governments are averse to the fiscal decentralisation process to PRIs because implementation of FRBM Act by the States squeezes their total expenditure. State governments are already facing vertical imbalances in sharing of resources between Centre and States. There is a high proportion of committed expenditure (like salary, pension and interest payments) in the States' budgets. Initiatives should therefore rest (to a great extent) with the CFC to explore means of augmenting the resources of State governments and also to deliberate on the share of local bodies in the Central government finances.

13th Finance Commission

As per the recommendation of 13th FC, along with the Basic Grant, the States are eligible to draw their allocations from performance grants, if they comply with the certain conditions. These conditions include Supplement Budget to the Local Bodies in the State budgets, comprehensive audit and maintenance of accounts of PRIs, appointment of independent Local Body Ombudsman, transfer of Local Body Grants (e-Transfer) within five days, prescribing qualification for appointment of SFC members, levying property tax and other taxes to raise the income of PRIs and specifying the standard for delivery of basic services by PRIs.

Neither the budget documents nor the finance accounts of most of the State governments give details relating to the expenditure incurred by PRIs (detailed heads or object heads wise). So far twelve States (Assam, Bihar, Chhattisgarh, Gujarat, Karnataka, Kerala, Manipur, Madhya Pradesh, Maharashtra, Sikkim, West Bengal and Rajasthan) have opened Panchayat window in their State budgets. However, the efficacy of the system differs from State to State and a mismatch between functional assignments and fiscal transfers continues to exist in almost all States, except in Kerala. The State governments should, therefore, make distinct budget provisions for local bodies in the State budget documents, and the expenditures relating to PRIs should be reported in the finance accounts. The Comptroller and Auditor General of India (CAG) has prescribed a format in which local bodies should prepare their budgets and maintain accounts but the adoption of these formats in many States (like Uttar Pradesh, Rajasthan and Kerala) is still a distant dream .

As far as utilisation of overall grants by the three previous FCs is concerned, it was found to be quite low. During first three years of 13th FC period, only 25 per cent of the total grants have been released to the PRIs. The PRIs have to draw the remaining 75 percent of the amount in

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next two years. The instances of low utilisation of funds were found in case of Kerala, Rajasthan and Uttar Pradesh. A major hurdle in this process has been the delay in submission of utilisation certificates and delays in the release of funds to the States and the PRIs (Table 1).

Table 1: Fund allocated by FCs and Amount Drawn(Amount in Rs. Crore)

Commission	Amount Allocated		Amount Drawn	Amount not Drawn
	PRIs	ULBs	PRIs	PRIs
10th FC (1995-2000)	4380.93*	1000	3576.4 (66.5 %)	804.6 (33.5 %)
11th FC(2000-05)	8000	2000	6601.9 (82.5 %)	1398.2 (17.5 %)
12th FC**(2005-09)	18000	4500	16664.7 (92.6%)	1335.2 (7.4%)
13th FC*(2010-15)	63, 053	24466	15962.3 (25 %) ***	47091 (75 %)

Source: 13th FC report and Ministry of Panchayati Raj, GoI
Note: * Rs. 100 per capita of rural population,
** from 1 April 2005 to 6 November, 2009,
*** Up to 2012-13

PRIs in Kerala did not receive any fund from the 13th FC in the year 2010-11. With regard to utilisation of funds, the Table shows that the PRIs were not able to fully utilise funds in the years 2011-12, 2012-13 and 2013-14. The percentage of utilisation was 77, 92 and 49 percent respectively for these years (Table 2).

Table 2: Utilisation of CFC Grants by PRIs in Kerala from 2010-11 to 2013-14
(Amount in Rs. Crore)

Year	Total Receipt from CFC	Expenditure reported by PRIs	% of Utilisation
2010-11	Nil	Nil	Nil
2011-12	288.5	223	77.3
2012-13	414.9	379.7	91.5
2013-14*	490.7	239.5	48.8

Source: Data collected through RTI from Directorate of Panchayats, Kerala
*Upto January 2014

In terms of fund flow mechanisms, States should make necessary arrangements for electronically transferring Local Body Grants (e-Transfer) within five days of receipt from Central Government. Looking at the situation of fund releases in Uttar Pradesh, Rajasthan, West Bengal and Kerala, it is found that funds have been transferred on time in Uttar Pradesh and Rajasthan and delays for more than 15 days has been observed in case of West Bengal and Kerala. In UP and Rajasthan, funds are directly transferred to PRIs from Panchayat directorate. However in Kerala, money comes from the Finance Department and flows to Department of LSGIs. It is then sent to Deputy Director Panchayat i.e. the GPs.

Table 3: Release of Grant to PRIs by Rajasthan Government in 2010-11
(Amount in Rs. Crore)

Head	Grants released by Centre to States		Grants released by States to PRIs	
	Amount	Date	Amount	Date
Central Basic Grant I	183.34	21.07.10	183.34	28.7.10
General Basic Grant II	183.34	25.01.11	183.34	31.01.11
Special Area Basic Grant I	1.69	21.07.10	1.69	29.07.10
Special Area Basic Grant II	1.73	25.01.11	1.73	31.01.11
Total	**370.1**		**370.1**	

Source: Compiled by CBGA from http://www.cag.gov.in/html/localbodies.htm

Key issues before the 14th FC

One of the major issues pertaining to local body finances is proper decentralisation of finances and timely availability of funds to PRIs. Absence of proper and timely devolution has a negative impact on the functioning of the PRIs, in terms of capacity of service delivery and executing the plans for economic development and social justice. It is found that PRIs face shortage of staff, poor infrastructure facilities like office infrastructure (Panchayat Bhawan, furniture, computers, and electricity) and transportation facility at all the three tiers. At present, the CFC grant is being provided to the local bodies only for operation and maintenance of water and sanitation and there is a restriction imposed by the States that such a grant should not be spent on establishment cost. Such has led to difficulties in implementation of schemes by the PRIs. It has been observed that PRIs are implementing a large number of Central schemes without adequate administrative cost and core support for staff, which is posing a major problem for effective service delivery.

In terms of infrastructure for the GPs, it is found that many GPs do not have their own building (around 30 percent GPs were without building in 2008). Wherever there is Panchayat secretariat, most of them have just one room without other facilities. There are limited staff at all levels of PRIs in many States and also most of the staff are on deputation from (and hence controlled by) the line departments. All these have an impact on fund utilisation patterns resulting in low utilisations as observed in UP, Rajasthan and Kerala. Most of the States lack accurate and quality data/information on the financial and operational performance of local bodies.

Centre for Budget and Governance Accountability's ongoing research in this area has revealed that in States like Uttar Pradesh (Barabanki and Balrampur districts), Rajasthan (Alwar district) and Kerala (Trivandrum, Trissur), the problem of staff shortage in the District Panchayats as well as in the relevant State Government departments is acute. In the Barabanki district of UP the percentage of

Table 4: Release of Grant to PRIs by WB Government to PRIs during the period 2010 to 2014(Amount in Rs. Crore)

Year	Instalment amounts	Date of receipt of the Instalments from Finance Department	Amount of Instalments released to Panchayats	Date of releases to Panchayats	Total Receipt
2010-11	129.93	19.07.2010	129.93	29.07.2010	130.73
	0.8	10.09.2010	0.8	25.02.2011	
2011-12	189.07	04.04.2011	189.07	08.04.2011	432.28
	241.61	21.10.2011	241.61	11.11.2011	
	0.8	21.10.2011	0.8	25.11.2011	
	0.8	25.02.2012	0.8	27.03.2012	
2012-13	246.73	11.07.2012	246.73	24.08.2012	533.03
	24.01	21.08.2012	24.01	24.08.2012	
	0.8	20.02.2013	0.8	28.09.2012/26.03.2013	
	261.49	20.02.2013	261.49	05.03.2013	
2013-14	188.28	15.05.2013	188.28	30.05.2013	477.05
	288.77	06.03.2014	288.77	19.03.2014	

Source: Data collected through RTI from Directorate of Panchayats, West Bengal

vacancies against sanctioned post in PRIs, Rural Development accounts, Zilla Panchayat and District Rural Development Agency, amounts to 34, 19, 42 and 46 percent respectively. While looking at the percentage of vacancies against sanctioned post in Alwar district, the table shows that percentage of vacancy is 26 (Table 5).

Table 5: Status of Vacancies in Uttar Pradesh (Barabanki district) and Rajasthan (Alwar district) in 2012-13

	No. Sanctioned Post	No. Filled Post	No. Vacant Post	% Vacancies
		Barabanki (UP)		
Panchayati Raj Department	158	114	54	**34.2 %**
Rural Development Department	389	315	74	**19.0%**
Zilla Panchayat	158	92	66	**41.7%**
District Rural development Agency	37	20	17	**45.9%**
		Alwar (Rajasthan)		
Zilla Panchayat	72	52	19	**26.4%**

Source: Compiled by CBGA from the respective departments in Barabanki and Alwar.

