

Politics over the Purse*

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India's quasi-federal democracy, which was in danger of collapsing into a centralised authoritarianism, seems to be holding up. The results of the 2024 Lok Sabha election that reduced the brute majority of the National Democratic Alliance fronted by the BJP, making the coalition it leads dependent on support from two regional parties—the Janata Dal (United) and the Telugu Desam Party—is one important reason. The whims of the centralist BJP have to be tempered to meet the demands of these regional partners, the exact nature and financial costs of which are by no means clear. In fact, the concessions to these parties and the States they rule that have been declared publicly seem so small that they appear to be the smokescreen for much larger quid pro quo payments. The latter are possibly not being revealed for fear of a backlash from other States, including some ruled by the BJP.

In addition, controversial laws and “decisions” limiting the power of the States can no longer be brazenly steamrolled through Parliament without due process or even debate. The presence of a vocal and rejuvenated opposition, and the willingness of the media to report their views is proving an embarrassment. The election result has also changed the socio-political ambience in the country, with the judiciary and the media finding it necessary to appear more balanced, when adjudicating Centre-State disputes or reporting the assault of the Centre on the States and the pushback from the States that have been crying hoarse about the heightened erosion of federalism over the last decade.

A trend that has been read as evidence of a turn of the judiciary is the release in succession of politicians in opposition-ruled States, who have been incarcerated for months or even years on corruption charges that normally would have led to quick release on bail followed by extended court hearings. Now, the higher courts agree to hear their petitions and grant them bail. In the case of Manish Sisodia, a former Minister in the Aam Aadmi Party government in New Delhi who was in jail under yet-to-be-proved corruption charges for 17 months, the Supreme Court that rejected his bail plea in October 2023 and extended custodial confinement in June this year, has in August held that “bail is a rule and jail an exception” and that the right to a speedy trial is a fundamental right and released him from prolonged incarceration. The question arises as to what has changed in recent months to recognise these principles that were ignored for long. There is some distance to go, as some like former Chief Minister Arvind Kejriwal still languish in jail, and new cases are being initiated against other politicians. But there are signs that the pressure on the Centre to hold back is rising.

The Centre, however, has not given in, and is using all power in its command, including (mis)use of central investigative agencies and appointment of pliant or overenthusiastically loyal Governors and constitutional heads in States and union territories, to disarm, if not destroy, the opposition at the national and State levels. Governors, mandated to act on the advice of State governments, have resorted to tactics such as delaying clearance or the return of what they see as an inconvenient legislation passed by the State Assemblies for reconsideration, choosing to refer it to the President instead in a number of instances, and engaging in public conflict with

the State government in behaviour not keeping with the decorum expected of constitutional heads. In more than one State, Governors have made notable interventions by attempting to override the rights and recommendations of State governments regarding the appointment of Vice-Chancellors to universities, exploiting their ceremonial roles as Chancellors. That cannot be dismissed as mere cussedness, given the proliferating instances from Jawaharlal Nehru University in New Delhi to Visva Bharati in Shantiniketan, Kolkata, where control over universities through Vice-Chancellors is used as a means to populate them with “right-thinking” faculty and students. Such interventions appear to be aimed at neutralising criticism of and protests against the BJP’s policies, as part of the party’s political strategy to become not just the leading national party, but the only party ruling at the central or State levels. Besides relying on what it wrongly believed was an unfading charisma of Prime Minister Narendra Modi, who has been at the forefront or even the sole campaigner in national and regional elections, the effort appears to be that of undermining the opposition by straightjacketing State governments, and making it impossible for them to pursue policies promised in their election manifestos or designed to win them legitimacy.

