State of the Economy

Part 2

Economic Survey Vol 2 Chapter 1

First Advance Estimates of 2019-20

- Growth in real GDP during 2019-20 is estimated at 5.0 per cent, as compared to 6.8 per cent in 2018-19
- Fixed investment as percentage of GDP at current prices is estimated to be 28.1 per cent in 2019-20, lower as compared to 29.3 per cent in 2018-19 (Table 6)

Table 6: Demand side components (as per cent of GDP)

	2017-18 1st RE	2018-19 PE	2019-20 1st AE	Percentage points change in share in 2019-20 over 2018-19 [Increase (+)/ Decrease (-)]
Total consumption	70.0	70.6	72.1	1.5
Government consumption	11.0	11.2	11.9	0.7
Private consumption	59.0	59.4	60.2	0.8
Gross Fixed Capital Formation	28.6	29.3	28.1	-1.2
Net exports	-3.2	-3.9	-2.8	1.1
Exports of goods & services	18.8	19.7	18.4	-1.3
Imports of goods & services	22.0	23.6	21.2	-2.4

Source: National Statistical Office

Note: RE - Revised Estimate, PE - Provisional Estimate, AE - Advance Estimate

Table 8 : Key Indicators

Data categories	Unit	2016-17	2017-18	2018-19	2019-20
GDP and Related Indicators					
GDP at current market prices	₹ lakh Crore	153.6	171.0	190.1[a]	204.4[b]
GDP at constant market prices	₹ lakh Crore	123.0	131.8	140.8[a]	147.8[b]
Growth Rate	(per cent)	8.2	7.2	6.8[a]	5.0[b]
GVA at current basic prices	₹ lakh Crore	139.4	154.8	172.0[a]	185.0[b]
GVA at constant basic prices	₹ lakh Crore	113.2	121.0	129.1[a]	135.4[b]
Growth Rate	(per cent)	7.9	6.9	6.6[a]	4.9[b]
Gross Savings	% of GDP	30.3	30.5	na	na
Gross Capital Formation	% of GDP	30.9	32.3	na	na
Per Capita Net National Income (at current prices)	₹	104659	114958	126406[a]	135050[b]
Production					
Food grains	Million tonnes	275.1	285.0	285.0[c]	140.6[c]
Index of Industrial Production (growth)	(per cent)	4.6	4.4	3.8	0.6[d]
Electricity Generation (growth)	(per cent)	4.7	4.0	3.5	0.3[d]
Prices					
WPI inflation (average)	(per cent)	1.7	3.0	4.3	1.5[e]
CPI (Combined) inflation (average)	(per cent)	4.5	3.6	3.4	4.1[e]
External Sector					
Merchandise export growth (in US$ term)	(per cent)	5.2	10.0	8.8	-2.0[e]
Merchandise import growth (in US$ term)	(per cent)	0.9	21.1	10.4	-8.9[e]
Current Account Balance	% of GDP	-0.6	-1.8	-2.1	1.5[f]
Foreign Exchange Reserves (end of year)	US$ Billion	370.0	424.5	412.9	457.5[j]
Average Exchange Rate	₹ /US$	67.1	64.5	69.9	70.4[e]
Money and Credit					
Broad Money (M3) growth (annual)	(per cent)	10.1	9.2	10.5	9.8[g]
Scheduled Commercial Bank Credit (growth)	(per cent)	8.2	10.0	13.3	7.2[g]

Data categories	Unit	2016-17	2017-18	2018-19	2019-20
Fiscal Indicators (Centre)					
Gross Fiscal Deficit	% of GDP	3.5	3.5	3.4[h]	3.3[i]
Revenue Deficit	% of GDP	2.1	2.6	2.2[h]	2.3[i]
Primary Deficit	% of GDP	0.4	0.4	0.2[h]	0.2[i]