In some States, GPs have, at best, one Panchayat Secretary/Rural Development Officer per Panchayat. In two blocks (Gainsari and Puchperwa) of district Balrampur of Uttar Pradesh, for instance, one Panchayat Secretary has to look after 5 to 6 Gram Panchayats and vacancies for the post of Secretary/Rural Development Officer are more than 50 percent against the total sanctioned posts. Similarly, the vacancies for the post of Additional Development Officers, accountant and clerks have been found to be around 50 percent (Table 6).

Table 6: Staff Position of Gainsari Block, Blarampur, Uttar Pradesh

Position	Sanctioned Post	Filled	Vacant	% of Vacancies
Block DevelopmentOfficer(BDO)	1	0	1	100
Additional Development Officer (ADO)	6	3	3	50
Gram Panchayat Officer	13	6	7	54
Rural Development Officer	11	2	9	82
Accountants	3	1	2	67
Clerks	2	1	1	50
Engineers	2	2	0	0
Total	**38**	**15**	**22**	**58**

Source: Compiled by CBGA from the Block office.

The representatives of PRIs are engaged in the implementation of a large numbers of flagship programmes of rural development and education on a full time basis and are often overworked. They are being paid a meagre honorarium.In Kerala, the District Panchayat President gets Rs. 7900; Block Panchayat President will get Rs. 7300 and Gram Panchayat President gets Rs. 6600 as honorarium per month. Apart from this, there has been an increased thrust to complete the physical infrastructure (roads, schools, AWCs, health centres, water and sanitation etc.) in GPs through CSS. Additionally, there is a need to focus on operation and maintenance of assets created by GPs. This would require devolution of a large quantum of untied fund flow to GPs so that they can maintain these assets. Therefore the burden of both maintenance of assets and human capacity has fallen on the local bodies. Given the restriction on expenditure of funds, revenue situation for local bodies are quite vulnerable.

Concluding Remarks

There is a need for restructuring the fiscal assignment to PRIs in a more equitable and efficient manner to achieve socially inclusive development of rural areas. It would be significant if the 14th FC could focus on improving functioning of the PRIs in terms of enhanced capacity for better service delivery and executing the plans for economic development and social justice. This could be achieved only through increased powers of planning, expenditure and decision-making by the PRIs. It would also require an augmented revenue situation for the PRIs to meet expenses of staff, infrastructure facilities at all three tiers in terms of office infrastructure (Panchayat *Bhawan*, furniture, computers, and electricity) and transportation facility. Additionally, it is also advisable to remove the restrictions on the use of the Finance Commission grant by the rural local bodies to enable the PRIs to hire the required core staff not only for improving the service delivery but also for maintenance of office accounts and local level data bank. In sum, given the persistence of deep-rooted problems in the domain of fund devolution and staff shortage at the lower levels, especially in the Gram Panchayats, in most States this remains a specific challenge for the 14th FC that needs urgent attention.

Suggestions for the Fourteenth Finance Commission on Renewable Energy

Jyotsna Goel*

The Terms of Reference (ToR) of the Fourteenth Finance Commission (FFC) includes that the Commission shall take into consideration "the need to manage ecology, environment and climate change that will be consistent with sustainable development" while making its recommendations. In the fiscal architecture of India, grants from finance commission are of immense importance for states which need grant assistance to cater their environmental and climate change concerns.

Taking into account the need for managing ecology, environment and climate change, the previous commission that is, the Thirteenth Finance Commission with period ending in 2014-15, recommended incentive grants of Rs. 5000 crore each for – Water Sector Management, Forest Protection, and Promotion of Renewable Energy (*See Note 1*). The Union Budget 2014-15 was expected, therefore, to set aside some resources (if not the entire Rs. 5000 crore) to be shared with the deserving States this year; but no such allocations have been reported in the Union Budget, though the main budget for 2014-15 was presented in July and hence there was some time (i.e. during April to June this year) with the Union Ministry of Finance to take stock of the situation. The Thirteenth Finance Commission recommended grants-in-aid for Environment and Forest sector have been provided for in the Union Budget, while there is no provision for the grants-in-aid meant for Renewable Energy (RE) (*See Note 2*). This was clearly a loss of opportunity for states to benefit from the recommended financial grants to address climate change concerns through mitigation efforts, at a time when Power utilities often facing financial barriers in development of Renewable Energy and infusion of clean energy in power sector (which has share of 43 per cent in GHG's emissions in the country) is important to reinforce the states' efforts for climate change mitigation.

An analysis was carried out on the current levels of spending by various states on renewable energy; from funds transferred directly from the Center to the States and through various Union Government schemes. Our analysis shows that there is lack of adequate funds with states to implement the renewable energy projects. Besides this, it was found that the state level spending needs to be more focused on key priority areas for development of RE.

Below are some suggestions to encourage faster inclusion of RE into the power sector in the country, which could be considered by the FFC.

1. Need to release at least a part of the Renewable Energy incentive grants to States upfront

The recommendation of the Thirteenth Finance Commission on RE was a performance based incentive grant, to be released to deserving States in 2014-15 after installation of RE capacity by them. This could have proven to be a deterrent for power utilities in the States as many of these have been in poor financial health. A detailed analysis of budgetary spending by States on Renewable Energy during 2010-11 to 2012-13 shows that several of the States with high levels of unachieved RE potential (such as, Jammu and Kashmir, Odisha, Assam, Haryana and Punjab) have spent small amounts on this sector (*See Note 3*). Given this scenario of inadequate spending by the States on RE, it could have been difficult for cash strapped power utilities to accelerate development of RE capacity (which requires high capital investment).

Hence, the Fourteenth Finance Commission should consider releasing at least a part of the incentive grant upfront for enabling the power utilities in the States to meet the financial requirements for installation of the RE capacity; States could be asked to submit Work Plans for the release of a part of the grants in the first year of the Commission's recommendation period (i.e. 2015-16).

2. Including Off-Grid Applications of Renewable Energy with installation of Micro-Grids

Inequities in energy access have been widening across States as well as between urban and rural areas within States. Out of the 29 States in the country, only nine States had achieved 100 percent 'village electrification' as on 31st of August 2013, (*See Note 4*). However, as per the new definition of 'electrified villages', a village is deemed electrified if at least 10 percent of all the households of the village have electricity access and electricity is provided to public buildings such as schools, panchayat offices, health centres, community centres and dispensaries. Clearly, the new definition of 'electrified villages' is not comprehensive. Moreover, a large proportion of the country's population living in remote areas does not have access to grids and faces deficiency of electricity for economic activities.

In such a scenario, off-grid application of RE offers a scalable and distributed solution. Installation of micro-grids can provide adequate grid connectivity to the RE generated through off-grid applications. Analysis of budgetary spending by States on Renewable Energy during 2010-11 to 2012-13 shows that States with large numbers of un-electrified houses, such as Arunachal Pradesh, Nagaland, Odisha and Tripura, have spent

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less than Rs. 10 crore in the these three years (*See Note 5*).

States can lead the investments in off-grid applications as part of meeting their electrification targets; however, the grant recommended by the Thirteenth Finance Commission was meant only for grid interactive RE. The Fourteenth Finance Commission should consider incentivisation for off-grid applications of RE with installation of micro-grids.

3. Incentive for Creation of Renewable Energy Evacuation Infrastructure

Presently, the responsibility of distribution of the power generated lies mainly with the State Governments. Although the private sector developers currently own as much as 86 percent of the installed RE capacity in the country, they depend on the State Governments for adequate evacuation infrastructure and grid connectivity for the RE generated.

The development of evacuation infrastructure and provisioning of measures for grid connectivity for RE sources is considered the responsibility of the State Transmission Utility (STU) or State Electricity Board (SEB). It has been observed that barring few of the State utilities, such as Maharashtra State Electricity Transmission Company Ltd., Rajasthan Vidyut Prasaran Nigam, and Himachal Pradesh State Electricity Board, the utilities in other States have not included evacuation infrastructure for RE as part of their overall transmission or distribution capital expenditure plans. *(See Note 6)*. Even for those State utilities that have better capital expenditure plans, lack of funds was found to be a major challenge in realization of their plans. Some of the critical challenges faced by STUs in integrating RE with grid are – lack of evacuation infrastructure, need for reserves/energy storage to deal with intermittency in RE generation, and need for robust communication systems to transmit real time RE generation data. (*See Note 7*). Capital expenditure, therefore, is a prerequisite for the required infrastructure for RE. However, the analysis of budgetary spending by States on Renewable Energy during 2010-11 to 2012-13 shows that merely three States, viz. Andhra Pradesh, Assam and Arunachal Pradesh, showed some amounts of Capital Expenditure on RE *(See Note 8)*.

