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Indian Fiscal Federalism at the Crossroads:

Some Reflections

Lekha Chakraborty[1]

Abstract

There is a growing recognition that something "fundamental" is happening in Indian fiscal federalism ex-post to the institutional changes like the abolition of the Planning Commission; creation of the NITI Aayog; the Constitutional amendment to introduce GST and the establishment of GST Council; and the historic high tax devolution to the States based on the recommendations of the Fourteenth Finance Commission. Recently the policy makers and experts have raised a few issues, which are (i) to make Finance Commissions permanent or to abolish the Finance Commissions by making the tax devolution share constant through Constitutional Amendment, (ii) the need for an institution to redress spatial inequalities, to fill in the vacuum created by abolishing the Planning Commission, and (iii) arguing the case for Article 282 of the Constitution to be circumscribed. The debates are also focused on whether there is a need establish a link between GST Council and Finance Commissions and should India devise a mechanism of transfer

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[1]This paper is prepared on the basis of the issues flagged in the book launch of "Indian Fiscal Federalism" written by Y V Reddy (former Governor, Reserve Bank of India and Chairman, Fourteenth Finance Commission) and G R Reddy (Advisor to Government of Telangana). The book was released by N K Singh, the Chairman of the Fifteenth Finance Commission. I was one of the panelists to the launching of the book along with Bibek Debroy (Chairman, Prime Minister's Economic Advisory Council), Montek Singh Ahluwalia (former Planning Commission Vice Chairman) and Haseeb Drabu (former Finance Minister of Jammu and Kashmir). The event was jointly organized by ICRIER and Oxford University Press. This book was launched at India International Centre, New Delhi on March 28th 2019.

which is predominantly based on sharing of grants for equalization of services rather than tax sharing. What could be a plausible framework for debt-deficit dynamics keeping intact the fiscal autonomy of States and to ensure "output gap" reduction and public investment at the subnational level, without creating bad equilibrium was also another matter of concern. These debates attain significance, especially when for the first time ever a group of States came together to question the Terms of Reference (TOR) of the 15th Finance Commission and there is a growing tension in the Centre-State relations in India.

Keywords: Fiscal federalism, Finance Commission, revenue sharing, fiscal equalization, GST, public debt, fiscal rules

JEL Codes: H77

Indian Fiscal Federalism at the Crossroads:

Some Reflections

A google search for "Indian Fiscal Federalism" shows 1.7 million results. The top hit among these results was the recent book on the topic written by Y V Reddy and G R Reddy. Recent "murmurings" that are happening in our country about fiscal federalism as listed out by Y. V. Reddy are the following: (a) the chapter in the book "Of Counsel" written by the former Chief Economic Advisor Arvind Subramanian about the need for a new federalism framework[2]; (b) former Finance Secretary and Chairman of Thirteenth Finance Commission, Vijay Kelkar's concerns about growing spatial inequalities[3]; (c) former Chairman, Prime Minister's Economic Advisory Council and Chairman, Twelfth Finance Commission Chairperson Chakravarty Rangarajan's urge to make the magnitude of devolution mandatory through Constitutional Amendment in the post-GST era[4]; and (d) RBI Governor Shaktikanta Das's view to make the Finance Commissions permanent[5]; and (e) the growing "trust deficit" of States and the first time ever conclave by the State Finance Ministers[6] on the TOR of 15th Finance Commission. This book on "Indian Fiscal Federalism' (herafter IFF) is an acknowledgement of the fact that something "fundamental" was happening in Indian fiscal federalism. It has given emphasis to these developments with empirical evidence. The "hysteresis" of fiscal federalism was analyzed to get the contemporary debates right.