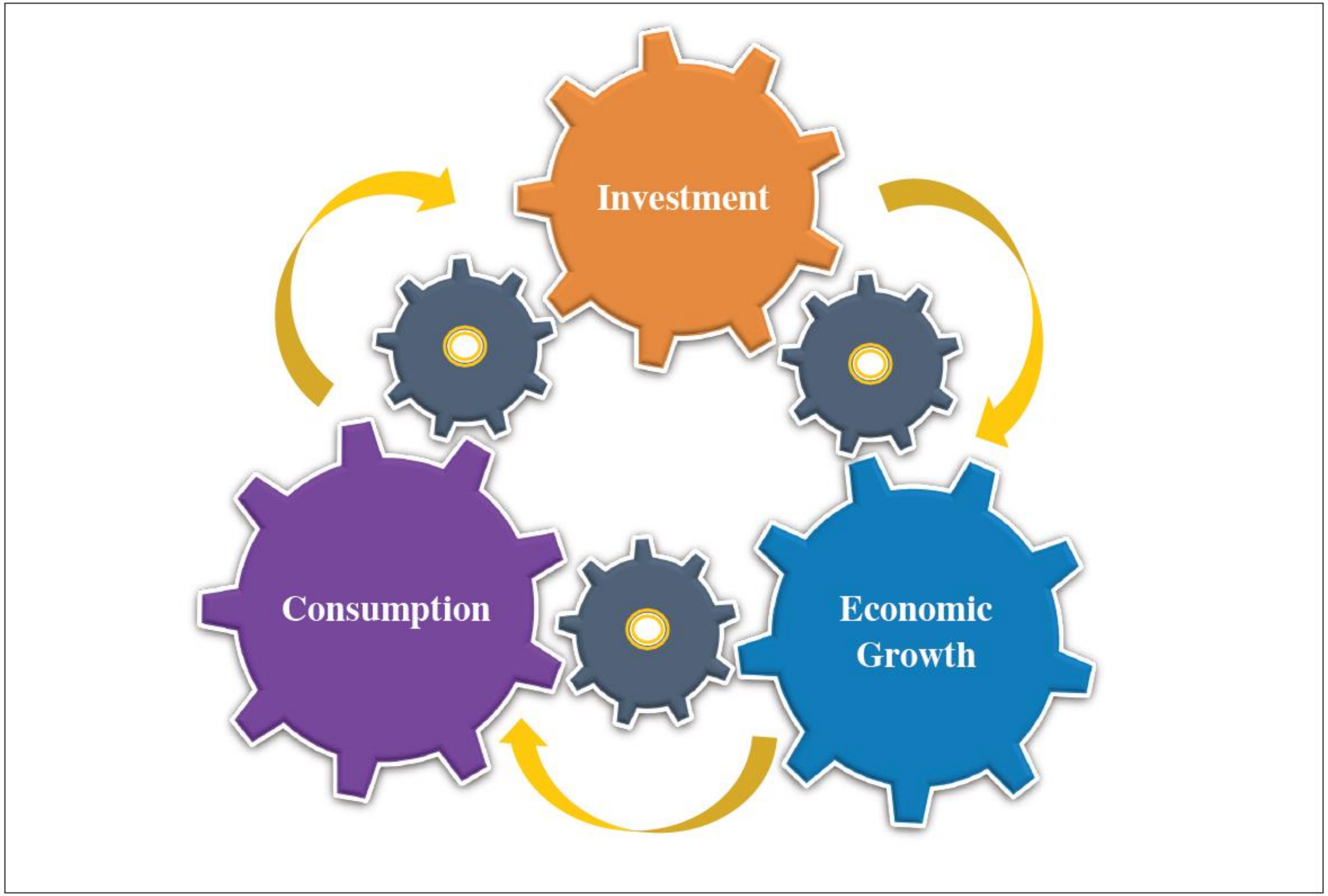
Notes: Na: Not available,
a: Provisional estimates, b: First advance estimate, c: Fouth AE for 2018-19 and first AE for 2019-20,
d: (April-November) 2019, e: (April-December) 2019, f: (April-September) 2019, g: November 2019,
h: Revised Estimate i. Budget Estimate j. End of December 2019

- Key indicators of the economy are reflected in Table 8.
- Given a 4.8 per cent real GDP growth in H1 of 2019-20, the first Advance Estimates imply that growth in H2 of 2019-20 will witness an uptick over H1 of 2019-20.
- Reasons:
- NIFTY India Consumption Index picked up for the first time this year with a positive year-on-year growth of 10.1 per cent in October 2019 as compared to negative growth in the previous months.
- The growth continues to remain positive
- Reinstating the positive confidence in Indian economy the secondary market continues to be upbeat
- Foreign investors continue to show confidence in India.
- The country has attracted a net FDI of US$ 24.4 billion in April- November of 2019-20 as compared to US$ 21.2 billion in April-November of 2018-19
- Net FPI inflow in April-November 2019-20
- The terms of trade for farmers has been improving and will lead to increase in rural consumption- food inflation since April 2019 has been rising.
- Industrial activity is on a rebound and is showing signs of pick up= IIP in November 2019 has registered a growth of 1.8 per cent as compared to a contraction by 3.4 per cent in October 2019 and by 4.3 per cent in September 2019
- Growth in merchandize exports has been improving as reflected in a contraction by 0.8 percent in Q3 2019-20 which was smaller as compared to a contraction by 3.7 per cent in Q2 2019-20.
- As per first Advance Estimates of 2019-20, contribution of net exports to the growth of GDP is estimated to increase by 1.1 percentage points over 2018-19.

THE RECENT GROWTH DECELERATION

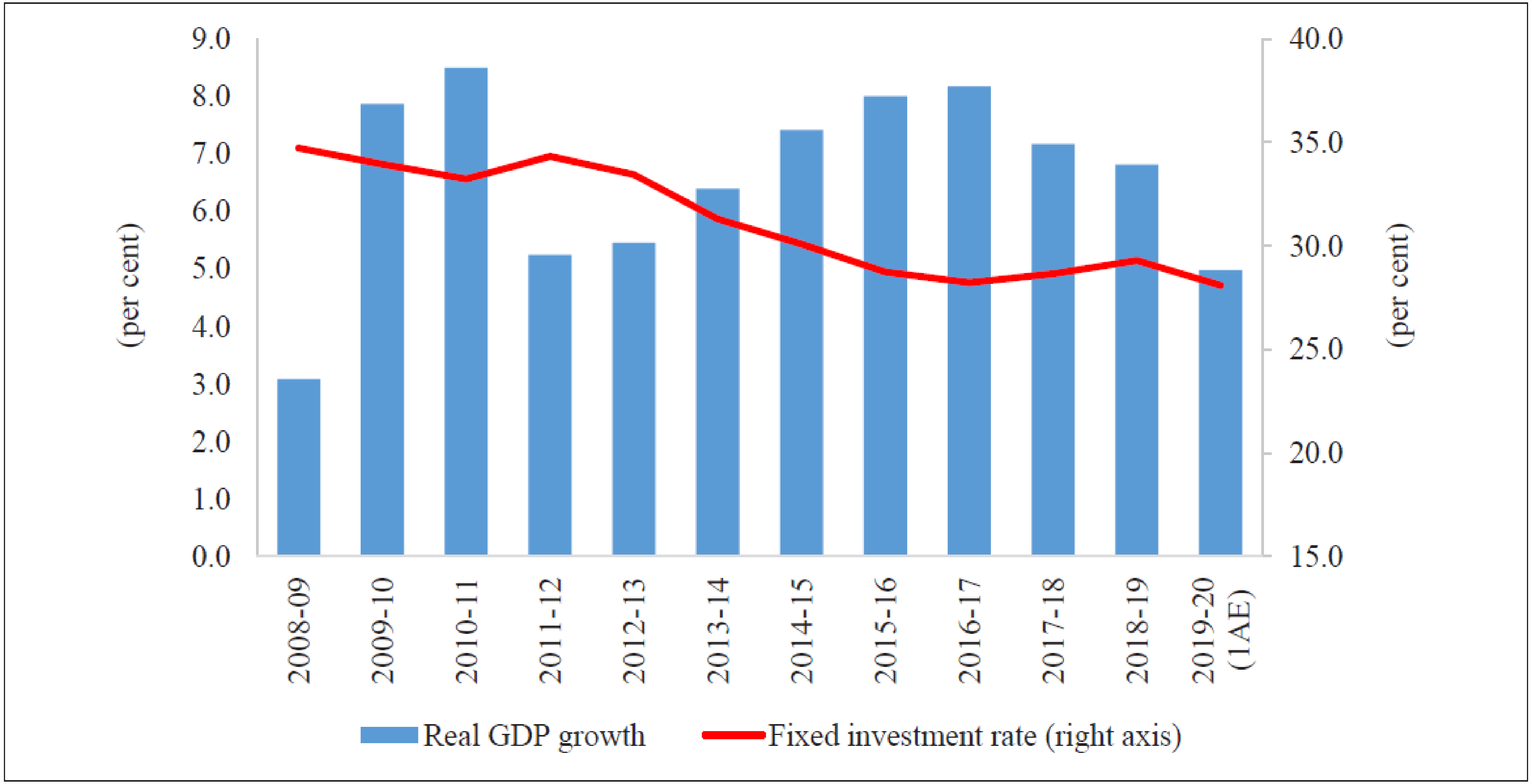
DRAG OF THE FINANCIAL SECTOR ON THE REAL SECTOR

