

WILL MODI GOVERNMENT'S NEW THINK-TANK HELP STATES GET FINANCIAL FREEDOM FROM THE CENTRE?

In the same week that prime minister Narendra Modi announced what was long anticipated, the dismantling of the Planning Commission in its existing form, another event took place which highlighted the kind of problem that the commission had become increasingly used to facing in its dying years — the ever-present battle between the Central and the state governments over financial resources.

This time around the problem focused on reforms to create a common goods and services tax (GST). If it does go through later this year as promised, the GST will be a landmark reform event. Currently any business looking to produce goods in one state and distribute it to consumers across different states faces a variety of local taxes and duties across regions. The GST aims to create a single set of taxes. It's a move that will be widely welcomed by business, but it's also a reform that states have mixed feelings about since it directly affects their power to impose taxes. States would like to keep goods which are key sources of tax revenue — alcohol and diesel, for example — out of the GST and retain the power to tweak taxes on them. The battle is over what goods and services to include under the GST and what to leave out.



The Planning Commission did not play much of a role in this particular battle; however, in recent years it had become the focus of states' ire over financial resources raised by the Centre but spent across states in areas like health, education and infrastructure. Indeed, it was widely believed that one reason why Modi was eager to dismantle the panel was his fights with it as chief minister of Gujarat. But dismantling the commission doesn't mean those fights are going to end. How will the fights play out under the new government?

A Rubber Stamp

Despite the image of the Planning Commission being an all-powerful bugbear of the states, the reality is that its power had dwindled over the years to virtually nothing, even in terms of the resources it had control over, and could transfer to states. Till recently only around 6% of the funds that go to states from the Centre were actually 'decided' by the Planning Commission — even there, it had only little discretion and had to follow a set formula that took into account how poor different

states were.

Indeed, the biggest blow didn't happen last week, but with the 1991 reforms and delicensing. Among the roles the commission was left with was to rubber-stamp the so-called 'state plans'. A relic of the planning era, these are effectively five-year projections of what each state wants to spend its money on. The Centre also chips in with funding to support those plans and this is where the Planning Commission came in.

Even in this it had become more or less irrelevant. Former Planning Commission member Arun Maira terms the meetings between states and plan panel officials for finalization of fund allocation as "hilarious", admitting that many chief ministers find the process itself an irritant. "It's like filling up a form just for the sake of formality. If a particular state gets an allocation, say of Rs 9,950 crore, the Planning Commission may just round it off to Rs 10,000 crore after a 15-20-minute meeting with the chief minister of that state," he says. "Earlier too, the question came: why should the Planning Commission continue to control states' allocation when it should ideally guide the states and become their strategic partner," asks Maira, who in 2010 consulted 20 eminent persons, including industrialists Ratan Tata and Kumar Mangalam Birla, policymakers like Chakravarthi Rangarajan and Bimal Jalan, before submitting a report on how to make the plan panel a dynamic organization. The UPA-II however, was in no mood to radically change the commission.

Centre vs State

The key problem between the Centre and the states can be put fairly simply. It's that the Centre controls the most important sources of revenue (income-tax and corporate tax, for instance). But under the Constitution using any money raised to fund some of the most important functions of any government — providing health, education, sanitation or urban infrastructure — is largely the job of the state governments. "It is this vertical imbalance that has been the main issue," says Tapas Sen, professor at the National Institute of Public Finance and Policy. "What should have happened was that the Centre mobilizes the money but transfers a large chunk of it to individual states while leaving it up to them to decide how it should be spent."

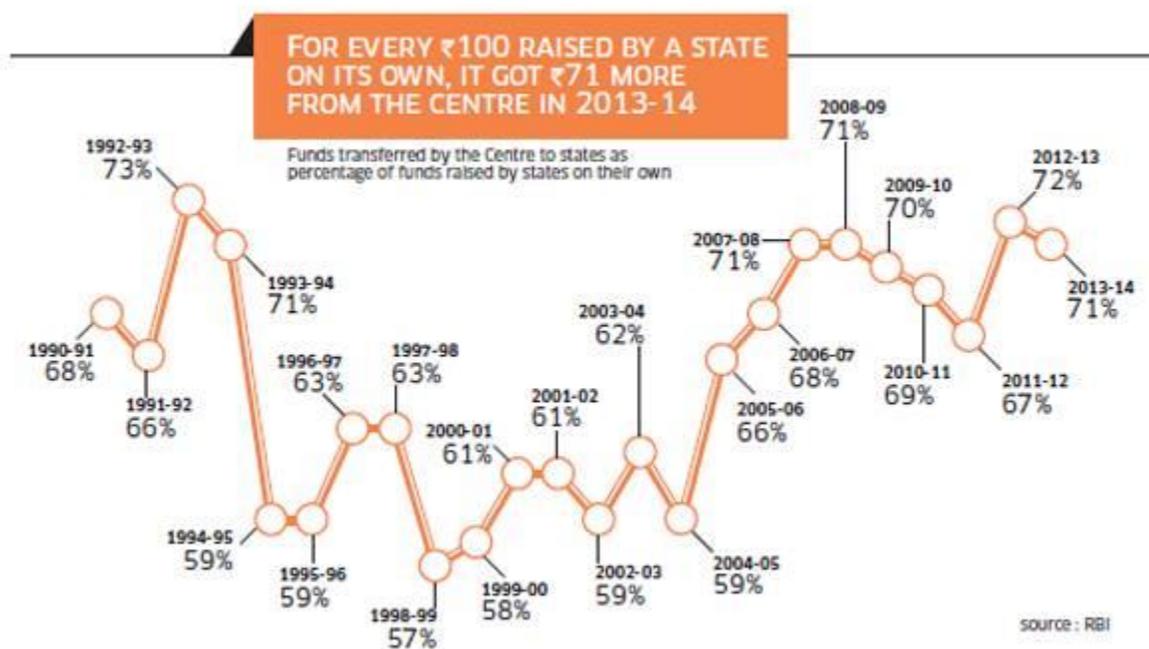
Under the Constitution, the Finance Commission has to decide what proportion of Central revenues should be given to states (currently it is around 32%), and how much to each state. Transfers to states under the Finance Commission were Rs 3,18,229 crore in 2013-14.