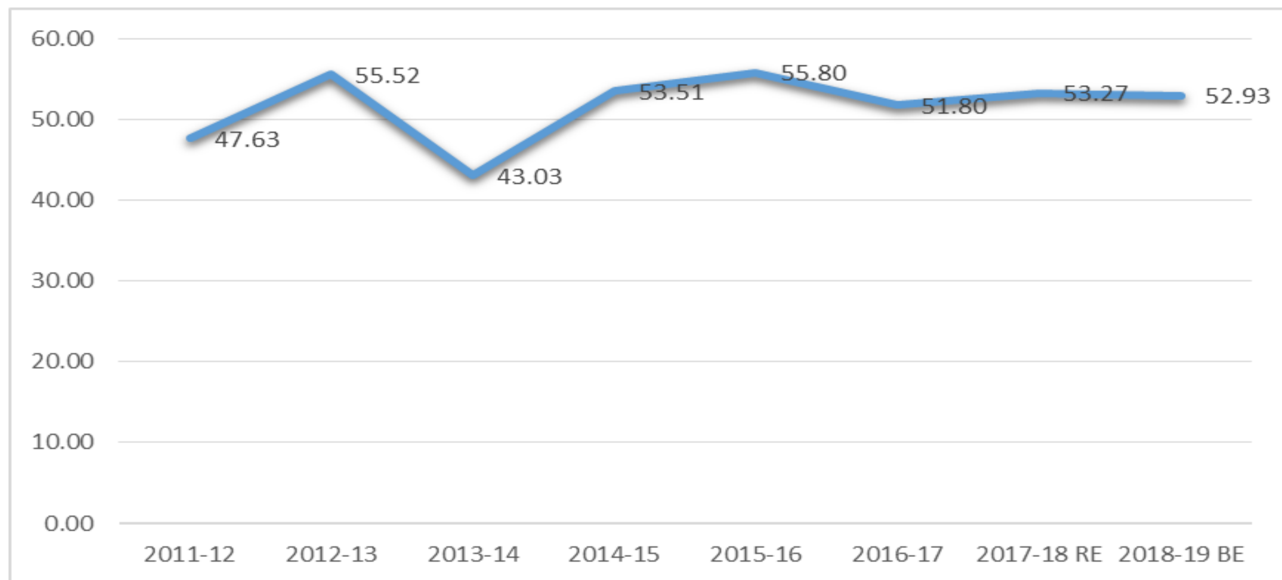
[2] Subramanian, 2018.https://penguin.co.in/book/non-fiction/of-counsel/
[3] Kelkar, 2019. https://www.nipfp.org.in/media/medialibrary/2019/01/WP_252_2019.pdf
[4] The Hindu, March 4th, 2019. https://www.thehindu.com/business/bring-in-constitutional-amendment-on-gst-revenue-sharing-proportion-rangarajan/article26475474.ece
[5] RBI, March 2019. https://m.rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1070
[6] The Hindu, May 14th, 2018. https://www.thehindu.com/opinion/op-ed/an-open-letter-to-finance-ministers/article23874674.ece

I 42 % tax devolution: Is it really a Game Changer?

The historic 42 % devolution of Centre's divisible tax pool to the States, recommended by the Fourteenth Finance Commission (herafter 14th FC), the highest ever till date, was hailed by Government, and the scholars in India and abroad alike. Y V Reddy, the Chairperson of the 14th FC meticulously explained the history of Indian fiscal federalism, inclusive of States' point of view and with a "practioner's perspective" on "how has 14th FC arrived at doing a great thing?". He has also consolidated the types of criticisms he had encountered. The first criticism is the States have **"**so much resources**"** ex-post 14th FC, that Centre has lost its fiscal space. The second criticism is that the local bodies did not get their due. On the first criticism, he reiterated that it is factually incorrect, and clarified that the real rise in terms of comparable basis intertemporally was not from 32 % to 42%, but from 39% to 42%[7]. As far as local bodies are concerned, he highlighted that more than 50% of the grants recommended by the 14th FC were for the local bodies. He explained that perhaps the "mistake" done by 14th FC was in not assigning "conditionality" to these grants. If we look at the aggregate transfers to the States as a percentage of Gross Revenue of the Central Government (See Figure 1), it has remained constant over the years.