An important tool in that effort, besides the use of central agencies, is to starve the States of funds. In what is now a widely-held assessment the evolution of the complex structure of devolution of tax resources from the Centre to the States—in an asymmetric structure where taxing powers are disproportionately with the Centre and spending responsibilities disproportionately with the States—is seen as a challenge in the management of India’s federal polity. The Constitution sought to address the problem by placing the responsibility of determining the “divisible pool” of central taxes, the vertical devolution (from the Centre to the States), and the horizontal distribution (across States) of those resources, on what were expected to be independent Finance Commissions constituted once every five years. As for the non-divisible portion, while the decision on implicit (through central expenditures in the territories of different states) and explicit Centre-State transfers rested with the Centre, those decisions used to be taken in consultation with the States in the now-defunct Planning Commission and the National Development Council. After the dissolution of the Planning Commission, its successor organisation, NITI Aayog, has only an advisory role with no financial powers. Moreover, the organisation has shown itself to be a think tank geared to advancing the Centre’s interests and the neoliberal agenda. Not surprisingly, most non-NDA Chief Ministers have had little faith in the NITI Aayog. A majority of them boycotted the minth meeting of its Governing Council held in July 2024, and while the Chief Minister of West Bengal, Mamata Banerjee, attended the meeting, she staged a walkout claiming that she was “stopped from speaking after five minutes”, while others were not.

While the issue of division of taxes has always been contentious, with the States feeling that the Centre was retaining a disproportionate share of taxes collected by it, and individual States claiming they were being discriminated against in the sharing formula, the conflict on this account has intensified on three grounds. First, that the Chair and members of Finance Commissions are increasingly not neutral arbiters, but inclined to favour the Centre which unilaterally appoints them in the first place. Second, using the Centre’s embrace of neoliberalism as justification, the Terms of Reference (ToR) of successive commissions have been designed to elicit recommendations that force the States to adopt neoliberal fiscal policies that limit

their expenditures, as well as allow the Centre to impose conditions such as reform of sectoral policies (as in electricity) and strengthening of the “ease of doing business” at the State level, with implications for regulatory policies adopted by the States. Finally, the Centre is seen as consciously and egregiously shrinking the divisible pool of tax resources, by relying on cesses and surcharges that are not treated as subject to sharing with the States. Those cesses and surcharges are meant to be transient and imposed to finance specifically designated expenditures. But such conditions have not been adhered to by the Centre, making them as good as any tax. With the revenues from these charges constituting as much as a fifth of the gross tax revenue of the Centre, there can be little doubt that the structure of taxation is being consciously skewed to deprive the States of transfers. Not surprisingly, as compared to the 41 per cent of central tax revenues that must accrue to the States as per the 15th Finance Commission’s award, the actual share stood at around 32 per cent. What is noteworthy is that though this anomaly has been widely noted, successive Finance Commissions have done little to correct it.

This is not the only bone of contention. The States have been agitated by the use of Article 293(3) of the Constitution, which requires the States to seek the permission of the Centre to raise a new loan, if they have payments outstanding on one or more past loans from the Centre. That is always the case. Using this power, States whose borrowing is limited to a percentage of their GDP under the Fiscal Responsibility and Budget Management Act have been compelled to adopt stringent measures under the guise of fiscal discipline. These States are further constrained by the inclusion of non-budgetary borrowing by state-owned enterprises when calculating their allowable debt exposure. Matters came to a head when in the case of Kerala, borrowing by the Kerala Infrastructure Investment Fund Board was included in the computation of the net borrowing on which the ceiling applied. The reasoning was these loans constituted borrowing for which the principal and/or interest was being serviced out of the Budget, or through assignment of taxes or cesses featuring in Budgets. A similar definition is not adopted by the Centre when computing its own acceptable borrowing levels. So the impact of the 15th Finance Commission’s view that, “governments at all tiers may observe strict discipline by resisting any further additions to the stock of off-budget transactions and contingent liabilities which is against the norms of fiscal transparency and detrimental to fiscal sustainability,” is felt only by the States. In the case of Kerala, which has a high share of its revenues diverted to meeting social and social protection expenditures, the restriction on its borrowing has pushed it into a situation where it is unable to fund ongoing welfare schemes. That led to the unprecedented situation where the Chief Minister of the State had to proceed to Delhi with his Cabinet colleagues and protest on the streets. That protest received support from other opposition parties as well.