Given that RE generation requires large amounts of capital expenditure; the FFC could consider prioritizing the grants for the capital expenditure plans of State Transmission Utilities for installing evacuation infrastructure and grid connectivity for the RE generated.

4. Incentives to States for achieving their targets on Renewable Energy Purchase Obligation

The State Governments have mandatory targets for meeting Renewable Energy Purchase Obligation (RPO). Section 86 (1) (e) of the Electricity Act, 2003 initiated the practice of RPO at the State level, which mandates the power distributing authorities to purchase a fixed percentage of power from RE sources. In terms of the progress made by various States in meeting their respective RPO targets, it has been reported that 22 out of 29 States have failed to meet their RPO targets as of 2012. *(See Note 9)*

The incentives proposed by the Thirteenth Finance Commission were focused on RE capacity addition across all States without any reference either to the RPOs set by the SERCs or to the national targets set by the National Action Plan on Climate Change. The Fourteenth Finance Commission can help accelerate RE capacity addition by States by incentivizing those States that meet their RPO targets; this could facilitate revenue generation by States by selling the RE generated under the existing mechanism of Renewable Energy Certificates.

5. Strengthening of the State Nodal Agencies for Renewable Energy

Since the actual implementation of the programmes of the Union Ministry of New and Renewable Energy is taking place through the State nodal agencies, it is important that these agencies are strengthened adequately in terms of human resources and skills. There is a need to facilitate the strengthening of the State nodal agencies for RE in the areas of – assessment of RE sources, database management, their local administrative setup and getting local self-government institutions (such as local Panchayats and Municipalities) involved in planning and implementation of RE projects.

The FFC could consider incentivizing the strengthening of the State nodal agencies for RE in terms of their human resources and technical skills.

Conclusion

It is important to increase grants-in-aids to states to promote RE development for addressing issue of energy security and climate change concerns at the local level. Given the fact that state level spending on Renewable Energy is poor, it is important, to financially strengthen state governments for RE development by adding grants-in-aid from the Fourteenth Finance Commission over and above allocation by the Union Government. Intervention focus for FFC grants on installation of off–grid technologies in remote areas and strengthening of RE evacuation infrastructure where RE initiatives already been taken-up.

Explanatory Notes

1. The Thirteenth Finance Commission had recommended the incentive grant of Rs. 5000 crore for grid-connected RE based on the States' achievement in RE capacity addition over the first four years of the Commission's recommendation period, i.e. from 1st April 2010 to 31st March 2014. This performance based incentive grant was supposed to be released by the Union Finance Ministry to the deserving States in 2014-15 based on States' achievement in RE capacity addition during the four years 2010-11 to 2013-14. *(Source : Report of the 13th Finance Commission)*

2. The Union Budget 2014-15 was expected, therefore, to set aside some resources (if not the entire Rs. 5000 crore) to be shared with the deserving States this year; but no such allocations have been reported in the Union Budget 2014-15 for Renewable Energy. *Source : Union Budget 2014-15,*

Expenditure Budget Volume –II, Ministry of Finance, Grant-in-aid Transfers to states, Demand No. 36

3. Total budgetary expenditure on RE in the States, has been compiled by taking into account both the expenditures made through the State Budgets and the direct transfers of Central resources for RE to State-level agencies that bypassed the State Budgets. It is observed that that several of the States with high levels of unachieved RE potential, such as, Jammu and Kashmir, Odisha, Assam, Haryana and Punjab, have spent small amounts on this sector during 2010-11 to 2012-13 (the period over which the States were being incentivized by the Thirteenth Finance Commission to step up their efforts for RE capacity installation). These estimates on spending by states do not include loans provided by central financing agency, IREDA for RE development with engagement of project developers. Unachieved potential is estimated based on figures of total estimated RE potential of States and installed capacity of RE as on 31.02.2013

Source for Budgetary Expenditure Data: State Finance Accounts for various years, Comptroller and Auditor General of India, GoI **and,** Source for Data on Unacihieved Potential of RE: Annexure-I referred to in reply by MNRE to part (c) of Lok Sabha Starred Question No.31 for 06.12.2013 regarding Power Generation from various Renewable Energy Sources. Available at http://164.100.47.132/Annexture/lsq15/15/as31.htm.

4. As per the Census 2011 figures on Household Amenities, the total number of households in the country without electricity has decreased marginally from 78 million to 75 million. Even after the launch of the *Rajiv Gandhi Grameen Vidyutikaran Yojana*, only nine States have achieved 100 percent village electrification even on the basis of the new definition of 'electrified villages', which is far from being comprehensive (a village is deemed electrified if at least 10 percent of all the households of the village have electricity access and electricity is provided to public buildings such as schools, panchayat offices, health centres, community centres and dispensaries. *(Source: Central Electricity Authority, Progress Report of Village Electrification as on 31.01.2014.)*

5. A close look at the budgetary expenditure by States on off-grid applications, during 2010-11 to 2012-13, shows that States with poor coverage of village electrification (such as Arunachal Pradesh, Nagaland, Odisha and Tripura) have spent less than Rs. 10 crore on Rural Applications of RE in the last three years. This estimates on spending by states do not include loans provided by central financing agency IREDA for RE development with engagement of project developers. *(Source: State Finance Accounts of various years, Comptroller and Auditor General of India, GoI)*

6. A Discussion Paper on barriers to development of renewable energy in India, IDFC Ltd., February 2010. Available at http://www.idfc.com/pdf/publications/Discussion-paper-on-Renewable-Energy.pdf

7. Integrating renewable energy and energy efficiency in the transmission and distribution grids of Tamil Nadu and Karnataka by New Venture India, 2013.

8. Currently, the private sector developers own as much as 86 percent of the installed RE capacity in the country; however, they depend on the State Governments for adequate evacuation infrastructure and grid connectivity for the RE generated. States with high percent of unachieved RE potential, such as, Kerala, Assam, Jammu & Kashmir, Manipur, Meghalaya and Nagaland, show relatively lower levels of participation by the private sector as of now. *(Source: Central Electricity Authority Annual Report 2012-13)*

9. Subsequent to the Electricity Act (EA) 2003, the National Action Plan on Climate Change (NAPCC) aims to derive 15 percent of India's energy requirements from renewable energy sources (non-solar) by the year 2020. The National Solar Mission requires SERCs to set solar RPO targets requirement increasing from 0.25 percent in the beginning of 2012-13 to 3 percent by 2022.

"Indian States miss renewable energy targets: Greenpeace". Article available at: http://www.thehindu.com/news/national/indian-states-miss-renewable-energy-targets-greenpeace/article4666827.ece

Strengthening Budget Transparency and Participation in India through the Pre-budget Process

Ravi Duggal and Anjali Garg*

The hallmark of a vibrant democracy is the strength and quality of participation by its citizens. Electing representatives to Parliament and State legislatures every five years is not enough. The real measure of participation is the extent to which citizens are actively engaged in the political process during those five years. Citizens should question representatives continuously and hold them to account. This is where our democracy has failed, as the vast majority of citizens vote but then withdraw, even aftervoting for “a change.” It’s only few “activists” or CSOs who in a small way engage with the system to monitor and demand accountability.But this by itself has a very limited impact because it is spread too thin.

Public participation in the budget process is especially important, as budgets that reflect the needs and priorities of a country and its people are fundamental to the success of any public policy, particularly policies related to service delivery. To help ensure that services respond to citizens needs’ and are of good quality, citizens– the recipients of services – must engage effectively throughout the budget process – from formulation to budgeting to implementation to auditing.

Publication of a Pre-Budget Statement

Participation during the formulation stage of the budget cycle is particularly important, because it is here that strategic interventions can help shape the budget that is finally placed in Parliament for approval. Once placed in Parliament, the executive *fiat* prevents any significant changes from taking place. Thus, if the budget is to be representative of the needs and demands of citizens, the pre-budget process must include extensive engagement of civil society as well as legislative members.

In our country, however, the executive dominates the formulation stage of the budget process, limiting the extent and quality of the pre-budget discussion. The partisan spirit of legislative debates, together with the threat that the government will collapse if the budget fails to pass, stifles a vigorous debate of the government’s policies and priorities. In this context, the production of a Pre-Budget Statement – which sets out the government’s budget strategy for the coming year and is released atleast 3 to 4 months ahead of the draft budget– is critical to ensuring that a space exists, where civil society and legislators can influence budget priorities.

Yet, of the eight key budget documents assessed by the International Budget Partnership’s Open Budget Index, the Pre-Budget Statement is the only document that India fails to produce. Countries such as Brazil, South Africa, and several of India’s neighbors – including Afghanistan, Cambodia, and Indonesia – produce and publish this important document. Active dissemination of a Pre-Budget Statement would help generate public debate on policies and resource allocation, which would strengthen democracy, accountability, and ultimately, governance in the country.