[7] The Commission subsumed normal plan assistance, special plan assistance, special central assistance and also state-specific grants. https://www.financialexpress.com/economy/15th-finance-commission-to-realise-the-goals-under-new-india-2022-here-is-what-centre-must-remember/960819/

Figure 1: Ratio of Aggregate Transfers to States to Gross Revenue Receipts of Central Government (in %)



Source: Union Budgets (various years), Government of India

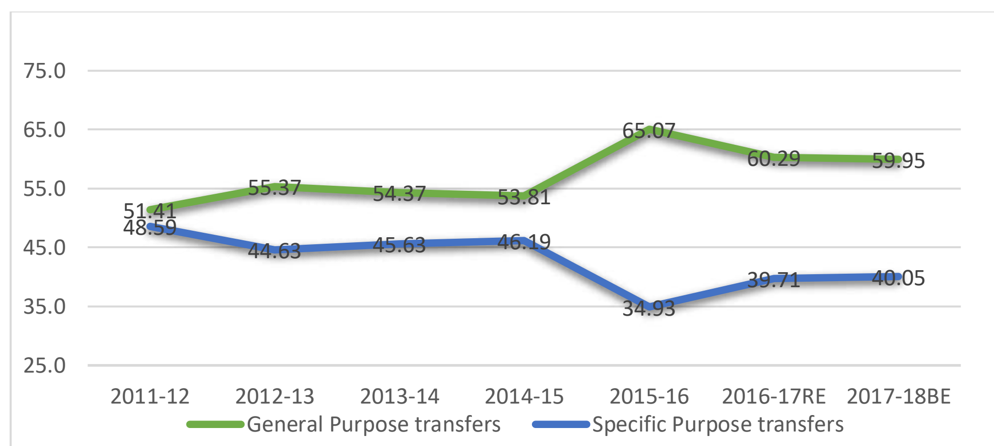
II. 7th Schedule (Article 246) and Article 282

A concern whether the labyrinth of "entitlement-based central legislations" (for instance, Mahatma Gandhi National Rural Employment Guarantee Act of 2005, the Right of Children to Free and Compulsory Education Act 2009 and the National Food Security Act 2013) conflict with the 7th Schedule of the Constitution (based on Article 246) was one of the highlights on federalism debate (Singh, N K 2019).

The 7th schedule of the Constitution clearly lays down the subjects for the Union List, the concurrent list and the State List with the exception that each will respect so to say the territorial limits of the other. Over the years, there has been a transgression of Centre into State subjects

through Centrally Sponsored Schemes (CSS) and enlargement of Concurrent List (page 76, IFF) on the grounds that such spending will serve national priorities better. It was cautioned that through this process, the fiscal autonomy of State was severely circumscribed. Singh, N K (2019) pointed out that the "original sin" was during the First Five Year Plan when Damodar Valley, Bhakra Nangal and similar schemes in the State's domain were funded by the Centre. This intergovernmental fiscal transfer (IGFT) outside the purview of Finance Commissions is the most sensitive part of Centre-State fiscal relations in India as the States feel that these transfers are large, discretionary, arbitrary and regressive (page 77, IFF). Have things changed after the 14th FC award? The answer is mixed. As evident from the Figure 2, the share of general purpose transfers which are unconditional has increased from 51.41 per cent of the total transfers to around 60 per cent of the total with a corresponding decline in the specific purpose or conditional transfers. However, this is misleading. Though there is an apparent increase in the general purpose transfers, effective increase will be much less due to the increase in States' contribution to centrally sponsored schemes (Chakraborty, Pinaki et al, 2018).

Fig 2: General & Specific Purpose Transfers (% of Aggregate Transfers)



Source: Chakraborty, et al. (2018)

The Article 282 of the constitution which says "*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.*" Though Article 282 embodies merely a residuary power, it has been misused totally outside the frames of Constitution. How to resolve this contradiction which creates dichotomy in the functions of Finance Commission, which requires wider debate (Singh, N K 2019). With the tax devolution of 42 % and the rationalization of CSS prior to the abolition of Planning Commission, there is a "triumph of experience over expectations" (page 74, IFF). The cesses and surcharges, and the non-tax revenue are kept outside the divisible pool, which can lead to clever financial engineering by undercutting the spirit of evolution (Singh, N K 2019).

The need for an institutional mechanism like "Fiscal Council" to enforce fiscal rules and keep a check on Centre's fiscal consolidation was highlighted. A need for consolidated fiscal roadmap for both Centre and States, with same rules of the game, for both (Singh, N K 2019). Another concern is that there is no constitutional check over borrowings for the Centre. Only for state government liabilities, Article 293 (3) provides a constitutional check over borrowings.

