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Fiscal Federalism

GS Paper 2: Issues and Challenges Pertaining to the Federal Structure.

GS Paper 3: Indian Economy and issues relating to Planning, Mobilization of Resources, Growth, Development and Employment.



What is the meaning of Fiscal Federalism?

- Fiscal Federalism refers to the division of responsibilities with regards to public expenditure and taxation between the different levels of the government.

What are broad principles associated with fiscal federalism?

- **Fiscal equivalency:** According to this principle, the jurisdiction determining the order of provision of each public good should include the set of individuals that consume it. This generally requires a large number of overlapping jurisdictions.
- **Decentralization theorem:** According to the “decentralization theorem” “each public service should be provided by the jurisdiction having control over the

minimum geographic area that would internalize the benefits and costs of such provision.

- **Principle of subsidiarity:** The “subsidiarity principle” states that functions should be performed at the lowest level of government.

What are the essential features of Indian Fiscal federalism?

- **7th schedule** acting as a constitutional base for division of resources between governments.
- **Unitary tilt in Indian federalism** as India is a union of states.
- Role of **finance Commission** in fiscal devolution.

Why is Fiscal Federalism important?

- Having a Fiscal Federalism mechanism allows the government to optimize their costs on economies of scale, because in this manner, people will get public service which they prefer, and there will be no unnecessary expenditure.
- From the economic point of view also, having a federalized structure helps as it creates a unified market.

Evolution of Fiscal federalism in India, pre-Independence:

- Contribution from the provinces to the Union in the 1920s.
- **GoI Act 1919 (Montague-Chelmsford reforms)** provided for a separation of revenue heads between Centre & State.
- **GoI Act 1935** established the basic structure of fiscal federalism in India, allowing for sharing of Centre’s revenue and for the provision of grants in aid to provinces.

Evolution of Fiscal federalism in India, post-Independence:

- Post independence center assumed greater importance.
- Single party domination impacts on rules and institutions.
- Problems of intergovernmental co-ordination in the new political environment.

What are the recent issues in India’s fiscal federalism?

- **Incongruence of Article 282 of the Constitution with the letter and spirit of the Seventh Schedule.** Article 282 of the Constitution states that “The Union or a State may make any grants for any public purpose, notwithstanding that the purpose is not one with respect to which Parliament or the Legislature of the State, as the case may be, may make laws”. Article 282 embodies merely a residuary power to central government but there is excessive use of Article 282 precisely in implementing Centrally sponsored schemes.
- **Fiscal incongruity** due to fiscal consolidation roadmap for sound fiscal management as per Fiscal Responsibility and Budget Management (FRBM) Act.
- **Politicization of institutions such as the Finance Commission:** Since the Finance Commission is a major means of fiscal transfer. But today, the Finance Commission became a politicized institution with arbitrariness and inherent bias towards the Union government.
- **Expenditure of the States has been shooting up, their revenues did not:** The ability of States to finance current expenditures from their own revenues has

declined from 69% in 1955-56 to less than 38% in 2019-20. State still spends 60% of the expenditure in the country — 85% in education and 82% in health.

- **Stagnant Revenue of States:** Since States cannot raise tax revenue because of curtailed indirect tax rights — subsumed in GST, except for petroleum products, electricity and alcohol — the revenue has been stagnant at 6% of GDP in the past decade.
- **Increase in non-divisive cess and surcharges that go directly into the Union kitty:** 14th Finance Commission mooted for increased share of devolution from 32% to 42%, was subverted by raising non-divisive cess and surcharges that go directly into the Union kitty. But, the non-divisive pool in the Centre's gross tax revenues shot up to 15.7% in 2020 from 9.43% in 2012, shrinking the divisible pool of resources for transfers to States.
- **Recent drastic cuts in corporate tax,** with its adverse impact on the divisible pool, and ending GST compensation to States have had huge consequences.
- **Exploitation of interest rate differentials by the Union government:** States are forced to pay differential interest about 10% against 7% by the Union for market borrowings. That increased surplus cash in the balance of States that money borrowed at higher interest rates invested by Reserve Bank of India(RBI), in short treasury bills issued by the Union at lower interest rate.
- **Implementation of central schemes:** Autonomy of the states were curbed by turning them into mere implementing agencies of the Union's schemes. There are 131 centrally sponsored schemes, with a few dozen of them accounting for 90% of the allocation, and States required to share a part of the cost. They spend about 25% to 40% as matching grants at the expense of their priorities.
- **Conceptions of Central schemes, are** driven by the one-size-fits-all approach, are given precedence over State schemes, undermining the electorally mandated democratic politics of States.
- **Violation of constitutional provision** due to Diversion of a State's own funds to centrally sponsored schemes, thereby depleting resources for its own schemes. Implementation of centrally sponsored schemes on an item that is in the State list.
- **Conflict over issues related to Goods and Services Tax (GST)** such as the rate structure, inclusion and exclusion of commodities, revenue sharing from GST and associated compensation.
- **Deepening socio-economic inequality due to political centralisation:** The poorest half of the population has less than 6% of the wealth while the top 10% nearly grab two-third of it. India has a poor record on taxing its rich. Its tax-GDP ratio has been one of the lowest in the world — 17% of which is well below the average ratios of emerging market economies and OECD countries' about 21% and 34%, respectively.
- **Reliance on Indirect taxation for raising revenue:** Indirect tax still accounts for about 56% of total taxes. Instead of strengthening direct taxation, the Union

government slashed corporate tax from 35% to 25% in 2019 and went on to monetize its public sector assets to finance infrastructure.