Within our government, some may be wary that the publication of the Pre-Budget Statement, ahead of the tabling of the draft budget in Parliament, may result in the disclosure of information – such as changes in tax policy, which some institutions might exploit and profit from. However, while the Pre-Budget Statement should include the government’s fiscal objectives over the medium-term, broad sectoral allocations, and expectations for broad categories of taxes and revenues, it need not get into the details of tax policy.

Quality of budget information at the sub-national level

In India, the limited civil society engagement with budgets happens mostly during the implementation stage and mostly as expenditure tracking, monitoring and social audit of program implementation at the micro level, and as a critical analysis/assessment of budget allocations and expenditures at the macro level. At the state and sub-state level this is constrained because of inadequate and/or poor quality budget information accessible in public domain: often CSOs have to struggle to get even the very minimal budget and expenditure data to facilitate budget/expenditure tracking and monitoring.

Further in the budget approval stage also we do see some engagement by CSO budget groups, both to influence select legislators to raise questions as well as to get the media to engage with various critical budget issues. However, strong citizen, CSO and legislative engagement in the formulation and audit stages of the budget process are the critical missing links in budget accountability in India.The CAG makes available all audit reports in public domain, but both civil society and legislators have failed to use the audit reports effectively to demand appropriate accountability. The use of audit reports in recent years to expose and bring to justice various scams has demonstrated the huge

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potential for civil society and legislators to use audit reports to demand improved accountability.

In the last two decades, post the Right to Information Act as well as significant efforts of the 12th and 13th Finance Commissions, substantial progress has been made to increase budget transparency at all levels. There are a few states like Maharashtra, Odisha and Andhra Pradesh, where online budget and expenditure data is available in public domain, even at the district and institutional levels through the koshwahini / treasury accounting systems. A few other states also provide substantial information, but overall there is a long way to go to reach a level of transparency and access that makes it easy for ordinary citizens or the local CSOs confident enough to participate in a significant way in the budget process.

Civil society participation in planning and budgeting (e.g. Program Implementation Plans)

Further, the devolution of governance has also created participatory spaces for citizen and CSO engagement, especially at the district and sub-district levels. The Peoples Planning initiative in Kerala, wherein planning and budgeting for about 40 percent of the development budget is done directly by gram sabhas and other citizen committees is one good example. In Nagaland, the VDCs engage directly with local development and budget allocations. But, these are exceptions.

There are also other opportunities for citizen participation like the Program Implementation Plans (PIPs) under NRHM or monitoring committees for various untied funds given to panchayats and to service delivery institutions. But, these opportunities have not been seized, partly for the lack of citizen politicization, but mostly because of inadequate budget transparency during the formulation phase of the budget. For instance, if citizens could effectively engage with the PIPs and develop need-based plans and budgets, as it happened in Kerala or Nagaland, the budget formulation process would be injected with vital insights and energy which would result in a budget statement that would truly reflect the needs of the citizens and would consequently strengthen service delivery and impact governance.

Recommendations for the 14th Finance Commission

The 14th Finance Commission is well within its agenda to facilitate the strengthening of pre-budget transparency and participation through its recommendations. Also the 14th FC is perched on a historic moment, where across the length and breadth of the country, there is demand for improved accountability and governance, elimination of corruption, reduction in tax exemptions to corporates, significantly greater allocations for social sectors like health, education, food security, SC and ST welfare and social security. The 14th FC also has an opportunity to be the Change it wants to see in fiscal transparency and accountability.

A few suggested recommendations for the 14th Finance Commission to strengthen budget transparency, accountability and participation:

- Recommending the publication of a Pre-Budget Statement and related budget information that will increase civil society and legislative participation in formulation of budgets
- Further strengthening the quality of budget information in line with Sundaramoorthy Committee report recommendations
- Developing a rational basis for increased and effective allocation of resources to the social sectors so that the objectives of the programs are effectively achieved.
- Institutionalized mechanisms for better access to quality budget information at subnational level, especially district and sub-district level
- Making mandatory civil society participation for planning and budgeting (like PIPs, untied funds etc.) for programs which directly benefit citizens through service delivery and benefits.

Policy Asks for the 14th Finance Commission on Budget Transparency

Nilachala Acharya*

Transparency, accountability and public participation have been recognized widely as the pillars of good governance; and arguments in favour of transparent and accountable governance through public participation have been well established since long. Further, issues pertaining to transparency and greater public participation in development process have been widely discussed. It is understood that a transparent and accountable government can lead to better socio-economic development of a nation.

Bringing transparency in all the activities of the government, particularly in policies relating to budgets, and in the overall fiscal domain i.e., from formulation to enactment to implementation of budgets, is quite important as it deals with public money. Hence, public has every right to know what the governments have been doing with the money collected through taxes and otherwise. In a structure of fiscal federalism like ours the ultimate burden of revenue augmentation policies of the Union or the state governments is borne by the public in the form of taxes. However, under the tax laws of this land, public cannot claim benefits equivalent to the amount she/he pays as tax. In the recent past, serious concerns have been raised on the issues relating to how governments have been prioritizing their expenditures in the annual budgets, what are the mechanisms in place to ensure budget transparency and accountability etc. Although at the Union level, India is fairly transparent with respect to its budgets and some opportunities do exist for the public (or organisations representing sections of population) to participate in the budget processes, a lot more would be required to strengthen these existing transparency mechanisms.

One would hardly object to the fact that increased public participation in the budget process is fundamental to the success of policies relating to service delivery. Public participation in the budget process is highly important, as it reflects the needs and priorities of a country. In order to ensure quality services which respond to citizens' needs, citizens must engage throughout the budget process. It has been observed that because of inadequate and/or poor quality budget information available in the public domain at the sub-national level, even civil society organisations engaged in analysing budgets have to struggle to get the minimal information about budgets. Further, disaggregated budget information at the district and sub district levels is often not shared in the public domain. This hinders citizens' engagement in wider debates and discussions on budgets and its priorities. Although there has been an increased demand by the community that data collected using public funds should be made available more readily, and on time, to all for enabling policy debates and participation in the decision-making process so that service delivery, its accountability and governance can be improved upon. However, in the last couple of decades, especially post Right to Information Act as well as significant efforts of various Union Finance Commissions, substantial progress has been made in increasing budget transparency in the country.

Treasuries are the nodal offices for all financial transactions of the State Government at respective district levels. They are the key authorities for maintenances of management accounting at the district levels. The Sub-Treasuries work as an extension of the District Treasuries at a local level within the district. With the expansion of the scope of the government over the years, there has been a substantial increase in the annual budgets for each year (both for the Union and State governments). In this regard, until mid of nineties, the treasuries were playing a crucial role in terms of maintaining accounts of the State, financial transactions and flows etc., as all the monetary transactions used to happen through treasuries. Of late, with the growing nature of Centrally Sponsored Schemes (CSSs), the flow of funds from the Central government to the States and Districts were by-passing the state treasuries and directly routing through state and district autonomous societies. However, for improving transparency in government accounts, time to time, the Central Finance Commission have been providing certain sum of grants (as part of Administrative Upgradation grants) to the States. Hence, computerisation of treasuries was part of the Upgradation grants of the Central Finance Commission.

This process of computerisation of treasuries dates back with the upgradation of Standards of Administration under the Sixth Finance Commission (1974-79) recommendation. For the upgradation of the Fiscal Services and Treasury and Accounts, the Seventh Finance Commission (1979-84) recommended for capital expenditure through grants-in-aid under Article 275 of the Constitution of India to the tune of Rs. 5.86 crore to the States of Himachal Pradesh, Madhya Pradesh, Bihar, Rajasthan, Tripura and Uttar Pradesh. The Eighth Finance Commission (1984-89) also recommended a grant to the tune of Rs. 208.18 crore for the establishment of additional sub-treasuries, structural additions and infrastructure developments and staff trainings. The Ninth Finance Commission (1989-95) recommended Rs. 140.77 crore for the upgradation of the treasuries and accounts administration. In the similar spirit, the Tenth Finance Commission assessed a requirement of Rs. 23.10 crores, at an average unit cost of Rs. 10 lakh per

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treasury and also recommended explicit grant for computerisation and automation of treasuries in various states. The Eleventh Finance Commission provided an amount of Rs. 200 crore for computerisation of the treasuries (procurements of computers, installation of hardware and software and related training expenses), along with other things under the broad head grants for Fiscal Administration in 25 states of India. However, the demand for such grants by the states was Rs. 2,087 crore.