The 15th Finance Commission will be the first Commission which will be writing on a "clean slate" (Ahluwaliah, Montek Singh 2019). He said 14th FC contributed to it making a clean slate by providing substantial tax devolution, and he gave credit to the Government for accepting the recommendations. He also highlighted the irony that we got rid of the unconditional grants, but the CSS continued. He proposed a very different way of doing horizontal share, by focusing on education and health. "*If we can design something which says each citizen in the state must get "x" Rs of money as grant to take care of health, and "y" Rs to take care of education, and*

multiplied that by the population, and say this is the grant a state is going to get. Having decided on the grant, divide the divisible pool so that the totals must add up. The biggest advantage of this will be , the you will be earmarking the allocation for health and education , to heath ad education, he said. The big problem with the dividing up of revenues as shares is that you are leaving it entirely to states how to "spend" it , he explained. This is, from a federal point of view, totally acceptable." And he also said that many States have strongly objected the centrally sponsored schemes (CSS). If you want to do get away from "revenue sharing", he suggested that one can go for "equal per capita". That will be mostly progressive, because the large population States will gain a lot, and also it will create a basis to say that States should do their job on health and education, which States are visibly not doing, he added. This is the only thing that is different from revenue sharing, this has never been tried before, he said. Every Indian citizen has a right to have certain amount of money for health and education. If anything has to fit in, the politics has to be "genuinely federal", he commented. He said that if you do not get the things Central Government and State Government have to do right, you cannot solve the devolution problem as central government end up doing everything.

III. The TOR of 15th FC

A group of States for the first time ever has raised issues about the TOR of Finance Commission. The authors of IFF noted that 15th FC "would have the courage and wisdom to be guided by the letter and spirit of the Constitutional provisions in discharging its responsibilities and upholding the sanctity of the institution." N K Singh, the Chairman of 15th Finance Commission has confined to only responding to the comments on TOR that "*it is the President's prerogative to determine both the wording and the context of the TOR assigned to the Commission. And it is the*

prerogative of the Commission to address them in a manner that it considers appropriate. The Commission is not obliged to agree but the Commission is obliged to address the specific reference which have been made to it. In doing so we are inherently bound by past precedence and the contours of our constitutional obligations."

IV. Fiscal Marksmanship and "Continuity" through Australian Model of continuous Grants Commission

It was equivocally flagged that fiscal federalism is a dynamic process so to say 'a Work in Motion.' A question was raised whether there is a need to have a recourse mechanism for mid-term correction (similar to Australian Model of continuous Grants Commission) to revisit "state relativities" every year, in case the tyranny of the Finance Commission be inflicted on the assumptions of macro-fiscal parameters and the macroeconomic models in terms of projections (Singh, N K 2019). The chapter in IFF titled "The Detail Matters" has analysed whether any significant deviations between forecasts and the actuals. However, given the fact that some States have raised concerns about the State GDP numbers used by the FCs, the unrealistic revenue projections and expenditure compression, it is important to undertake systematic fiscal marksmanship analysis. The importance of reality checks was highlighted to analyse whether the perception among many States that Finance Commission lacks marksmanship while forecasting the revenue and the expenditure of the Centre vis-a-vis the states (Reddy, G R 2019). He narrated that from the analysis of last few years Finance Commissions - when the forecasts are compared with the actual outcomes – they found that the allegations against the Finance Commissions were absolutely incorrect, and whatever approach that was adopted by the Finance Commissions was uniformly applied for the forecasts, for arriving at the forecasts for the centre as well as States**.** All

awards of the Finance Commission are based on realistic assumptions on what is an acceptable macro-economic model in terms of key parameters like revenue projections, State GDP growth, permissible expenditure growth etc. (Singh. N K, 2019).

Table 1: Partitioning the Sources of Fiscal Forecasting Error

Ex_ante Fiscal Rules	***Bias***	**Unequal variation**	**Random**
Revenue Receipts	0.24	0.07	0.69
Capital Receipts	0.45	0.14	0.41
Revenue Expenditure	0.05	0.15	0.80
Capital Expenditure	0.06	0.22	0.72
Revenue Deficit	0.36	0.01	0.63
Fiscal Deficit	0.31	0.01	0.68
Primary Deficit	0.32	0.00	0.67
Ex_post Fiscal Rules	***Bias***	**Unequal variation**	**Random**
Revenue Receipts	0.01	0.04	0.95
Revenue Expenditure	0.00	0.31	0.69
Capital Expenditure	0.00	0.02	0.98
Revenue Deficit	0.04	0.01	0.96
Fiscal Deficit	0.02	0.01	0.97
Primary Deficit	0.05	0.02	0.93