Figure 23: Virtuous cycle of growth



- Virtuous cycle of growth: increase in the rate of fixed investment accelerates the growth of GDP
- Which, in turn induces a higher growth in consumption
- Higher growth of consumption improves the investment outlook,
- Which results in still higher growth of fixed investment that,
- Further accelerates the growth of GDP, inducing a still higher growth of consumption.
- This virtuous cycle of higher fixed investment-higher GDP growth-higher consumption growth (Figure 23) generates economic development in the country.
- Conversely, declining rate of fixed investment decelerates GDP growth with a lag, which eventually causes a deceleration in the growth of consumption as well.
- In case of India, the lag between rate of fixed investment and its impact on GDP growth is seen to be of 3-4 years
- Similarly, the impact of GDP growth on consumption growth gets reflected in 1-2 years
- Therefore, a contemporaneous comparison of trends of GDP growth and investment is not appropriate
- Since 2011-12, there has been a slowing cycle of growth.
- The fixed investment rate has started declining sharply since 2011- 12 and plateaued from 2016- 17 onwards.
- Given the lagged impact of the investment rate on GDP growth, the deceleration in growth since 2017-18 is consistent with the framework described here (Figure 26).

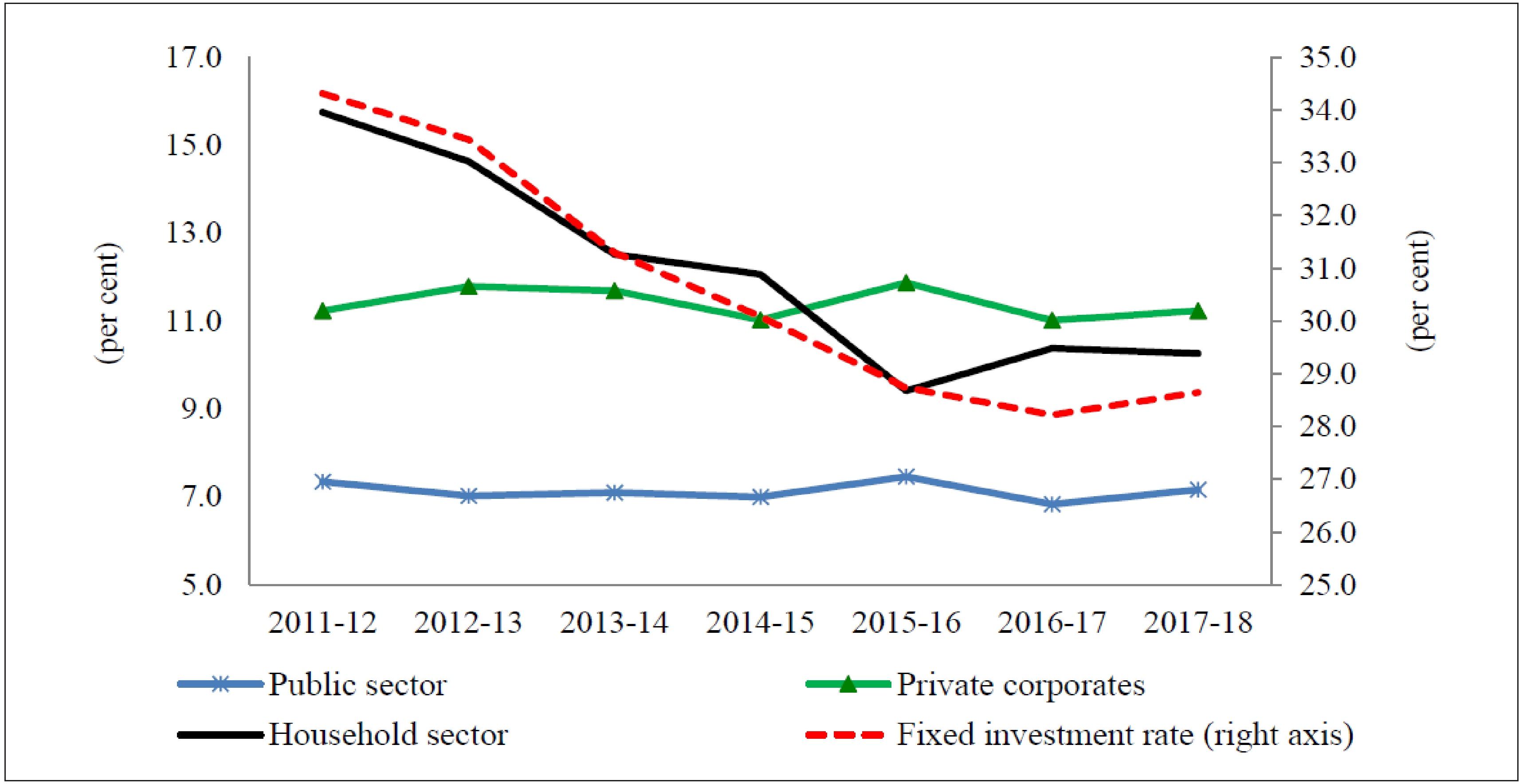
Figure 26: Real GDP growth and Investment – Annual movement