As part of the Twelfth Finance Commission grant, the State government of Arunachal Pradesh was given an assistance of Rs.10 crore for the construction of its treasury buildings. Similarly, under the e-Governance project, Bihar had received Rs. 40 crore for collecting and using on-line data relating to commercial taxes, registration, treasuries and sub-treasuries and the Directorate of Provident Fund, with the data centre located in the finance department. The project covered not only internal computerisation of the above offices, but also their district level offices across the state. Further, the Thirteenth Finance Commission had also recommended a sum of Rs. 616 crore to strengthen the data base at state, districts and local level. In line with the recommendation of the Thirteenth Finance Commission (a mission mode project for computerisation of State Treasuries in the country), Government of India had approved a project under the new e-treasury scheme, with an allocation of Rs. 625 crore to bring about transparency and to enhance efficiency of the public delivery system. The scheme was supposed to be implemented in about three years beginning 2010-11 fiscal, with a view to support States and Union Territories to fill the existing gap in their treasury computerisation, upgradation, expansion, and interface requirements, apart from supporting basic computerisation facility. The treasury computerisation project was expected to make budgeting processes more efficient, improve cash flow management, promote real-time reconciliation of accounts, strengthen Management Information Systems (MIS), improve accuracy and timeliness in accounts preparation, bring about transparency and efficiency in public delivery systems, better financial management along with improved quality of governance in States and Unions Territories. The project essentially had two objectives. One is to computerise the existing treasury system and other one is linking this treasury system with the web (online) so that it can facilitate interface with various stakeholders and a transparent system can be established, especially with regard to financial operations.

As noted earlier, until very recently, flow of funds from the Union government to the states and districts were bypassing the state treasuries and directly getting routed through state and district autonomous societies. When funds are not flowing through the Treasury system at the state utilisation of the same does not fall under regular audits by the office of the Comptroller & Auditor General (C & AG) of India. Performance and Financial Audits of expenditure in such cases were largely carried out by independent empaneled chartered accountants. This flexibility with regard to auditing of the expenditures in the CSS has given rise to strong criticisms pertaining to weakening of the transparency and accountability mechanisms from many quarters, including the C & AG of India. Further, several other concerns have also been raised when the central funds bypass the state budgets as this undermines the oversight role of the state legislature in the sphere of public expenditure.

In consideration with the persistent criticisms of the proliferation of CSSs, a committee headed by B. K. Chaturvedi had suggested a roadmap for strengthening of institutional mechanisms of transparency for implementing these. The Committee had suggested doing away completely with the practice of central funds bypassing the state budgets. Following the recommendation, the Union Budget 2014-15 proposed that the central funds should be reflected in the state budgets under all CSSs, instead of any such amount being sent directly to the autonomous bank accounts of the societies / scheme implementing agencies. This certainly is a significant step towards enhancing institutional mechanisms of transparency in the CSS.

Towards enhancing budget transparency in the country, the Central Finance Commission has been playing a crucial role since long. In this context, we would urge the 14th Finance Commission to recommend appropriate amount of grants for strengthening institutional mechanisms to ensure greater budget transparency in the country.

Key expectations from the 14th Finance Commission:

1. Strengthening the existing mechanisms of 'Treasury System' in the States and providing user friendly public access to treasury information.

An important institutional mechanism that exists in the country is 'online treasury management system', which has substantial disaggregated information relevant to the common citizen. However, the treasury information is neither completely accessible by the common citizen nor is it provided in a user friendly manner. There have been attempts by the previous Finance Commissions to strengthen the online treasury management system in the country. For instance, the Thirteenth Finance Commission had recommended grants to strengthen the database at state, district and local levels. As mentioned earlier, subsequent to this recommendation, a mission mode project for computerisation of state treasuries in the country was implemented to bring about transparency and to enhance efficiency of the public delivery system. However, little progress has been made so far in this regard. Although most of the States have linked their treasury with the web, very few states have been providing general access to this information in a user friendly manner. Hence, in order to make available of treasury information in the public domain, with easy access, grants to sub-national governments would be urgently required.

2. **Giving policy directions to State Governments as well as Local Governments to create budget information database at the Block-level and promote public access to such database; which would enhance budget transparency at the grassroots level.**

Effective public engagement in the budget process depends on the availability and citizens' access to timely and locally relevant budgetary information. In this regard, strengthening mechanisms of budget transparency at various levels of governance, particularly at the sub-national levels, have drawn considerable attention of the policy makers. Creating budget information database at the block level (as block has been chosen as a unit of development by the Twelfth Five Year Plan) and wide access to that information will not only help greater engagement of public in planning and budgeting process, but also promote budget transparency. We are suggesting that the budget information database should contain at least four things, along with other things. These are: a) amount of funds sanctioned and released under different development programmes and schemes; b) timeline of such fund sanctions and releases; c) implementing authorities/agencies of such programmes and schemes; and d) list of beneficiaries. In order to make this information available to the public for greater engagement in the planning and budgeting process, the appropriate authorities should take steps to publicise the same through writing on the notice boards, writingon the walls of the public institutions, stand posts at the work / project sites, uploading on the websites, preparation of glossaries and updating these in timely manner etc.

Summary of States' Recommendations to the Fourteenth Finance Commission*

State	Share in (Divisible Pool of) Central Taxes to be Devolved to States	Grants-in-aid for States	Specific Purpose Grant for States	Parameters in the Devolution Formula (for State-wise distribution of Central Taxes devolved to States)
Andhra Pradesh (Undivided State)	40 per cent of the divisible pool	· Grants equivalent to at least 4 per cent of the Central taxes be recommended for the local bodies · Central share in disaster relief fund be enhanced to 90 per cent from the present 75 per cent	Grants to the tune of Rs.30,425 crore for various sectors like education, health, irrigation, public distribution system, forests, women & children, development of backward and scheduled areas to plug critical gaps	Area and the year 1971 population may be assigned weights of 30 and 20 per cent respectively
Bihar	· 50 per cent of the divisible pool · Include all cesses, surcharges and windfalls	· Non-core grants (other than Non-Plan Revenue Deficit Grant, Local Bodies and Disaster Relief Grants) should be dispensed with · State Disaster Relief Funds (SDRFs) should be based on Hazard-Vulnerability-Risk profiles · Share of Bihar local bodies in total local bodies grant is 11 per cent.		20 per cent weightage to population, 70 per cent to income distance and 10 per cent to fiscal discipline

Compiled by Rohith Jyothish and Saumya Shrivastava. Authors work with the Centre for Budget and Governance Accountability (CBGA), New Delhi.

State	Share in (Divisible Pool of) Central Taxes to be Devolved to States	Grants-in-aid for States	Specific Purpose Grant for States	Parameters in the Devolution Formula (for State-wise distribution of Central Taxes devolved to States)
Gujarat	Distribute at least 50 per cent of the divisible pool of central taxes, cess and surcharges	Conditionalities attendant to the grants should be reduced and the release of the grants, which should have pan-India relevance, must be related to performance and outcomes	Allocate a 90 per cent grant for the Narmada Yojana under the Accelerated Irrigation Benefit Program	2011 population may be taken into account with a 25 per cent weightage for resource allocation among the states
Jharkhand	Raise divisible pool to 36 per cent	· Rs 5,186.61 crore for panchayats for building and staff, Rs 7,040 crore for ULBs · Indicative benchmark covering all transfers to be increased to 45 per cent.	Rs 1,42,098 crore as specific purpose grants	10 per cent weightage to a simple headcount of population and 5 per cent to average growth rate of population between 1971 and 2011, at least 5 percent weights should be assigned to the share of SC/ST in the population
Kerala	· Raise divisible pool to 50 per cent · Target 'revenue foregone' through exemptions and deductions for better managing size of divisible pool of taxes · Surcharges and cesses levied for more than two years should be shareable	Grants should be disbursed as percentages from gross tax revenues of the Centre and not as fixed amounts. They should be sector-specific and purpose-based so that they benefit States lagging in social and economic indicators	Rs 7,339.34 crore for registration, police department, prisons, maintenance of irrigation works, plan funding for upliftment of adivasi groups, National Food Security Act, Fisheries Sector, Health Sector, State Disability Initiative, National University for Disability and Rehabilitation Sciences, Elder care in the state, e-citizens services of various departments and mitigation of man-animal conflict	

State	Share in (Divisible Pool of) Central Taxes to be Devolved to States	Grants-in-aid for States	Specific Purpose Grant for States	Parameters in the Devolution Formula (for State-wise distribution of Central Taxes devolved to States)
Madhya Pradesh	· Raise divisible pool to 50 per cent · 50 per cent share in cesses, surcharge, telecom license fee, spectrum auction and petroleum mining licence fee	Fiscal deficit should be compensated through the state's share of grants and central taxes.	· Narmada Action Plan · No more Centrally Sponsored Schemes	2011 census instead of the 1971
Odisha	· An increase in the state's share from central revenue from 32 to 50 per cent · A guaranteed floor level of tax devolution of at least 90 per cent of the projected amount	· Rs 4.6 lakh crore · Modify the sharing pattern of SDRF between the Centre and the state to a ratio of 90:10 · In order to augment the consolidated fund of the state to supplement the resources of the local bodies, the existing share of central taxes should be increased to 5 per cent · Conditions attached to specific grants should be kept to the minimum so that state can avail these grants easily		· Fiscal discipline may be given a weightage of 20 per cent in order to balance of the overall approach of equity with efficiency · The area factor as suggested by the Government should be defined as scheduled area plus the low population density with a weight of 10 per cent · 1971 population should be adopted and the share of SC/ ST population should be taken into account in a composite population factor with a weightage of 20 per cent