Source: Chakraborty and Sinha, 2018

Technically, researchers can use these empirics provided in IFF to analyse the magnitude of errors of macro-fiscal variables, and the source of errors of Finance Commission projections (whether it is a "random error" and beyond the control of fiscal forecaster, or whether the "errors are systemic and biased") (Chakraborty, Lekha 2019). We can also analyse whether the magnitude of errors was higher for revenue or expenditure; and whether for capital budget or revenue budget. However, as indicated in Table 1, forecasting errors is not something just confined to Finance Commissions, it is analysed for Centre and State Budgets as well. The source of such errors in forecasting for the parameters are largely of random in nature (Table 1) which is beyond the purview of the policy makers.

IX. How to Address the Issue of Development Deficit in Indian Federal Fiscal System?

Is there a need for an institution to redress spatial inequalities, to fill in the vacuum created by abolishing the Planning Commission? One aspect that did not receive adequate recognition in the context of "what holds India together" is the role of Finance Commissions[8]. The IFF rightly highlights the significance of the existing institutional mechanisms for providing "predictability in the federal fiscal relations" along with the smooth transition of political regimes through peaceful elections, State Re-organization mechanisms and the other institutions of economic management. The IFF throws light into these aspects of "asymmetric" and "co-operative" federalism in India. There was "continuity". There was "change". The effectiveness of such processes in creating "convergence" is an empirical question. Such empirical questions have gained significance

[8] https://www.financialexpress.com/opinion/15th-finance-commission-what-really-holds-india-together/1062389/

globally. In Brooking Papers (2017)[9] there was a similar analysis of "economic convergence" about whether "Europe as a political project too ambitious?" They have found that there is a great extent of "economic convergence" within the European Union, despite widening cultural and institutional heterogeneities within an "economically integrated" Europe. However, the "cultural divergence" – "nationalism" – is the stumbling block. Such issues have started appearing even in the well-functioning federations like the US, with "protectionist" policies. In India, has the "equality of processes" in fiscal federalism resulted in "equality of outcomes"? Has this goal of economic convergence been achieved, with poor States "catching up" in growth with the richer States in India? Existing empirical evidence is mixed[10]. There is "convergence" in social sector outcomes, but there is no "economic convergence" (Chakraborty and Chakraborty, 2018). Further empirical research is required in this area, incorporating fiscal federal variables, especially ex-post to the phasing out of Planning Commission transfers which were designed to address such spatial inequalities. However, it was cautioned that the convergence does not happen if States get more money, but it is the totality of a State's policy (Ahluwaliah, Montek Singh 2019).

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[9] https://www.brookings.edu/wp-content/uploads/2017/08/alesinatextsp17bpea.pdf

[10] Chakraborty, Lekha and Pinaki Chakraborty, 2018. "Federalism, fiscal asymmetries and economic convergence: evidence from Indian States", Asia-Pacific Journal of Regional Science (2018-04-01) 2: 83-113, Springer. https://link.springer.com/article/10.1007%2Fs41685-018-0087-z

Box 1:

Fiscal Asymmetries and Economic Convergence

Theoretically federations are seen as 'indestructible union of indestructible states'. However empirical evidence show that such federations are rare. In a federal set up, there are political asymmetries and economic asymmetries. India has 29 States and these States are at asymmetric levels of socio-economic development. These asymmetries are vertical and horizontal. The vertical symmetries are the imbalances between Centre and the States in terms of complex outcome of constitutional division of resources and responsibilities across levels of governments. The horizontal asymmetries are the imbalances across the States. Chakraborty and Chakraborty (2018) tried to analyse whether there is economic convergence across States in India over the years controlling for asymmetries in fiscal and social outcomes. Economic convergence means that a state that starts off at low growth performance levels should see a "catching-up" growth process with the states which had better start. Empirical evidences are inconclusive about economic convergence. Against the backdrop of federal asymmetries in terms of gross capital formation, social and demographic outcomes, and differentials in public capital budgeting, Chakraborty and Chakraborty (2018) provided empirical evidence that unconditional convergence failed to show evidence of poorer states "catching up" with the richer states. Conditional convergence tests also show no evidences of strong economic convergence among Indian States. A separate analysis of coastal and inland states is also undertaken by the authors to analyse economic convergence as it has been observed in literature that "economic geography" plays a crucial role in the development of a region. The results show that public capital expenditure has positive and significant effect on growth, for both the coastal and inland regions. Health outcome proxied by Infant Mortality Rate shows