Data Source: National Statistical Office

- The drop in fixed investment by households from 14.3 per cent to 10.5 per cent explains most of the decline in overall fixed investment between 2009-14 to 2014- 19 (Figure 27)
- The stagnation in private corporate investment at approximately 11.5 per cent of GDP between 2011-12 to 2017- 18 has a critical role to play in explaining the slowing cycle of growth- the recent deceleration of GDP and consumption.

Figure 27: Fixed investment by institutional sector (as per cent of GDP)



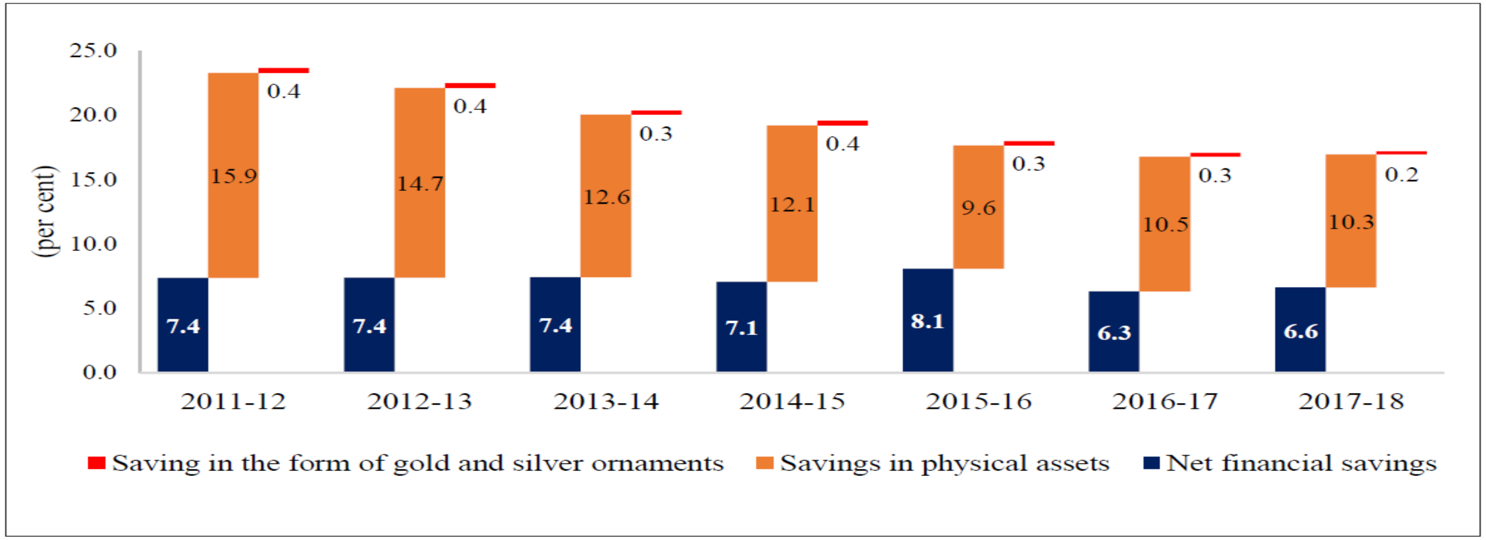
Data Source: National Statistical Office

- The decline in corporate investment stems from issues related to the financial sector and boom in credit (Mian and Sufi, 2018)
- A sudden purely supply led credit expansion results in short lived expansion of output and employment but causes significant contraction in the long run.
- In most cases, the credit channel works through household debt where households increase demand using debt in the short run and,
- Reduce demand during the deleveraging phase, thereby, resulting in recessions.
- In the Indian context, the credit channel has worked through corporate investment.
- Here, it may be useful to ask if the origins of slowing cycle of growth lie in the enormous lending boom when non-food bank credit almost tripled between 2003-04 to 2007-08 and doubled between 2007-08 to 2011-12.
- Is it possible that this excessive bank lending, driven by the irrational exuberance of the boom period, led to a decline in corporate investments in the future?
- Empirical evidence suggests that firms that excessively borrowed between 2007- 08 to 2011-12 actually ended up investing significantly less during 2012-13 to 2016-2017.
- 2007-08 when firms started to borrow excessively coincides with the year in which RBI extended regulatory forbearance to almost all loans.
- It appears that the firms that were beneficiaries of excess lending, facilitated by regulatory forbearance, seem to have cut down investment the most

