

## **1. Firm steps to ease the Fiscal Federalism Tension**

### **Why was in News?**

- ▶▶ Centre now proposed that there should be a permanent expenditure fund created for defence spending out of the total tax revenue pool. In addition there was a talk of constituting the Expenditure Council similar to the GST council to determine the spending of the government's. This will stripped off the state government's taxation power.

### **Background:**

- ▶▶ After a seemingly innocuous entry through the Goods and Services Tax (GST) by the Centre into the territory of taxation powers of States, it is now arming itself to elbow the States out entirely of its fiscal powers. This is a dangerous development, especially coming at a time when the nation is at its divisive worst.
- ▶▶ **India is a Union of States.** Citizens of every State elect their government independently.
- ▶▶ The primary responsibility of such an elected government is efficient governance and accountability to its voters. An elected government is typically granted the powers to be able to raise revenues through taxation of its citizens and incur appropriate expenditure for their benefit.

### **Fiscal Federalism:**

- ▶▶ **Fiscal Federalism**, financial relations between units of governments in a federal government system. Fiscal federalism is part of broader public finance discipline. Fiscal federalism deals with the division of governmental functions and financial relations among levels of government.

### **Importance of Fiscal Federalism:**

1. Regional and local differences can be taken into account
  2. Lower planning and administrative costs
  3. Competition among local governments favours organizational and political innovations
  4. More efficient politics as citizens have more influence
- ▶▶ Over the past five years, democratically elected State governments have been stripped of almost all powers of taxation; there is an attempt to palm off the Centre's expenditure obligation to the States and there is now talk of even limiting expenditure powers of the States.

### **The Meal Scheme Lesson:**

- ▶▶ In 1982, Tamil Nadu government wanted to expand the midday meal programme to all 70 lakh children across 52,000 government schools to improve student enrolment. This entailed an additional expenditure of ₹150 crore, which the government did not have.
- ▶▶ The government decided to levy an additional sales tax on goods sold in Tamil Nadu to cough up the amount needed. The programme was then further expanded by successive governments which then catapulted Tamil Nadu's literacy rate from 54% in 1981 to 83% in 2011. In just three decades, Tamil Nadu was counted as one of India's most literate States.

### **Representation Without Taxation:**

- ▶▶ Typically, **more than 80% of Government's Revenues come From Taxes**, primarily from income tax (direct tax) and sales taxes (indirect tax). State governments in India do not have powers to levy income taxes.
- ▶▶ With GST, the Centre stuck its nose into the metaphorical indirect taxes tent of State governments. **States lost their sole powers to levy indirect taxes. Instead, they depend on a GST Council to determine Tax Rates and Revenues**, in the mischievous disguise of cooperative federalism.
- ▶▶ So, a democratically elected State government in India can neither levy income tax nor sales tax.

### **Planned Steps:**

- ▶▶ Centre has now proposed that there should be a **permanent expenditure fund created for defence spending out of the total tax revenue pool**. The Centre keeps 52% of the total tax revenue pool and distributes 48% to all the States and Union Territories. Instead of using its 52% share to spend on defence, the present government wants to palm off this expenditure to all the States.
- ▶▶ This will likely further reduce the tax revenues distributed to States for their own expenditure. Just as how in the garb of cooperative federalism the Centre intruded into States' taxation powers, under the garb of nationalism, it wants to further dilute the overall tax revenue pool of the States.
- ▶▶ There is now talking of **Constituting an Expenditure Council**, similar to the GST Council. Not only did States lose their taxation powers but with this idea, they will lose its sole spending powers too.
- ▶▶ An elected Chief Minister of a State with no discretionary powers to earn or spend for the people of the State can virtually hand over the reins of governance to Delhi.

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**Conclusion:**

- ▶▶ To restore the balance of fiscal federalism is to **grant State governments the powers to levy income taxes**. Since the birth of the republic, State governments have not had the powers to levy income taxes on citizens, except for agriculture taxes which are very small.
- ▶▶ In large federal democracies such as the United States, State governments and even local governments have the right to levy income taxes.
- ▶▶ In an India that is now increasingly diverging, it is imperative that **Democratically Elected State Governments are Given Powers to Raise Revenues** and incur expenditure in **accordance with each State's needs and Priorities**.
- ▶▶ There is a distinction between unity and uniformity. **Uniformity is not an essential condition for Unity**. On the contrary, a celebration of plurality may foster greater unity in a nation such as ours.