that improvement in health outcome results in higher economic growth. These results have two important policy implications. One, if the path to fiscal consolidation is achieved through curtailing public capital spending by the States, it would have negative consequences on economic growth in the long run. Two, the quality of human capital formation is a pre-requisite for economic growth. The results show that health related variables matter for economic convergence among States in India, and therefore public investment in health can be growth-enhancing, both for club and (aggregate) conditional convergence.

Source: Chakraborty and Chakraborty, 2018

The IFF has effectively analysed the how the formation of States, economic convergence and the efficiency-equity principles have influenced the thought processes of Finance Commissions intertemporally. Do you think we have "empirically" answered all the questions pertaining to Indian fiscal federalism the book highlights? The answer is "No". One of such crucial empirical questions is about the reliance of an economy on history. The IFF delves deep into the significance of history of Indian fiscal federalism in understanding the contemporary debates – and such analysis is rare in federalism literature in India. When global recession gripped the schools of thought in economics, the macroeconomists have started realizing the reliance of financial economics on history. However, we still do not understand very well the significance of the impact of this "hysteresis" in the evolution of fiscal federal design on macroeconomic stability, growth and development (Chakraborty, 2019).

X. Progressivity of the transfers

There is a debate about the significance of conditional versus unconditional fiscal transfers. Some economists believed a quick rebound of economy to “global goals” and economic convergence through designing a plethora of “conditional transfers”, while some others raise concerns over such transfers which are broadly of “one size fits all” design (Chakraborty, 2019). They highlighted the lack of State capacity (and the subnational finance matching component) to implement such transfers and suggested “unconditionality” in fiscal transfers. The IFF highlights these questions and remain “stoic” about it, leaving a cue that researchers need to examine it empirically – scientifically – through the **“**progressivity” analysis of tax transfers versus grants.

XI. State level Public Debt and FRBM

On Public Debt, the IFF recalls the extensive recourse to “seigniorage financing” – the automatic monetization – since 1957 by providing net RBI credit to the government to finance deficits, and the subsequent shift in the financing pattern from money-financing to bond-financing since 1990s, ex-post to the “economic reforms”. At the State level, the IFF further points out that “fiscal rules” determine State’s access to debt, subject to the approval of Central government. It is interesting to recall the changing perceptions on public debt in macroeconomic debates globally. The recent FRBM/rule-based fiscal policy in India stipulates 60 per cent threshold for public debt as part of fiscal consolidation. An empirical question I could gather here is whether State’s access to public debt, though “not good”, can be “so bad”? Of course the answer is “it is context-specific”. So what could be the plausible analytical frameworks to be considered when a Finance Commission

take steps towards public debt management? This portion on "Public Debt" in the IFF has reminded me the Presidential Address[11] by Oliver Blanchard in American Economic Association (AEA) meetings in Atlanta in January 2019 which I have attended. In his talk, he had put it upfront that **"**public debt has no fiscal costs if real rate of interest is not greater than real rate of growth of economy". He also highlighted that high public debt is not catastrophic if "more debt" can be justified by clear benefits like public investment or "output gap" reduction. (Output gap is the difference between actual GDP and potential GDP). He also highlighted the "hysteresis effects" (the persistent impact of short-run fluctuations on the long-term potential output) and suggested that a temporary fiscal expansion during a contraction could even reduce debt on a longer horizon. There is an increasing recognition of the fact that public investment has suffered from fiscal consolidation across advanced and emerging economies[12]. This is particularly important, when public investment is one of the crucial determinants in strengthening private corporate investment in the context of emerging economies[13]. Blanchard mentioned that if we are worried about a "bad equilibrium", it is better to have a "contingent fiscal rule" (which may not need to be used) rather than steady fiscal consolidation. Similarly, the IFF noted that "a uniform and rigid fiscal rule not only undermine the fiscal autonomy of the States, but would also result in "public (developmental) expenditure compression" to comply with numerical threshold ratio". This is refreshing, especially