- Post the credit boom, the credit growth of banks also started to slow down.
- Growth (CAGR) of non-food credit for SCBs fell from 16.7 per cent in 2009-14 to 10.5 per cent in 2014-19.
- This followed a rise in the NPA of banks from an average of 3.0 per cent of gross advances in 2009-14 to 8.3 per cent in 2014-19.
- Bank credit growth (CAGR) to large units, MSMEs, infrastructure and even Non-Banking Financial Companies (NBFCs) significantly fell in 2014-19 as compared to 2009-14.
- The household sector includes family households as well as 'quasi-corporates': Unincorporated enterprises belonging to households, which have complete sets of accounts
- A break-down of household sector investment shows that investment in the groups 'Machinery and equipment' and 'Dwellings, other buildings and Structures' together account for more than two-thirds of total household sector investment.
- Unincorporated household enterprises, in addition to supplying directly for retail consumption, are also suppliers to incorporated enterprises from the back end of the value chain.
- The stagnation in machinery and equipment investment of households at around 2.4 per cent of GDP, from 2011-12 to 2017-18 can possibly be linked with the leveling of private corporate investment during the same period.
- The decline in household investment in 'Dwellings, other buildings and Structures', over 2011-12 to 2017-18 reflects slower growth in purchase of houses by households.
- The real estate sector has been reeling with issues of delayed project deliveries and stalled projects leading to a build-up of unsold inventory over the years.

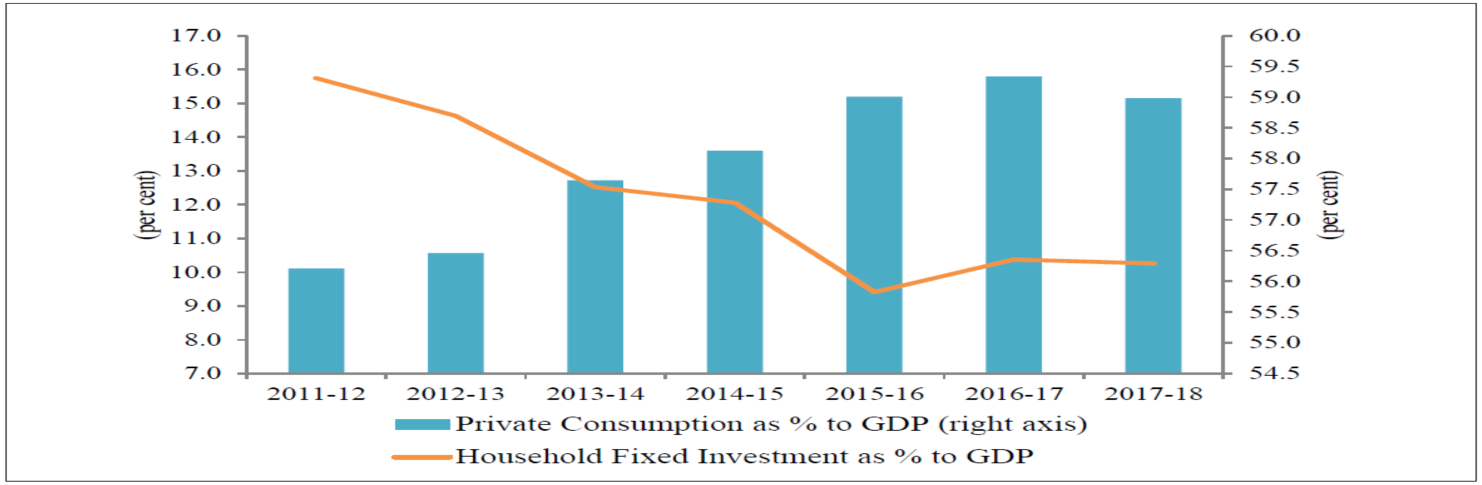
- The effect of GDP growth on consumption manifests after a lag of 1-2 years.
- Therefore, the declining trend in consumption from 2017-18 reflects partly the effect of decline in GDP growth on consumption.
- Change in household investment contributed to increasing consumption in the period until 2016-17 (Figure 33)
- A drop in savings in physical assets of households has been observed over this period (Figure 32)
- Income not saved in physical assets by households is either saved in the form of valuables (gold or silver) or as net household financial savings or is consumed.
- During 2011-12 to 2016-17, when savings in physical assets dropped, neither savings in gold and silver by households nor net household financial savings rose as a proportion of GDP.
- Thus, it appears that resources not deployed by households in physical assets 2011-12 onwards were mostly expended on consumption.

Figure 32: Household savings by asset type (as percentage of GDP)



Data source: National Statistical Office

Figure 33: Household fixed investment and Private Consumption (as percentage of GDP)



Data source: National Statistical Office

Outlook

- Based on the first Advance Estimates of India's real GDP growth in 2019-20, an uptick in GDP growth in H2 of 2019-20 is expected as compared to first half of the same year.
- With a view to assessing the likely growth in GDP, both the downside and upside risks to an expected acceleration in GDP growth are discussed below.
- ***Downside Risks***
- Continued global trade tensions could delay the recovery in the growth of global output, which may constrain the export performance of the country.
- Weaker export growth may reduce the inducement to increase the fixed investment rate in the economy.

- Escalation in US-Iran geo-political tensions may increase the price of crude oil and depreciate the rupee.
- Net FPI inflows may weaken, as a result, adding further pressure on the rupee to depreciate.
- If a fuller pass-through of the costlier crude oil is allowed, it may fuel inflationary pressure in the economy, cause the growth of private consumption to decline and weaken the incentive to invest.
- Even if a partial pass-through happens, fiscal deficit may swell, may increase the yield on G-sec and increase the cost of capital that may again weaken the incentive to invest.
- Growth in advanced countries has weakened with very low inflation and conventional monetary policy has almost run its full course.
- Subsequently, quantitative easing may fuel inflation and reduce the real interest rate.
- In future, if short-term interest rates are raised by the central banks to contain inflation, it may result in capital flight.
- The rupee may come under pressure making imports costlier.
- Leakage from the domestic circular flow of income may increase which may adversely impact private consumption and investment.
- If instead, fiscal expansion is the preferred policy option, increase in short-term interest rates may happen all the earlier and weaken the growth impulse.