State	Share in (Divisible Pool of) Central Taxes to be Devolved to States	Grants-in-aid for States	Specific Purpose Grant for States	Parameters in the Devolution Formula (for State-wise distribution of Central Taxes devolved to States)
Punjab	Share of states at 50 per cent	· Sought debt relief grant of Rs. 24,813 crore to overcome financial challenges and achieve stable growth · Rs. 8,775 crore for agriculture diversification · Rs. 24,813 crore as Debt Relief Grant towards outstanding Small Savings and Government of India (GoI)	State specific grant of Rs. 9,639 crore	· Demanded weightage of 15 per cent in devolution criteria for welfare of SC/ST communities · The weightage of the areas must be increased from existing 10 per cent to 15 per cent in the devolution criteria to meet the higher administrative costs to deliver similar level of public service across the country
Rajasthan	Vertical devolution should be enhanced to 50 per cent of the divisible pool of the central taxes	· Allocation of 5 per cent of the divisible pool for local bodies · An additional grant of Rs. 17,927 crore was sought for the road and buildings sector	Proposals relating to State Specific Grants mainly in drinking water, health and solar projects amounting to Rs. 26,562 crore were made	On horizontal distribution, it was suggested that population basis be 1971 with a weight of 25 per cent on the basis of composite index of six factors, fiscal capacity distance 40 per cent, fiscal discipline 10 per cent and area 25 per cent weighted by the inverse of the density of the population.

State	Share in (Divisible Pool of) Central Taxes to be Devolved to States	Grants-in-aid for States	Specific Purpose Grant for States	Parameters in the Devolution Formula (for State-wise distribution of Central Taxes devolved to States)
Tamil Nadu	· Vertical devolution should be 50 per cent of the divisible pool of the central taxes · Overall transfers should be substantially increased by bringing all Cesses& Surcharges into the shareable pool	· Higher proportion of fund flow from the Centre to states should be on the basis of the recommendations of the constitutionally mandated Finance Commission rather than through other mechanisms. The Calamity Relief Fund should be fully funded by Union and if not, at least to the extent of 90 per cent with an annual increment of 10 per cent · The State also recommended allocation of requested to allocate 5 per cent of the divisible pool for local bodies with greater weightage for urban local bodies proportional to the degree of urbanisation in each state		For horizontal distribution amongst States, it was suggested that 1971 population may be assigned a weight of 33.3 per cent, fiscal capacity distance 33.3 per cent and fiscal discipline 33.3 per cent

State	Share in (Divisible Pool of) Central Taxes to be Devolved to States	Grants-in-aid for States	Specific Purpose Grant for States	Parameters in the Devolution Formula (for State-wise distribution of Central Taxes devolved to States)
Uttarakhand	Shareable pool of taxes should be raised to 40 per cent	· No conditionalities for grants recommended for the functioning of the Local Bodies as they became difficult to fulfill and the local bodies could not avail of the grants recommended by 13th Finance Commission	· 14th Finance Commission was requested to continue with the plan and non-plan financing of Special Category States even if they show better results on human development indices, as these mountainous states forming a class by itself have larger expenditure requirements on account of their topography · State specific 'special problems' and 'up-gradation of standards of services' was projected at Rs.2,910.38 crore · 'Green Bonus' of Rs 2,000 crore	Incorporate forest cover as an additional criterion for horizontal devolution, with an assigned weightage of 10 per cent.

State	Share in (Divisible Pool of) Central Taxes to be Devolved to States	Grants-in-aid for States	Specific Purpose Grant for States	Parameters in the Devolution Formula (for State-wise distribution of Central Taxes devolved to States)
Uttar Pradesh	Share of central taxes to the States as part of vertical devolution be raised from 32 per cent to 36 per cent	· Special assistance has been sought for the State to tide over the difficult financial situation accentuated by the implementation of the Financial Restructuring Programme of the DISCOMs · Demanded that inflation factor be taken into account by the Commission for recommending grants · Proposed to increase the allocation for the Local bodies to 5 per cent of the divisible pool		Horizontal sharing of the divisible pool for allocation of shares amongst States be made on the basis of weightage of 25 per cent for 2011 population, 5 per cent for area, 50 per cent for fiscal capacity index and 20 per cent for fiscal discipline
West Bangal		Rs 2,55,000 crore for five years (2015-20) to improve the state's physical and social infrastructure and various development works	Special Purpose Grant of Rs 51,000 crore for servicing the stock of National Small Scale Fund (NSSF) loans outstanding as on March 31, 2013	

Commitments on Fiscal Federalism and Taxation in Election Manifestos of Select Political Parties for 16th Lok Sabha Elections

	Bharatiya Janata Party (BJP)	Indian National Congress (INC)	CPI (M)	All India Anna Dravida Munnetra Kazhagam (AIADMK)	Aam Admi Party (AAP)
Fiscal Federalism and 14th Finance Commission	Create 'Regional Councils of States', with common problems and concerns, with a view to seeking solutions that are applicable across a group of states.	- Substantial increase in untied funds; - Encouragement to Panchayats to raise their own resources so that they can consult gram and ward sabhas and decide how and what to spend money on; - Strengthening gram sabhas.	-Amending Articles 355 and 356 to prevent their misuse; -Review the Terms of Reference of 14th Finance Commission and seek approval of the same from the Inter-State Council; -Devolving 50 per cent of the total pool of collection of Central taxes to the States; -Raising States' share of market borrowing to 50 per cent; -Make non-tax revenues of Central government a part of the divisible pool and introduce constitutional amendment for this; -States to have a say in the composition and terms of reference of the Finance Commissions; - Transferring Centrally Sponsored Schemes under the State subject with funds to the States; -Setting a target minimum level of Local Self -Government expenditure to GDP; funds devolved to the local bodies to be routed through the State Governments.	-A more transparent release of non-conditional grants to states; -Limit the share of grants under Article 275 which is at the discretion of Central government to 7 per cent and ensure that more resource transfers occur through the Finance Commission recommended tax devolution route; - Transfer of subsidies burden to the states will be followed by adequate resource transfers as well; -Reject Raghuram Rajan Report particularly with reference to resource allocation based on index of underdevelopment; -5 per cent of the shareable Central Pool will be allocated to local bodies.	-Swaraj Bill to devolve power to gram sabhas and mohalla sabhas; -Gram and mohalla sabhas to be given untied funds to use it according to their own needs and priorities;

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	Bharatiya Janata Party (BJP)	Indian National Congress (INC)	CPI (M)	All India Anna Dravida Munnetra Kazhagam (AIADMK)	Aam Admi Party (AAP)
Taxation	-Provide a non-adversarial and conducive tax environment; -Rationalize and simplify the tax regime -Overhaul the dispute resolution mechanisms; -Bring on board all State governments in adopting GST, addressing all their concerns; -Provide tax incentives for investments in research and development, geared towards indigenization of technology and innovation.	-Enactment of GST and DTC within a year; -Ensure avoiding the unpredictable risk of retroactive taxation; -All taxes, Centre and State, that go into an exported product must be waived or rebated; -Clear policy on tax treatment of foreign firms and Mergers & Acquisitions (M&A) transactions while ensuring that taxes are paid by MNCs in the jurisdiction in which the profits are earned.	-Tax speculative gains by restoring Long Term Capital Gains Tax and increasing Securities Transaction Tax; - Increase wealth tax for the super-rich and introduce inheritance tax; -Plug the Mauritius route through the Double Tax Avoidance Agreement; -Corporate profit tax should be increased by increasing statutory rates so that effective tax rates are not low causing huge loss of revenue; -Taxation of capital gains from the international transfer of shares in foreign company with underlying assets in India; -GST to be implemented only after ensuring a higher rate for the states so as to at least partially correct the present fiscal imbalance; -Amending SEZ Act and Rules to do away with myriad tax concessions and regulate land-use.	-Review of Double Taxation Avoidance Agreements (DTAA) to deal with laundering of black money; -Loopholes in the Transfer Pricing Policy are being exploited to evade tax; -Enhance tax revenues by eliminating loopholes; -The Finance Bill 2013 amended Section 40 of the Income Tax Act to provide that any amount paid by way of fee, charge, etc. which is levied exclusively on a State Government Undertaking, by the State Government, shall not be allowed as deduction for the purposes of computation of income of such undertakings. This provision has hurt the non-tax revenues of Tamil Nadu considerably. GoI will earn additional income tax in the process. The provision also does not apply to Central PSUs. This Amendment will be withdrawn; -Raise income tax exemption limit to Rs 5 lakh p.a.; -Cesses and surcharges to be shared with States	-Simple, progressive and stable tax structure to raise tax-GDP ratio; -No more routine tax amnesty programmes and stringent measures to recover taxes from evaders

Recent Developments in National and International Economic Policy

Protiva Kundu*

Introduction:

This note is an attempt to analyse some of the key legislations and policy developments that came to fore in past few months in India. It also discusses some recent international events and policy dialogues development, some of which may have crucial implications for India. The article is divided in three sections. Section I talks about three legislations passed in the past year. Section II outlines some draft development policy measures that were approved by the Union Cabinet. Section III describes some major global policy developments in recent times.