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[11] The speech is posted in https://piie.com/commentary/speeches-papers/public-debt-and-low-interest-rates and paper is available at https://www.aeaweb.org/aea/2019conference/program/pdf/14020_paper_etZgfbDr.pdf . The policy brief of the paper can be accessed at

[12] In my paper co-authored with Vinod H and H Karun titled "Encouraging private corporate investment" (Elsevier: Handbook of Statistics, edited by H Vinod and C R Rao, 2019 https://www.sciencedirect.com/science/article/pii/S0169716119300033?via%3Dihub), using maximum entropy ensembles bootstrapping , we found that public (infrastructure) investment is the significant determinant of private corporate investment.

[13] There is no financial crowding out through real interest rate mechanisms. (Chakraborty, Lekha 2016: 'Fiscal Consolidation, Budget deficits and Macro economy, New Delhi: Sage Publications).

in the context when the path towards fiscal consolidation is equally important as the debt target thresholds, because the fiscal consolidation through strengthening the tax buoyancy than public expenditure compression can be less detrimental to economic growth. However the "output gap" can be a difficult notion for Finance Commission. Extreme precaution is required when we measure "deficits". It may be incorrect to think that "cyclical neutral fiscal deficit" instead of fiscal deficit, is what Finance Commissions need to focus. The empirical literature flags that we do not know whether "disruptions" or "downturns" permanently depress the level of output and employment or whether the economy can bounce back to its initial upward trend after a decline (the notion of "business cycle"). Gita Gopinath (Chief Economist, IMF) in her co-authored work[14] flagged that in emerging economies, there could be a "drop" from the trend growth than a "deviation" from the trend and she calls it "cycle is the trend". If empirical research proves that in Indian context "business cycle does not exist", then Finance Commission using the cyclicality of deficits can be challenging. Here is why Finance Commissions so far have resisted from using such sophisticated notions of "cyclical" and "structural" deficits. Finance Commissions cannot incorrectly assume that an upturn in business cycle can eliminate the "cyclical" part of deficit, while such things cannot happen if there is no return of economic growth cycle to prior trend growth path and therefore the buoyancy of revenue receipts could remain below the prior-potential level.[15]

[14] https://scholar.harvard.edu/files/gopinath/files/cycleisthetrend.pdf

[15] The empirical literature has noted that this could be true of Central Bank in case of the usage of "output gap" in inflation targeting.

XII. The third tier

The IFF has given importance to fiscal decentralisation. When it comes to third tier, the real issue is "unfunded mandates". To analyse this empirically, we need reliable data at the third tier. In India, general government data is a challenge. IMF Government Finance Statistics (GFS) gives cross-country data on general government (Chakraborty, 2019). However, we need to build up the third tier fiscal data. The role of State Finance Commissions (SFCs) also need to be emphasized for their significance in providing steady flow of funds to the local self-governments. The SFC has a prominent role in making the devolution less "arbitrary" and less "ad hoc" at the third tier. There is an increasing concern about the arbitrariness and ad-hocism of fiscal transfers at the third tier. Isher Judge Ahluwaliah has eloquently narrated the significance of Finance Commissions giving importance to the third tier, and especially the resource requirements of municipalities and the formation of cities. Montek Singh Ahluwaliah also mentioned about the third tier. He said, successful economic growth and employment happen only when successful agglomerations are created, which can drive investment. What municipalities get as revenue is just one per cent of GDP. In other emerging economies, it is 5 per cent of GDP. The debates are confined to Centre State devolution, there is a traction required whether States devolving its resources to third tier. This is an area where finances are required and can earmark a part of devolution to go to municipalities, as Chief Ministers never take interest in cities other than metropolitan areas. Bibek Debroy also has emphasized on fiscal decentralisation. Against the backdrop of the Seventh Schedule, he urged that we should debate not just the role of Union Finance Commissions, but also about the State Finance Commissions in the devolution of funds to all local bodies. Debroy noted that, *"We are mostly reacting to the Constitution as it stands. We are reacting to Finance*

