
Financing development in a broken federalism

The context

- Aggression against the states, especially those ruled by non-NDA parties
 - The use of fiscal transfers and deployment of central expenditures to undermine the legitimacy of the opposition
 - Seeks to tie the hands of the states when it comes to both mobilizing resources and undertaking expenditures
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The background

- The framers of the Constitution of an India seen as a union of states, recognised the asymmetry in which the most buoyant tax powers rest in the hands of the Centre for reasons of efficacy, while a disproportionate share of development spending had to be the responsibility of the states.
 - But the reliance on centrally appointed Finance Commission's making recommendations on multiple forms of transfers to the states was at best a solution built on the faith that the Centre would act responsibly and the Commissions would be independent and fair.
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Faith belied

- Transfers to the states have been not only been restricted by shrinking the “divisible pool”
 - Centre’s reliance on dividends and profits (including transfers from the Reserve Bank of India) has increased.
 - A rising share of central spending in the jurisdictions of the states taken out of channels that involve states in decision making (such as the erstwhile Planning Commission)
 - Decisions on allocations and destinations consciously discriminatory.
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Impact of neoliberalism

- Neoliberalism has only worsened these tendencies.
 - The Centre unilaterally chooses to offer tax concessions in keeping with its distorted neoliberal agenda, thereby shrinking sharable taxes.
 - States enticed into ceding a substantial portion of their limited taxation powers to a council controlled by the centre with the promise that it would substantially raise their revenues and that they would be compensated for any shortfalls.
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Impact of neoliberalism (contd)

- Legitimised fiscal conservatism and pushed state's into tying themselves down with fiscal responsibility acts which limit borrowing.
 - It has ensured this and the adoption of other neoliberal reforms affecting the state public sector and even state spending on infrastructure and welfare, by linking centre state transfers to “reform” through Finance Commission's that embrace neoliberalism and favour centralisation.
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Weaponisation of these means to achieve multiple ends

- Earlier this offensive was camouflaged and justified when needed as being in the larger interests of the states.
 - But, more recently under NDA regimes these means have been weaponised with multiple objectives.
 - Limit state spending capabilities to an extent where most developmental spending has to be financed by the Centre, purely through non-rule based and discretionary choices, with the schemes presented as centrally delivered schemes.
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Weaponisation of means 2

- Deprive governments in states ruled by parties that belong to the non-NDA opposition at the Centre of the borrowing to finance their own programmes as well as of a fair share of programmes financed by the Centre and implemented in their jurisdictions.
 - Increase the share of the states in spending on even the centrally designed schemes they are eligible for, which given the fiscal crunch they would not be able to afford such that the blame for non-implementation can be shifted onto the states.
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New objectives

- Use the fall out of the fiscal bind to both politically delegitimise non-NDA opposition parties as well as support a campaign among the electorate to vote an NDA government to power in the state, on the grounds that only such a “double engine government” (with a supporting central locomotive) would be can benefit them.
 - Use the resource weapon to force states to adopt neoliberal policies and to turn the private sector for investment support.
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Fall-out for Kerala

- Kerala's governments increasingly constrained given the political environment.
 - Yet Kerala has been able to protect its human development achievements and even advance the quality of services.
 - One difficulty was allocation of resources for much needed infrastructure, that would have triggered investments that leveraged its strengths, such as human capital.
 - Resolved through KIIFB, but even that under challenge.
 - But enough legacy strengths to attract private investors.
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Do private investors have to be “attracted”

- Implies “incentivising” and “derisking” investments with public funds, by redeploying limited resources.
 - Requirement of concessions inflated by competition between states.
 - Necessitate reductions in welfare spending and cuts in implicit or explicit subsidies (by imposing user charges or reducing transfers) that ensure affordability of basic services.
 - Experience with PPP projects, and government programmes such as provision of viability gap funding, cost-plus purchase agreements (as in power for example), or direct subsidies (as in the production-linked incentive scheme) show how expensive these can be and indicate that they are not all effective.
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Implications

- Private investment not a substitute for public financing.
 - When authoritarian centralisation and neoliberalism combine to squeeze the states ruled by non-NDA parties or coalitions, there are only two alternatives:
 - Use available resources to protect and build on past achievements
 - Continue the fight against central dominance by forging alliances
 - Private investment is indeed welcome—but human capital advantages and well-planned investments in infrastructure rather than subsidies and transfers must be the “attractors”.
 - Sacrificing welfare to incentivise and subsidise private capital is not good strategy.
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Recent signs of the challenges ahead

- The decision to replace the MNREGA with an oddly named alternate scheme which is not demand-led and demands higher cost sharing by the states.
 - The Finance Commission's recommendations to keep the states share in a shrinking divisible pool at 41 per cent, recognise but justify the Centre's practice of relying increasingly on non sharable tax and non-tax revenues that reduces the divisible pool, and do away with post-devolution revenue deficit grants, through which Kerala had received almost Rs 38,000 crore under the 15th FC's award.
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Recent developments and implications

- The newly announced Urban Challenge Fund under which central support to the states to the tune of 25 per cent of urban development projects has been made contingent on the state mobilising an additional 50 per cent of the required capital “from the market”, through issue of municipal bonds, bank loans, public-private partnerships, and other such means.
 - This reflects not just competition for resources in the context of a system of vertical devolution. It is the centralisation, consolidation and weaponisation of fiscal powers to erode federal principles to achieve both political and neoliberal ends.
 - Unless that tendency is stalled and reversed the project of financing development for the people will not be advanced.
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