- The implementation of IBC Code is making progress slowly.
- Unless this speeds up, the risk aversion of banks to lend further may not reduce.
- Risk premiums may then continue to be high and cuts in repo rates may not transmit to lowering lending rates.
- Private investment may, therefore, remain muted.
- Increase in public sector may Investment is expected after the announcement of the National Infrastructure Pipeline
- If this leads to expansion of fiscal deficit, bond yields may increase, thereby, possibly crowding out private investment.
- If instead private investment seeks external funding, CAD would widen and depreciate the rupee, bringing in its wake the adverse impact on consumption, investment and growth.
- Should productivity gains not significantly increase with reforms, it may raise the requirement of fixed investment rate to boost economic growth.
- A non-rising gross domestic savings rate may further deteriorate the CAD, depreciate the rupee and make the virtuous cycle more difficult to realize.

Upside Risks

- There are tentative signs that manufacturing activity and global trade are bottoming out.
- This may positively impact India's exports.
- At the same time, there is renewed initiative to boost exports through various reform measures including scaling up of logistics infrastructure that may increase export competitiveness.
- Government’s thrust on affordable housing is evident, in order to boost the real estate sector and consequently the construction activity in the country.
- Higher investment in housing by households may increase the fixed investment in the economy.
- Existing unsold housing inventory can be cleared, and the balance sheets of both bank/ non-bank lenders cleaned if the real estate developers are willing to take a ‘hair-cut’ by allowing the house-prices to drop.
- Global sentiment continues to favor India as reflected in robust and rising inflows of net FDI into the country.
- Relocation of investors from other countries to India in the wake of trade tensions will also add to the flow.
- The announcement of NIP may further increase FDI inflows into the country in both brown-field and green-field infrastructure projects.
- Continuous relaxation of FDI guidelines may address the concerns of foreign investors and improve the investment climate.
- A boost to Make in India may not only enhance exports but replace imports of products in which India has sufficient scope for expansion in domestic manufacturing.

- India has been making steady progress in improving its rank in the Ease of Doing Business Index
- Earlier the rank had improved with the implementation of GST.
- Lately the improvement in rank has resulted from progress in trade facilitation as cross-border movement of goods has involved lesser waiting time.
- As the implementation of GST further settles down, the increased unification of the domestic market may reduce business costs and facilitate fresh investment.
- Reforms in land and labor market may further reduce business costs.
- Reduction in the base corporate tax rate to 15 per cent for new manufacturing companies may increase the rate of return on investment above the hurdle rate of the cost of capital and encourage a surge in new investments.
- Merger of public sector banks may increase the financial strength of the merged entities, lower the risk aversion and result in lowering of lending rates.
- ***Projection of GDP growth in 2020-21***
- ***If*** upside risks prevail, GDP growth of India should strongly rebound in 2020-21 and more so on a low statistical base of 5 per cent growth in 2019-20.
- On a net assessment of both the downside/upside risks, India’s GDP growth is expected to grow in the range of 6.0 to 6.5 per cent in 2020-21.

Social Infrastructure, Employment and Human Development

- Investment in social infrastructure is a pre-requisite for inclusive growth and employment.
- The expenditure on social services (education, health and others) by Centre and States as a proportion of Gross Domestic Product (GDP) increased by 1.5 percentage points from 6.2 to 7.7 per cent, during the period 2014-15 to 2019-20.
- An increase was witnessed across all social sectors during this period viz Education (2.8% to 3.1%) and Health (1.2% to 1.6%)

Table 1: Trends in Social Service Sector Expenditure by General Government (Combined Centre and States)

Item	2014-15	2015-16	2016-17	2017-18	2018-19 RE	2019-20 BE
(₹ in Lakh crore)						
Total Budgetary Expenditure	32.85	37.61	42.66	45.16	55.17	60.72
Expenditure on Social Services	7.68	9.16	10.41	11.40	14.47	15.79
of which:						
i) Education	3.54	3.92	4.35	4.83	5.81	6.43
ii) Health	1.49	1.75	2.13	2.43	2.92	3.24
iii) Others	2.65	3.48	3.93	4.13	5.74	6.12
As percentage to GDP						
Expenditure on Social Services	6.2	6.6	6.8	6.7	7.6	7.7
of which						
i) Education	2.8	2.8	2.8	2.8	3.1	3.1
ii) Health	1.2	1.3	1.4	1.4	1.5	1.6
iii) Others	2.1	2.5	2.6	2.4	3.0	3.0

- India’s rank in the Human Development Index (HDI)1 improved to 129 in 2018 from 130 in 2017, out of a total of 189 countries. The value of HDI for India reached to 0.647 in 2018
- As per National Sample Survey (NSS) Report ,2017-18 Drop-out rate was 10 percent at primary level, 17.5 percent at upper primary/middle and 19.8 percent at secondary level.
- As general education improves knowledge of the people while skill training enhances their employability and equip them to tackle requirements of labour market.
- According to the Periodic Labour Force Survey (PLFS) 2017-18 only 13.53 per cent of the workforce in the productive age- group of 15-59 years has received training.
- A large section among informally trained workers, about 55.9 per cent received it either through self-learning or and about 38.51 per cent have received it on-the-job.