Commissions assuming the Constitution is the way it is today. But the evolution of the Constitution was a historical process. The evolution of the Constitution was insipient in a way in the Government of India Act 1935. The reason I am flagging this the Finance Commission and the fiscal federalism is not just about the tax side, it is also about the expenditure side. So it is also about the Seventh Schedule." Debroy narrated that we have a mechanism to take decision through GST Council, which is at present limited to a variety of indirect taxes. He flagged a point that we should seriously think about expenditure, "whether it is optimal level at which expenditure takes place in terms of the Seventh Schedule is discussed, or revamp of seventh schedule is discussed, and the devolution of Union to States, and within State takes place in that context". Mani Shankar Iyer has pointed out why there is mention of only 7th schedule, while there was no mention of 11th and 12th schedules. He also highlighted that "panchayat finances" also need to be given emphasis by the Finance Commission, not alone the urban local bodies. All the panelists highlighted the role of State Finance Commissions (SFCs) in ensuring stable flow of funds to the third tier.

XIII. Link between GST Council and Finance Commissions

Drabu (2019) flagged three questions. One, the need for new model of fiscal federalism, and the seeds of that thought came from the 14th FC that India will exclusively focus on "revenue sharing", and not do the "expenditure underwriting". Two, the need "resource sharing" instead of "revenue sharing" as India is a raw-material deficit economy. He explained that a fiscal architecture to be designed for "resource sharing" than revenue sharing. Three, the institutional relationship between GST Council and the Finance Commission. He asked, is there a need for both co-ordination and a

conflict resolution mechanism between these institutions. Post GST-compensation, is there any need for revenue deficit grant (Drabu, 2019).

Against the backdrop of GST regime, is there a need to change "horizontal criteria"? Earlier, Finance Commissions have used the criteria "tax effort" in the horizontal devolution formula (Drabu, 2019). What criteria can replace that "tax effort" in the post-GST regime? Drabu (2019) also pointed out that earlier Finance Commissions were looking at revenue deficit grants, pre-compensation and post-compensation, and in post-GST regime, the entire mechanics of Finance Commission will undergo a change and in turn the inter-se allocation between these states. Drabu (2019) pointed out that 15th FC's TOR blatantly violates the Constitution, and it is making effort to negate every single thing that 14th FC has done. Drabu (2109) urged why cannot the TOR of Finance Commissions be drafted by the GST Council or at least the Empowered Committee of Finance Ministers.

XV. The Composition of Finance Commissions

The IFF talks about the "growing prominence of economists in the Commissions after the economic reforms", quite contrary to the initial FCs' composition of more lawyers to interpret Constitutional clauses on federalism. This takes me to an upcoming empirical literature on "career theories" of a leader, whether a leader's traits influence the policy outcomes? For instance, in the context of Western Europe, an analysis was done to examine – this is a paper published in Public

Choice[16] - whether the "personal characteristics" (education, work experience, ideology/political affiliation) affect changes in public debt. In monetary-macro, we can ask this empirical question whether the personal characteristics of Central Bank Governor affects the policy rate decisions. Timothy Besley of London School also analysed the leadership effectiveness on policy outcomes. In fiscal federal literature, in future, such empirical questions may be asked by scholars, whether the personal characteristics of the Chairperson of Finance Commission influences the magnitude and criteria of tax transfers; and the debt-deficit dynamics at the subnational level (Chakraborty, 2019).

XVI. Model of Tax Sharing versus Grants

Finally, I noted the absence of a cross-country backdrop on federalism experiences in the IFF. But I realize how different Indian fiscal federalism is from other country models. In other federations, intergovernmental fiscal transfers (IGFT) is predominantly "grants", not "tax transfers". So such "fiscal equalization models" may be of different relevance to India. It is a must-read for the scholars who are interested in federalism, as it helps us to understand the nuances of federalism to "innovate" Finance Commissions better and to "explore" more empirical questions in fiscal federalism.

To conclude, as eloquently put by Y V Reddy, 15th FC has a very big challenge in terms of incorporating the new institutional developments in Indian fiscal federalism. The fundamental

[16] https://www.jstor.org/stable/24507522?seq=1#metadata_info_tab_contents

premise, why first time ever, a group of States questioning the TOR of Finance Commission, needs to be dealt with “courage and wisdom” to continue the trust between Centre and the States. Once this is ensured, then comes the question of a new fiscal federalism model, whether India needs to continue “tax sharing” or switch on to a new “grant equalization” model.

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