Two other factors have intensified this crisis. One is the shortfall in the growth of State revenues from the Goods and Services Tax (GST) relative to the promised 14 per cent annual growth from a pre-GST base of revenues from indirect taxes subsumed under the GST. That shortfall was compensated with revenues from a cess for five years, but that cover has not been extended subsequently despite demands from the States. With the rollout of the GST, States had ceded a range of taxing rights to a council dominated by the Centre and that was a major blow to their revenues. Second, the implicit transfers from the Centre to the States through centrally sponsored schemes (CSSs, in which expenditures are shared by the Centre and the

States) and central sector projects (CSPs, fully funded by the Centre) have also become weapons in the hands of the Centre to squeeze State governments, especially those ruled by opposition parties. Not only has the Centre's contribution to the financing of CSSs been reduced and that of the States raised, but decisions on the States in which new central projects must be located are determined by the need to favour States with "double engine sarkar" or with governments run by the ruling BJP at the Centre. The new need for the BJP to appease governments in Bihar and Andhra Pradesh led by the JD(U) and the TDP respectively would further skew the horizontal distribution of central sector projects away from the opposition-ruled States, worsening their situation. Meanwhile, even centrally sponsored schemes for which State governments contribute a significant part of the expenditure are required to be attributed to the Centre and/or named after the Prime Minister, failing which they are deprived of the Centre's contribution. All development spending at the State level is sought to be presented as being the result of the largesse of the party ruling at the Centre.

These multiple efforts to fiscally strangle the States are reflective of the larger political project. Before the election of successive BJP-led NDA governments at the Centre since 2014, the tension over fiscal federalism reflected a contest between the Centre and the States for shares in the national revenue cake. After 2014, that tension derives from an effort to incapacitate opposition-ruled State governments as a means of undermining their legitimacy in the eyes of voters. The ToR for the 16th Finance Commission and its constitution, with "experts" known for their pro-government views as members, suggest that these trends would now receive further support from the statutory body.

However, the battle is not over. Kerala has moved the Supreme Court against the Centre's imposition of limits on the borrowing by the States from all sources, arguing that it violates Article 293 of the Constitution. There is a real possibility that the issue of GST and its implications for the ability of States to mobilise a fair share of tax resources as envisaged in the Constitution would also reach the courts as the fiscal crisis in the States intensifies. For the States, there is hope in a recent 8-to-1 majority judgement by the Supreme Court in a case with a 35-year history, regarding the right of States to impose a cess on royalties charged by the Centre on mining output in their jurisdictions. There are multiple issues involved here. The highest court ruled that royalty is not tax, but a "contractual consideration", while the cess on royalties was a "tax". It further held that, while under the Mines and Minerals (Development and Regulation) Act of 1957 the Centre has a right to impose royalties, the right to tax rested with the States. In this case that right related to powers granted under entry 40 on taxes on land and buildings under the State List in the Constitution. But that interpretation can be stretched. In a strongly-worded statement, the court noted the following: "Indian federalism is defined as asymmetric because it tilts towards the Centre, producing a strong Central Government. Yet, it has not necessarily resulted in weak State governments. The Indian States are sovereigns within the legislative competence assigned to them. In a federal form of government, each federal unit should be able to perform its core constitutional functions with a certain degree of independence. The Constitution has to be interpreted in a manner which does not dilute the federal character of our constitutional scheme. The effort of the constitutional court should be to ensure that State legislatures are not subordinated to the Union in the areas exclusively reserved for them."

It remains to be seen whether, on grounds such as these, the change in the balance of voting power in Parliament and the voice of a rejuvenated opposition would move the Supreme Court to intervene to redress the gross imbalances in Centre-State relations on many fronts.

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