Box 1: Programmes and Scheme for School Education

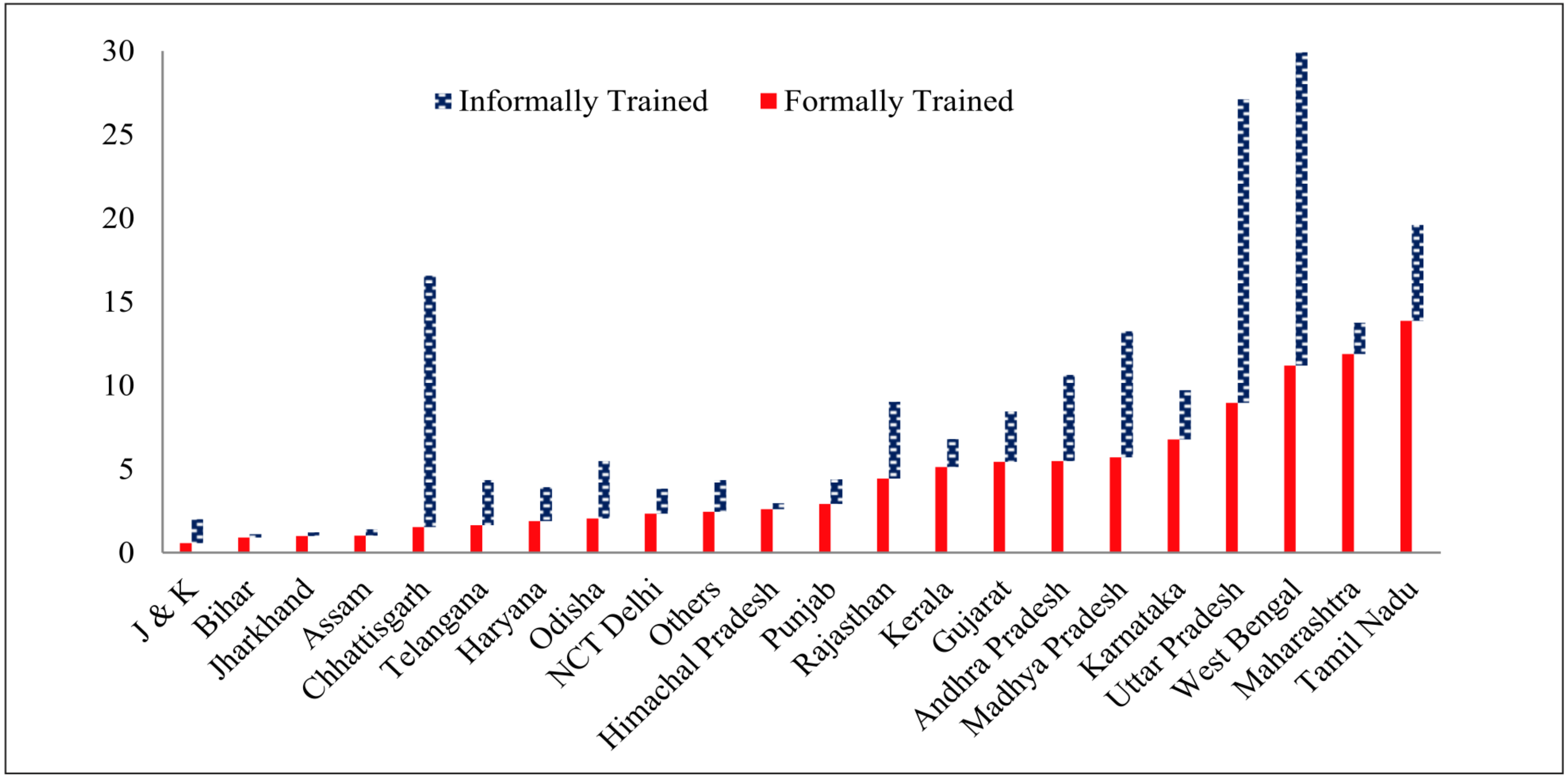
- Earlier, Sarva Shiksha Abhiyan (SSA) effective till 2017-18 was the designated Centrally Sponsored Scheme to meet the objectives of the RTE Act in elementary schools, provided assistance to State Governments and UTs for universalization of elementary education in the country. The Department of School Education and Literacy has launched an Integrated Scheme for School Education - Samagra Shiksha w.e.f. 2018-19, which subsumes three erstwhile Centrally Sponsored Schemes of Sarva Shiksha Abhiyan (SSA), Rashtriya Madhyamik Shiksha Abhiyan (RMSA) and Teacher Education (TE). The new integrated scheme envisages school education as a continuum from pre-school to senior secondary level and aims to ensure inclusive and equitable quality education. Under Samagra Shiksha, States and UTs are supported for strengthening of existing government schools, and for creation and augmentation of infrastructure facilities based on proposals received from respective States/UTs. The scheme also envisages an annual recurring composite school grant varying from ₹ 25,000/- to ₹ 1,00,000/- per annum depending upon the enrollment of students, for all government schools. Each school is required to spend at least 10 per cent of the composite school grant on activities related to Swachhata Action Plan. The scheme also provides for annual maintenance and repair of existing school building, toilets and other facilities to upkeep the infrastructure in good condition besides various interventions for improvement of quality of education such as induction and in-service training of teachers and school heads, learning enhancement programmes, use of ICT in education, assessment of learning outcomes, provision of libraries and supplementary graded material to schools etc.