The Power Tussle

One of the states' biggest complaints over the years has been that successive Central governments couldn't really keep their hands off the money they mobilized, and increasingly wanted a say in how it should be spent at the state level. This led to the problem of 'tied funds' — which were

transferred to states by the Centre over and above those set by the Finance Commission, but with explicit riders to states on how the money should be spent.

Centrally sponsored schemes like the National Rural Employment Guarantee and the Indira Awas Yojana are classic examples of this. As of 2013-14, the Centre allocated around Rs 2,13,879 crore for 156 such schemes. Worse, if the Centre put up say 70% of the funds for a scheme, the state was required to put up the remaining amount. States complained they were being forced to divert their own resources towards a programme that had little regard for local conditions, and over which they had little control. The power to regulate and administer these schemes lies not with the plan panel or the state, but the Central ministry which set up the scheme. "Getting rid of the Planning Commission may not end the CMs' trauma of begging for funds from the Centre. The states still have to run to the ministries for funds," says a government official who had a stint in the commission.



Will the states get economic freedom from the Centre, as Modi has promised? Former Planning Commission secretary NC Saxena does not expect that to happen any time soon. Indeed, one of the ironies of the post-liberalization era has been that even as states have gained in power politically with the emergence of powerful regional parties, they remain as dependent as ever on the Centre financially, for resources. Currently, for every Rs 100 that a state raises on its own, it gets about Rs 71 more from the Centre — a ratio almost unchanged since 1991 (see chart below). "Over the years, the Centre has become a donor to the states. It's more a post-1991 phenomenon when the

growth rates improved dramatically and more money came into the Centre's hands," says Saxena.

The Centre began to craft big-ticket schemes on health and rural development which are essentially state subjects, to dole out what's called tied funds. As Sen points out: "What is the justification for the Centre to get involved in something like primary education? In most countries, this is a subject that is handled by local authorities, or at most, by individual states." For example, Modi's emphasis on open defecation-free India by 2019 is likely to give birth to a new mega Central scheme on sanitation which is essentially a state subject. In other words, the Centre's diktat to states on where to spend money could continue during this regime too.

Will Modi be Different?

To be fair, the states have to shoulder their share of the blame. One of the reasons why successive Central governments have wanted to step in was precisely because states gave them the excuse to do so, by allocating less money to basic needs than they possibly should have. "The Centre's handholding is essential. Otherwise, there could be a scenario where a particular state may end up using its money in building airports than spending it on health or education," says Saxena. "As states improve administration and increase their capacity on planning, more and more power on how to use its money should be delegated," he adds. "This is a country with huge regional inequalities," says economist Abhijit Sen, also a former member of the Planning Commission. If the Modi government were to simply decide to divvy up funds across states along the lines decided by the Finance Commission, it leaves little room for narrowing those differences through specific targeted funds and schemes. "If not the Planning Commission, someone will have to take that call," he adds.

The true test of the Modi government's approach to dealing with states is not in dismantling an already largely defunct institution. It will be in whether it will continue the trend of earlier Central governments of deciding how states should spend money. Tapas Sen, ironically, sees cause for hope in the government's move to highly centralize its functioning, by reducing power of individual ministers and pushing power to the Prime Minister's Office. The true test of the Modi government's approach to dealing with states is not in dismantling an already largely defunct institution. It will be in whether it will continue the trend of earlier Central governments of deciding how states should spend money. Tapas Sen, ironically, sees cause for hope in the government's move to highly centralize its functioning, by reducing power of individual ministers and pushing power to the Prime Minister's Office.