- **Inter-state disparities:** There are inter-state disparities due to inequities in planning.
- **New era of political centralization and cultural nationalism** drives today's fiscal policy neglecting concerns of socio-economic inequities.



What are the mechanisms to resolve issues related to fiscal federalism?

- Issues related to GST have a forum for discussions as they are usually the agenda for GST council meetings.
- Other matters are generally flagged by the Finance Ministry based upon reports and studies done by the Reserve Bank of India (RBI) and the Comptroller and Auditor General of India.

Way Forward:

- **Restructure Seventh Schedule i.e. the allocation of centre-state responsibilities** while keeping in mind development of Indian value chain and national priorities and notable policy initiatives like Swachh Bharat, the New Education Policy, Ayushman Bharat and Swachh Jal through Jal Jeevan Mission that transcend boundaries.
- **Rationalization of centrally sponsored schemes** and central outlays through central entities that took overview of number and forms of centrally-sponsored schemes.
- **Clearly define the role of the National Institution for Transforming India (NITI Aayog)**, which is primarily a think tank institution and not a financial body, in the financial sphere.

- **Continuous reforms in public finance management (PFM) systems** that will help us to rethink the design and structure of a genuine fiscal partnership.
- **Rebuilding Institutional Capacity** by reviving institutions like Inter-State Council after abolition of Planning Commission.
- **More effective devolution of funds to local bodies** by giving them more taxation powers.

Sharad

Leopard

News: 60 percent rise in Leopard population across the Country; India now has 12,852 leopards.



About Leopard:

- The leopard (*Panthera pardus*) is the smallest species of the genus *Panthera*.
- In India, the leopard is commonly known as “panther”.
- Leopards have small round rosettes, or rose-shaped patterns, all over a generally yellow body coat colour.
- The coat colour and rosettes may vary slightly under different environmental conditions across its distribution range throughout the world.
- Leopard is an expert tree climber, the animal is known for carrying its prey up into trees to a safe height so that it can devour its prey at leisure

- **Ranges:** All of the sub Saharan and North Africa, the Middle East and Asia Minor, South and Southeast Asia, and extended to the Amur Valley in the Russian Far East. Island ranges included Sri Lanka, Java, Zanzibar and Kangean.
- **Ranges of Leopard in India:** Forested habitats in tiger range areas of the country but other leopard occupied areas such as non-forested habitats (coffee and tea plantations and other land uses from where leopards are known to occur), higher elevations in the Himalayas, arid landscapes and majority of North East landscape.
- **Habitats:** It occurs in almost every kind of habitat, from the rainforests of the tropics to desert and temperate regions. Indian subspecies, *Panthera pardus fusca*, is found in all forested habitats in the country, absent only in the arid deserts and above the timberline in the Himalayas. In the Himalayas they are sympatric with snow leopards.

Reasons for loss of leopard population:

- Habitat loss.
- Prey depletion
- Human Wild -Life Conflict: Leopards frequently occur outside protected areas in human dominated landscapes, increasing their vulnerability to conflict with humans.
- Poaching.

Conservation Status of Leopard:

- **International Union for Conservation of Nature (IUCN): Vulnerable**
- **Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES): Appendix I.** Appendix I lists species that are the most endangered among CITES-listed animals and plants.
- **Wildlife Protection Act 1972: Schedule 1.** Schedule I and part II of Schedule II provide absolute protection to threatened species. Offences under these are prescribed the highest penalties.

Outcome of the recent Leopard survey

- More than 60% increase in population has been recorded: India now has 12,852 leopards as compared to the previous estimate of 7910 conducted in 2014.
- The States of Madhya Pradesh(3,421), Karnataka (1,783) Maharashtra(1,690) recorded the highest leopard estimates.
- **Region wise distribution:** Central India and Eastern Ghats have the highest number of leopards at 8,071, Western Ghats: 3,387 leopards, Shivalik and Gangetic Plains: 1,253 leopards, Northeast hills: 141 leopards

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Public Expenditure

News: Rising fiscal indiscipline among the Centre and States.

GS Paper 3: Indian Economy and issues relating to Planning, Mobilization of Resources, Growth, Development and Employment.

What is the meaning of Sub-nationalism?

- Sub nationalism is existing or occurring below a national level, relating to or being a group or region within a nation.

What are the two kinds of public expenditure?

- **Mandatory spending** is expenditure that is governed by formulas or criteria set forth, rather than by periodic appropriations and as such, unless explicitly changed, the previous year's spending bill applies to the current year for these items of expenditure.
- **Discretionary spending** is expenditure that is governed by annual or other periodic appropriations. While States demand more fiscal space for increasing discretionary spending, the Centre is pushing for more fiscal discipline by reducing the scope for discretionary spending and limiting States to focus on mandatory expenditures.