I. Key Legislations:

Last year in the monsoon session of the Parliament (5th August to 7th September, 2013) three landmark legislations relating to food security, land acquisition and eradication of manual scavenging were passed.

The National Food Security Act, 2013

The National Food Security Act received the assent of the President on 10th September, 2013. The Act seeks '*to provide for food and nutritional security in human life cycle approach, by ensuring access to adequate quantity of quality food at affordable prices to people to live a life with dignity and for matters connected therewith or incidental thereto*'.

Salient features of the Act:

- The bill ensures the right to receive five kilograms of foodgrains per person per month at subsidised prices, to persons belonging to eligible households under Targeted Public Distribution System. Households covered under Antyodaya Anna Yojana will also be entitled to thirty-five kilograms of foodgrains per household per month at subsidised rate.
- All pregnant women and lactating mothers are entitled for free meals during pregnancy and up to six months after the child birth. A minimum Rs. 6,000 maternity benefits will also be provided to these women, provided they are not in regular employment with any government sector and not covered by any similar benefits.
- The Act also protects nutritional needs of the children in age group of six months to six years by providing meals free of charge every day, through the ICDS or mid-day meal scheme. If a state fails to provide entitled foodgrains, then there is clause in the Act for providing food allowances to each person as guided by Central government.
- The Act does not specify criteria for the identification of households eligible for PDS entitlements. The identification of eligible households is left to the State governments, subject to the scheme's guidelines for Antyodaya, and subject to guidelines to be "specified" by the State government for Priority households. Numbers of eligible persons will be calculated from Census population figures.
- The Act provides for the creation of State Food Commissions to monitor the implementation of the Act. Advice to the State governments and their agencies, and inquiry into violations of entitlements are also under the purview of the State Food Commission.
- Reforms in the public distribution system, focus on women empowerment and provision for grievance redressal mechanism are some of the positive features of the National Food Security Act, 2013.

Critical aspects

The critics frame India's food security debate as one on the "question of hungry people versus fiscal responsibility". The bill is likely to cost the government Rs. 1.25 lakh crore each year. Given India's present economic condition, the Act was criticised on the ground that it will worsen the fiscal deficit situation. There is also speculation that India's trade deficit will be hit hard as the programme will require 70-80 million tonnes of additional food grains every year. India does not produce that much and the shortfall will have to be met from imports. The move might also result in rise in prices of food grains for non-beneficiaries of the programme.

Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013

The Act is commonly known as 'Land Acquisition Act' which provides for land acquisition as well as rehabilitation and resettlement. It replaces the age old Land Acquisition Act, 1984.

Salient features of the Act:

- Developers need consent of up to 80 percent people whose land is acquired for private projects and of 70 percent of the land owners in the case of Public–Private Partnership (PPP) projects. However, no such consent is required in case of PSUs.
- The compensation for land has increased by four times and two times the present market value, in rural and urban area respectively.
- Government can acquire land for a maximum of three years without any provision for rehabilitation and resettlement in this period.

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- The provision of the bill is not applicable for acquisition under certain existing Acts

Critical aspects

There are many loopholes in this Act which need to be addressed. Due to dismal state of land records, the most difficult step in this process is identification of who owns how much land. Moreover, the new Act does not protect land rights or deals with historic injustices committed in name of development and public purpose against Dalits, Adivasis, landless workers and farmers. It is also not clear from the Act how the market price will be assessed. Companies can witness cost overruns due to higher land acquisition prices, which can stop or delay some infrastructural projects.

The Prohibition of Employment as Manual Scavengers and Their Rehabilitation Act, 2013

This bill was passed by the Parliament in monsoon session in 2013 and received assent of the President on 18th September, 2013. The bill seeks '*to provide for prohibition of employment as manual scavengers, rehabilitation of manual scavengers and their families, and for matters connected therewith or incidental thereto*'.

Salient features:

- Elimination of manual scavenging and the rehabilitation of manual scavengers in alternate occupations.
- Elimination of insanitary latrines, which include latrines where human excreta need to be cleaned or handled manually.
- Persons engaged or employed for manual cleaning of human excreta in an insanitary latrine or in an open drain or pit, railway tracks etc. have been brought under the definition of manual scavengers.
- Provisions for identification of manual scavengers and insanitary latrines
- Prohibition of hazardous manual cleaning of septic tanks and sewers to ensure health and safety of manual scavengers
- Provision for setting up of vigilance and monitoring Committees at the Sub-division, District, State and Central levels and strict punishment for contravention of the Act.

Critical aspects

The Act is facing criticism as it has many shortcomings and also lacks clarity on some aspects. The bill has a clause for providing land to the manual scavengers for rehabilitation purpose but no mention of its implementation mechanism. The Act is silent on the rehabilitation of those scavengers who left this profession in the past 20 years.

Some important steps have also been taken by cabinet in last few months mainly in education and health sector.

II. Policies

National Early Childhood Care and Education Policy (ECCE):

Union cabinet approved the national ECCE policy on 20th September, 2013. ECCE includes elements of care, health, nutrition, play and early learning within a protective and enabling environment. Early childhood refers to children under six years of age with well -marked sub stages: conception to birth, birth to 3 years and 3 years to 6 years. The ECCE is comprised of i) Early Childhood Education (ECE) ii) Early Childhood development (ECD) iii) Early Childhood Care and Development (ECCD) iv) Integrated Child Development (ICD)

The objective of achieving universal access to ECCE with equity and inclusion will be mainly accessed through Integrated Child Development Scheme (ICDS) in convergence with other relevant sectors/ programmes. Universal access to services for each sub-stage and ECCE centres would be functional as per population norms. It was also mentioned that age and developmentally appropriate national framework will be developed within 6 months of the notification of this policy.

Rashtriya Ucchatar Shiksha Abhiyan (RUSA):

The Cabinet Committee on Economic Affairs approved Rashtriya Ucchatar Shiksha Abhiyan (RUSA) on 3rd October, 2013 for reforming the state of higher education system. This is a flagship programme under higher education and will be in operation over the 12th and 13th Five Year Plan period. This centrally sponsored scheme is designed to improve access, equity and quality of higher education in State higher educational institutes. A total of 316 state public universities and 13,024 colleges will be covered under RUSA.

The objective of this scheme is to increase Gross Enrolment Ratio (GER) from 19 percent to 30 percent by 2020. The eligibility for funding under RUSA will be determined by certain prerequisite conditions and select State universities/ institutes will get their funding based on their performance. Reducing regional imbalances in access to higher education in rural and semi urban areas, setting up more higher education institutions in unserved and underserved areas, equity in education by providing opportunities to socially deprived communities, integration of skill development with conventional higher education system are some of the major objectives of RUSA.

Pharmaceutical Purchase Policy:

Cabinet approved policies for procuring medicines produced by central PSUs for ensuring availability of medicines at lower prices on 30th October, 2013. This policy will be applicable to 103 medicines for 5 years and will be consumed by PSUs, central government departments and autonomous bodies.

It will also be applicable to purchase of medicines by State governments under government funded health programmes like National Health Mission (NHM). A uniform 16 percent discount would be given to all products. The pricing of products under this scheme will be done by the National Pharmaceutical Pricing Authority using cost-based formula and will be revised annually based on the Wholesale Price Index, as per provisions contained in Drugs Prices Control Order, 2013.

Pradhan Mantri Jan Dhan Yojana:

Pradhan Mantri Jan-DhanYojana (PMJDY) is an ambitious programme launched on 15 August, 2014 to promote Financial Inclusion. The objective is to ensure access of weaker sections and low income groups to various financial services. The plan envisages universal access to banking facilities with at least one basic banking account for every household, ensuring financial literacy, access to credit, insurance and pension facility. In addition, the beneficiaries would get RuPay Debit card having inbuilt accident insurance cover of Rs. 1 lakh. The target is to cover all unbanked households in the country by 26th January, 2015.

