

The 15th Finance Commission and Defence Expenditure*

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On July 29 the terms of reference of the Fifteenth Finance Commission were suddenly modified by a Presidential order. The Commission is now being asked to examine whether a separate mechanism for financing expenditure on defence and internal security should be set up, and how it can be operationalised.

The basic idea behind this Presidential order which has already been discussed and approved by the Union cabinet is to make the expenditure on defence and internal security a charge on the gross tax revenue of the central government before the size of the divisible pool which the Centre has to share with the states in accordance with the recommendations of the Finance Commission has been decided. This basically implies that defence and internal security expenditure will come at the expense of the divisible pool which means that its size will shrink and the states will be correspondingly squeezed in terms of resources.

This is a total fraud on the Constitution. In its Seventh Schedule the Constitution has three lists, the Central list, the State list, and the Concurrent list. These clearly mention the subjects that belong to the domain of each tier of the federal structure, with the Concurrent list being one where both the Centre and the states have joint jurisdiction. Now, defence belongs clearly and unambiguously to the Central list. What the Central government wants now is that the states should share the burden of financing expenditure in an area that belongs to the Central list. The Constitution of India does not permit this, and yet the Central government is going ahead with this proposal.

In fact this issue is even outside the purview of the Finance Commission itself. As the Centre collects a whole lot of taxes, the revenue from which exceeds what should be its expenditure, while the opposite is true in the case of state governments, the Finance Commission is set up once in five years to decide on the magnitude of devolution of resources from the Centre to the states. That is its Constitutional mandate; how the Centre manages to finance its various commitments from within the resources available to it is the Centre's business, and not that of the Finance Commission. The additional terms of reference of the Fifteenth Finance Commission notified on July 29 therefore are un-Constitutional. The Centre is pushing the Finance Commission to find resources for itself at the expense of the states.

Incidentally, if defence and internal security expenditures are to come from the resources that are Constitutionally earmarked for states, then, logically speaking, defence and internal security should be moved from the Central to the Concurrent list, in which case state government representatives should also sit in decision-making bodies relating to the Rafale deal and all other such purchases: whether they are necessary, how they should be made, and on what terms and conditions. To take state resources away from them for expenditures whose amount and modus operandi are determined exclusively by the Central government, goes against a fundamental principle.

The American War of Independence was fought on the slogan "No Taxation Without Representation". The states here, analogously, would be justified in saying, in case

their resources are taken away from them, “No Resources From Us Without Our Say on How they Are Spent”. But that of course would be anathema for the Centre, which would like to take money from the states but still have exclusive say over how that money is spent, exactly as British imperialism had done vis-à-vis the American colonies.

Already the Centre is cheating the states by resorting to additional resource mobilization not by altering tax rates but through cesses and surcharges. Now, while the tax revenue of the Centre is shareable with states, the revenue earned from cesses and surcharges is not. If the Centre for instance earned additional revenue from a rise in income tax rates then that is shareable with the states, while if it raised the same additional revenue through a surcharge on the income tax then that does not have to be shared.

In fact it has been estimated that while the Fourteenth Finance Commission had recommended the devolution of 42 percent of the Centre’s Gross Tax Revenue to the states, because of the plethora of cesses and surcharges, the actual share of states does not even reach 32 percent. A huge amount of Central revenue is simply kept out of reach of state governments.

This cheating, together with the hustling of states into the GST regime (the transition to which is often presented as inescapable, even though the largest capitalist country in the world, the United States, has escaped this transition with impunity), has dealt a heavy blow to state finances. Further reducing the size of the divisible pool by taking the amount of defence and internal security expenditure out of it, would really reduce the states to the status of mendicants.

When they do get so reduced, they would naturally come to the Centre with begging bowls. And that is when the Centre, implicitly if not explicitly, would put forward “conditionalities”: you support us on the abrogation of Article 370 and we shall give you money; you break ranks with the opposition parties and we shall give you money; and so on.

In fact in the dismal saga of the rise of Hindutva, critics have been quick to note the abridgement of democracy and civil liberties that it has entailed; and the assault on secularism it has launched. The parallel attack on federalism however often goes unnoticed. But it is no less serious, as federalism is a part of the “basic structure” of the Constitution.

The reason why the assault on states has gone unnoticed (except very recently and that too only in the political sphere) is because there is an impression that after the 14th Finance Commission, the states can no longer complain about a raw deal from the Centre. The 14th Finance Commission raised the share of the states in the divisible pool from 32 percent earlier to 42 percent. This is considered a generous gesture: if the states still have financial constraints then that has to do with the general shortage of resources, but not with the Centre’s niggardliness. The Modi government in fact made a great song and dance about accepting the 14th Finance Commission’s report with alacrity.

But a closer look suggests that if we take total devolution of resources, including discretionary transfers of various kinds, the resources transferred to the states as a

proportion of GDP actually fell, despite 42 percent being transferred via the Finance Commission route. What the Centre did in other words is that it squeezed other forms of transfer while accepting the FC- ordained transfers. It made much noise about “cooperative federalism”; it paraded its altruism in accepting without question the FC’s recommendation; but behind everybody’s back it squeezed the state governments. This squeeze is about to intensify with the proposed financing of defence and internal security expenditure by using state government resources.

In fact once the idea of having a fund for defence and internal security expenditure, which draws on the divisible pool, gets accepted, then, given the BJP’s penchant for a muscular “nationalism”, this fund will keep expanding. Any opposition to such expansion on the grounds that it is squeezing development expenditure and welfare expenditure that is meant for the poor, will invite the charge of being “anti-national”.

It will be a very convenient arrangement for the BJP. It can claim credit for being “concerned with the nation”; it will cover itself with the cloak of “patriotism”. But the bill for its “patriotism” will be borne by the state governments belonging to a multiplicity of other political parties.

To retain a modicum of Constitutional propriety, to prevent yet another Constitutional institution, the Finance Commission, from being hijacked by the BJP government for its own ends, and to ensure that expenditure on the welfare of the people is not constrained by the exaggerated demands of “hyper-nationalism”, it is absolutely essential that this nefarious move of the Centre is thwarted.

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