What are the issues faced due to discretionary public spending?

- Discretionary expenditure is more volatile than mandatory expenditure.
- Discretionary expenditure is not contemporaneously correlated with output growth and the correlation is low for the next immediate time period.
- Once started, some of the discretionary expenditure, used to increase demand in the economy, continues for longer periods leading to fiscal stress.

What are the challenges in sub-national fiscal correction?

- It is hard to decrease discretionary government spending, especially on expenditure heads that raise private consumption, as it requires some counterbalancing measures to deal with the resistance from the public.
- Discussion on matters related to state's expenditure on welfare schemes of States and implementation of central schemes often ends up as exchanges of shifting the blame, especially when the Centre and the concerned State have different political parties in power.
- In a federal system, States' fiscal stress gets spilled over to the Centre, leading to a situation of overall magnified fiscal slippages.
- In India many States indulge in higher levels of expenditures towards maintaining '**models of welfare provisioning**'. The effects of such expenditures on growth of the economy and well-being of the beneficiaries are ambiguous as there is a lacuna of credible evidence.

- Dwindling revenue receipts of many States led to expenditure compression to adhere to the fiscal responsibility legislation target.
- Recent RBI data show that States' outstanding debt has registered an upward movement due to the implementation of **the Ujwal DISCOM Assurance Yojana (UDAY)**, farm loan waivers, sustained increase in populist welfare measures and growth slowdown especially in 2019-20. **The debt-GSDP ratio of States increased from 22.6 in 2013 to 25.1 in 2018, and further to 31.2 in 2022 (budget estimates).**

Way forward:

- Fiscal correction at the State level.
- Diligent expenditure polarization along with raising additional resources at the sub-national level.
- Center on its part needs to demonstrate commitment to fiscal discipline by sticking to the announced fiscal glide path to ensure the sustainability of a frictionless cooperative federal structure

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Hyper-Lapse consumerism

GS Paper1: Salient features of Indian Society, Diversity of India.

GS Paper3: Issues related to the Indian Economy.



What is Consumerism?

- Consumerism is a cultural model that promotes the acquisition of goods, and especially the purchase of goods, as a vehicle for personal satisfaction and economic stimulation.

What is hyper lapse Consumerism?

- In **'hyper lapse consumerism'**, there is a clamour to be the fastest to reach the consumer. The ubiquitous growth of the Internet and the rise of e-commerce have

fuelled hyper lapse consumerism, which refers not only to the kinds of products being sold but also to the ease with which consumers order them and the speed at which such products are delivered.

What are the shifts in the nature of Consumerism?

Nature of consumerism has seen tremendous shifts from the to the

- Hunter-gatherers whose consumption was survival-centric.
- During the industrial revolution, the rise of the middle class in developed countries has led to a growth in consumption.
- One stream of thought advocates minimalism.
- For millennials consumption is about fulfilling aspirations.
- **COVID-19 pandemic brought shifts in consumer behaviour:** Lockdowns brought more people into the e-commerce fold.
- Post-pandemic recovery and suppressed consumerism is now leading to 'revenge shopping'.
- Modern-day consumerism is not only about wanting more but also wanting it fast.

Benefits of hyper lapse Consumerism:

- According to NITI Aayog, in 2020-21, about 7.7 million workers were engaged in the gig economy, accounting for 1.5% of the total workforce in India. This is expected to grow to 23.5 million workers by 2029-30, making up for 4.1% of the total livelihood in India.
- According to a report titled 'Unlocking the Potential of the Gig Economy in India', by Boston Consulting Group and the Michael and Susan Dell Foundation, India's burgeoning gig economy has the potential to provide up to 90 million jobs in the non-farm economy alone, generate over \$250 billion in the volume of work and contribute 1.25% to the country's GDP in the long term.
- **Behavioral shifts among consumers:** Along with being fast, shopping has become more impersonal. The local kirana store owners have paved the way for 'delivery buddies' and OTPs. Many people don't buy groceries on a monthly basis any more; they buy them in a more piecemeal fashion. Often, they prefer getting meals delivered at home instead of going out.

Negative impact of hyper lapse consumerism:

- In India we saw food and grocery delivery companies announcing 10-minute deliveries for consumers in select cities. This might lead to reckless driving and put themselves and others at risk in their rush to stick to timelines.
- Indiscriminate work pressure can lead to fatigue, mental health issues and other health issues among delivery professionals.
- Absence of social security for gig and platform workers, including paid sick leave, health access and insurance, and occupational disease and work accident insurance.
- In the rush to come up with better value propositions for the customer, businesses often tend to ignore the social, ethical, environmental and personal costs of business decisions

- Usage of manipulative advertising to gain consumers.

Conclusion: Both consumers and businesses should be mindful of the wide-ranging consequences of their actions, and 360-degree analysis of business decisions must be undertaken for the larger good. After all, technology gives us leverage to solve many problems, but only wisdom can tell us which problems are worth solving.

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