Swachh Bharat Abhiyan:

The Swachh Bharat Abhiyan, launched on 2nd October this year, marks the beginning of the largest programme on sanitation by the Government in India till date. The programme aims to ensure access to sanitation facilities (including toilets, solid and liquid waste disposal systems and village cleanliness) and safe and adequate drinking water supply to every person by 2019. The unit costs of individual household toilets, angwanwadi toilets, school toilets and community sanitary complexes have been revised. Funding for these new initiatives will be through budgetary allocations, contributions by corporates and individuals to the Swachh Bharat Kosh and through commitments under the Corporate Social Responsibility. The total proposed investment (from all sources) according to media reports is likely to be to the tune of Rs 1.96 lakh crore.

III. Key Policy Developments at Global Platforms:

Some important and significant policy dialogues have taken place in the international arena in the past year. In this section, the focus is on some of these global policy developments.

G-20 Summit, 2013:

Last year, the eighth G-20 summit, the world's forum for economic cooperation, was held in St. Petersburg, Russia on 5-6 September, 2013. Leaders agreed on a number of issues to strengthen the global economy. The main objective of the summit was to ensure coordination of economic policies to promote strong, sustainable and balanced growth and addressing global challenges that no country can tackle alone. Some of the specific and pertinent global issues like climate change, trade expansion, tax evasion, nuclear industrial liability, work place safety and corruption were discussed in the forum.

Some of the significant declarations in the summit are:

1. Promoting growth and creating better quality jobs was top economic policy priority in this summit.

2. Phasing down production and consumption of a potent category of greenhouse gases through the Montreal Protocol.

3. Addressing international tax evasion and fixing tax rules to restrict MNCs to pay tax anywhere. Helping less developed countries to strengthen their revenue collection was also one of the important declarations at the summit.

4. A strong multilateral trade agreement with trade facilitation as core objective and extension of protectionist trade measures for an additional two years.

What did India gain from this G-20 summit?

As the former Prime Minister Dr. Manmohan Singh had pointed out in his speech, the unconventional monetary expansion in developed countries has some spill-over effects on developing countries like India. As a result, these countries experience varying degrees of currency depreciation. The Declaration addressed this key concern by asking the Central Banks of the developed world to calibrate its monetary policy to minimise volatility in capital flows and currencies. The most vital takeaway for India from the summit was from Japan. Japan will increase its current swap arrangement with India from USD 15 billion to USD 50 billion. In addition, BRICS countries comprising Brazil, Russia, India, China and South Africa have finalised a corpus of USD 100 billion for emergency funding.

A New Global Partnership: Eradicate Poverty and Transform Economies through Sustainable Development—The Report of High Level Panel of Eminent Persons on the Post-2015 Development agenda

Fourteen years since the Millennium Declaration, enough progress has been achieved in reducing poverty, improving access and equity in education and healthcare. However, the development process is not inclusive enough as the Millennium Development Goals (MDGs) failed to integrate the economic, social and environmental aspects of sustainable development. In this backdrop, a high level panel was set up to work towards eradicating poverty and transforming economies through sustainable development. The new development agenda was to carry forward the best of MDGs with focus on poverty, water sanitation, hunger, education and healthcare and explore possible trends to find optimum way forward for a post 2015 sustainable development. In this process, the central objective would be eradication of extreme poverty from the world by 2030.

The panel identified five priority transformations for post-2015 development and recommended work on these transformative shifts as a universal agenda.

1. **Leave No One Behind:**The objective is to ensure that no person – regardless of ethnicity, gender,

geography, disability, race or other status is denied basic economic opportunities and human rights.

2. **Put sustainable development at the core:** Climate change and environmental degradation are unavoidable threats to humanity. Attempts should be made for rapid shift towards greening economies for sustainable development.

3. **Transform economies for job creation and inclusive growth:** Creation of economic opportunities and profound economic transactions through a rapid shift in sustainable pattern of production and consumption is one of the important recommendations of the committee. Making room for equal opportunity and capability to access quality education, healthcare, water and sanitation is a primary agenda of post 2015 development process.

4. **Build peace and effective, open and accountable institutions for all:** Conflict and violence free nation, transparency and good governance are core elements of well-being. An agenda has been set forth to treat these core elements as fundamental rights of well-being, not as an additional option.

5. **Forge a new global partnership:** Each priority sector identified by panel as post 2015 agenda should be supported by dynamic partnership. Solidarity, transparency, cooperation and mutual accountability are the main ingredients to build up partnership between governments, civil society organisations, local community, multilateral institutions, business community, women, marginalised groups, academicians and private philanthropists.

Base Erosion and Profit Shifting (BEPS): Role of OECD

Base erosion and profit shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no overall corporate tax being paid (OECD, 2013). Though, in most of the cases BEPS is a legal strategy and due to loopholes in current tax rules, fair allocation of taxing rights between countries is suffering.

The G20 leaders' meeting in Los Cabos on 18-19 June 2012 explicitly referred to "the need to prevent base erosion and profit shifting" in their final declaration. The OECD was called on to develop an action plan to address the BEPS issues in a coordinated and comprehensive manner.

Responding to this call, the OECD tried to design a policy framework which will facilitate and reinforce domestic actions to protect tax bases and provide comprehensive international solutions to respond to the issue.

Action Plan of OECD on BEPS:

The OECD in a report in July, 2013 analyses the root causes of BEPS and identifies six key pressure areas in particular of the digital economy: (i) hybrid mismatch arrangement and arbitrage (ii) excessive deductibility of interest income and other financial payments (iii) intragroup financing, with companies in high-tax countries being loaded with debt; (iv) transfer pricing issues (v) ineffectiveness of anti-avoidance rules (vi) the existence of preferential regimes. To counter these major issues of BEPS, OECD sets forth fifteen point Action Plans. Some recommendations are:

1. Neutralise or end of hybrids and mismatches which generate arbitrage opportunities

2. Redesigning and Strengthening Controlled Foreign Company Rule (CFC) and other anti-deferral rules to counter BEPS in a comprehensive manner.

3. Recommendations regarding the design of rules to prevent base erosion through the use of interest expense and other financial payments economically equivalent to interest payments.

4. Evaluation of preferential tax regime in the BEPS context and promoting transparency and substance to counter harmful tax practices more effectively.

5. Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent treaty abuse.

6. Develop rules to prevent BEPS by moving intangibles among group members, transferring risks or allocating excessive capital among group members so that transfer pricing outcomes are in line with value creation.

7. To monitor the implementation of the Action plan, development of data base for BEPS and setting up tools for effective analysis of data.

8. Mandatory disclosure rules for aggressive/abusive transactions and tax planning to improve transparency.

9. Re-examining transfer pricing documentation to enhance transparency for tax administration.

10. Developing solution to counter treaty related disputes under Mutual Agreement Procedure (MAP).

11. Developing multilateral instrument to enable jurisdiction to implement measures related to tax and public international law issues and amend bilateral tax treaties.

The Action Plan will be implemented through a transparent and inclusive consultation process with developing countries and non-governmental stakeholders like business and civil society representatives.

Agenda for G20 Summit 2014:

The communiqué of the G20 Summit, 2013 had identified the agenda items for the November 2014 Summit. Enabling growth and creating jobs was given the top priority. Ten thematic issues, namely Anticorruption, Development, Employment, Energy, Financial Regulation, Comprehensive Growth Strategy, Investment and Infrastructure, Reforms of Global Institutions, Tax, and Trade have been identified for the discussion in the Leader Summit. In the agenda, 'Development' is defined as creating conditions for developing countries to attract infrastructure investment, strengthening tax system and improving access to financial services. Important aspects like social infrastructure, gender concerns, poverty etc. are missing from this official G20 discourse. Some of the specific issues on the agenda for the forthcoming G20 Summit are:

- Reducing the costs of corruption through transparency of ownership and control of companies.
- Combating tax avoidance and increasing the sharing of information between tax authorities and expanding the use of formal financial services.
- Addressing tax avoidance, particularly, base erosion and profit shifting (BEPS) by companies to ensure profits are taxed in the location where the economic activity takes place
- Removing obstacles to trade through easing the cost of trading across borders and facilitate participation by businesses in regional and global value chains.
- Strengthening development through increasing financing for infrastructure investment in developing countries
- Measures to lift labour force participation, particularly female work force participation and creating the right conditions for private enterprise to generate employment opportunities
- Improving the operation of global energy markets and energy efficiency.

Concluding remarks:

The Indian Government has taken some strong and positive measures in the social sector. Among them, the most significant are the Right to Education, Right to Work and Right to Food. However, the country's performance on social indicators still has a long way to go. India needs to balance its dual imperatives of growth and inclusion. The Twelfth Five Year Plan approach was for 'faster, more inclusive and sustainable growth'. Higher standard of living and development opportunities for all should be the ultimate aim of public policy which can make the development process more inclusive.

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