- To further focus on quality education, the Central RTE Rules have been amended to include reference on class-wise and subject-wise Learning Outcomes. The Learning Outcomes for each class in Languages (Hindi, English and Urdu), Mathematics, Environmental Studies, Science and Social Science up to the elementary stage have, accordingly, been finalized and shared with all States/UTs. These would serve as a guidelines for States and UTs to ensure that all children acquire appropriate learning level. The RTE Act, 2009 was amended in 2017 to ensure that all teachers acquire the minimum qualifications prescribed under the Act by 31st March, 2019 to reinforce the Government's emphasis on improvement of quality of elementary education.
- The Navodaya Vidyalaya Scheme provides for opening of one Jawahar Navodaya Vidyalaya (JNV) in each district of the country to bring out the best of rural talent. Its significance lies in the selection of talented rural children as the target group and aims to provide them quality education comparable to the best in a residential school system.
- A National Mission called NISHTHA – National Initiative for School Heads' and Teachers' Holistic Advancement under the Centrally Sponsored Scheme of Samagra Shiksha in 2019-20 is being launched to improve learning outcomes at the elementary level. The Integrated Teacher Training Programme envisages to build the capacities of around 42 lakh teachers and head of schools, faculty members of SCERTs, DIETs, Block Resource Coordinators, and Cluster Resource Coordinators. The aim of this training is to motivate and equip teachers to encourage and foster critical thinking in students, handle diverse situations and act as first level counsellors.
- Promoting joyful learning through cultural activities including art, music, dance and theatre is playing a very critical role in a student's life and school activities. The National Curriculum Framework emphasized the importance of such activities and how they helped to enhance learning.
- Pradhan Mantri Innovative Learning Program (DHRUV) was launched to identify and encourage talented students to enrich their skills and knowledge.
- To broadbase technology aided teaching and learning, States and UTs are being actively involved to contribute and use the Digital Infrastructure for Knowledge Sharing (DIKSHA) platform. Steps are also being taken to improve the quality and diversify the nature of e-content on DIKSHA. Other e-content sites like e-pathsala, National Repository of Open Educational Resources (NROER) are also being integrated with DIKSHA to ensure easy access.

Box 2: Programmes and Schemes in Higher Education

- The government launched Pandit Madan Mohan Malaviya National Mission on Teachers and Teaching (PMMMNMTT) which aims at building a strong professional cadre of teachers by setting performance standards and creating top class institutional facilities for innovative teaching and professional development of teachers in higher education. Teachers of existing Central, State Universities/Educational Institutions including private institutions can participate in capacity building programmes as well as induction training.
- Higher Education Financing Agency (HEFA) was established to provide sustainable financial model for higher education institutions, Kendriya Vidyalayas, Navodaya Vidyalayas, AIIMS and other educational institutions of the Ministry of Health with the objective to fund projects to the tune of ₹ 1 lakh crore by 2022. As on 11th December, 2019, projects worth ₹ 37,001.21 crore have been approved and the number of educational institutions that have availed funding through HEFA stands at 75.
- National Educational Alliance for Technology (NEAT) announced a PPP Scheme for using technology for better learning outcomes in Higher Education. The objective is to use Artificial Intelligence to make learning more personalised and customised as per the requirements of the learner. This requires development of technologies in Adaptive Learning to address the diversity of learners. EdTech companies would be responsible for developing solutions and manage registration of learners through the NEAT portal.
- The Department of Higher Education, in the Ministry of Human Resource Development has finalized and released a five-year vision plan named Education Quality Upgradation and Inclusion Programme (EQUIP). EQUIP is a vision plan aiming at ushering transformation in India's higher education system by implementing strategic interventions in the sector over the next five years (2019-2024).
- SWAYAM 2.0 was launched to offer online degree programmes with enhanced features and facilities by top ranking universities. 'Deeksharambh' a guide to student induction programme and 'PARAMARSH' scheme is to mentor institutions seeking National Assessment and Accreditation Council accreditation are some of the other major schemes of Department of Higher Education launched in 2019.

Figure 4: State-wise workforce (15-59 years) who received training through formal/ informal sources (per cent)

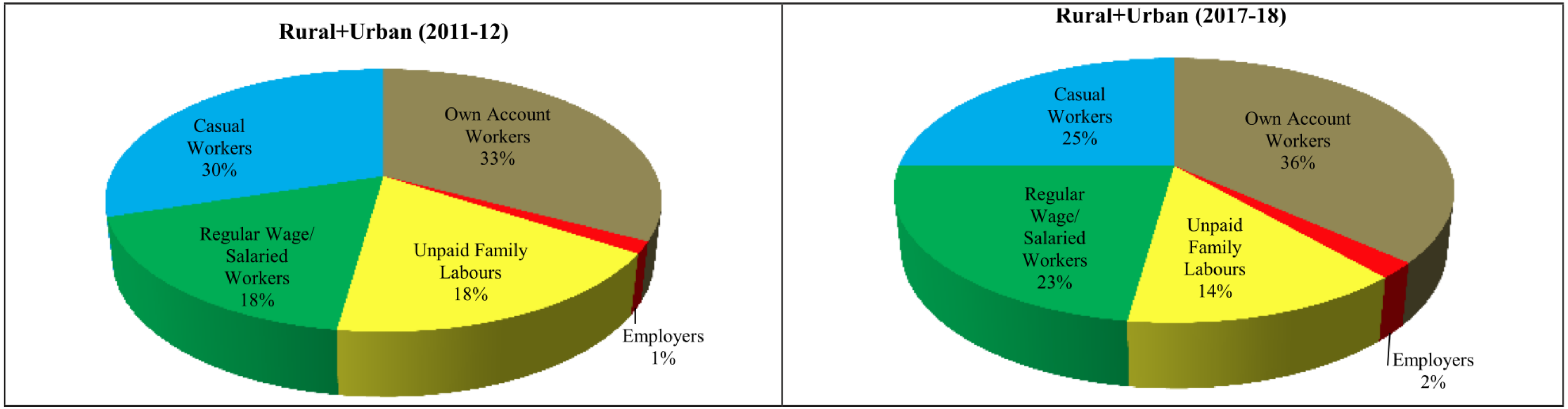


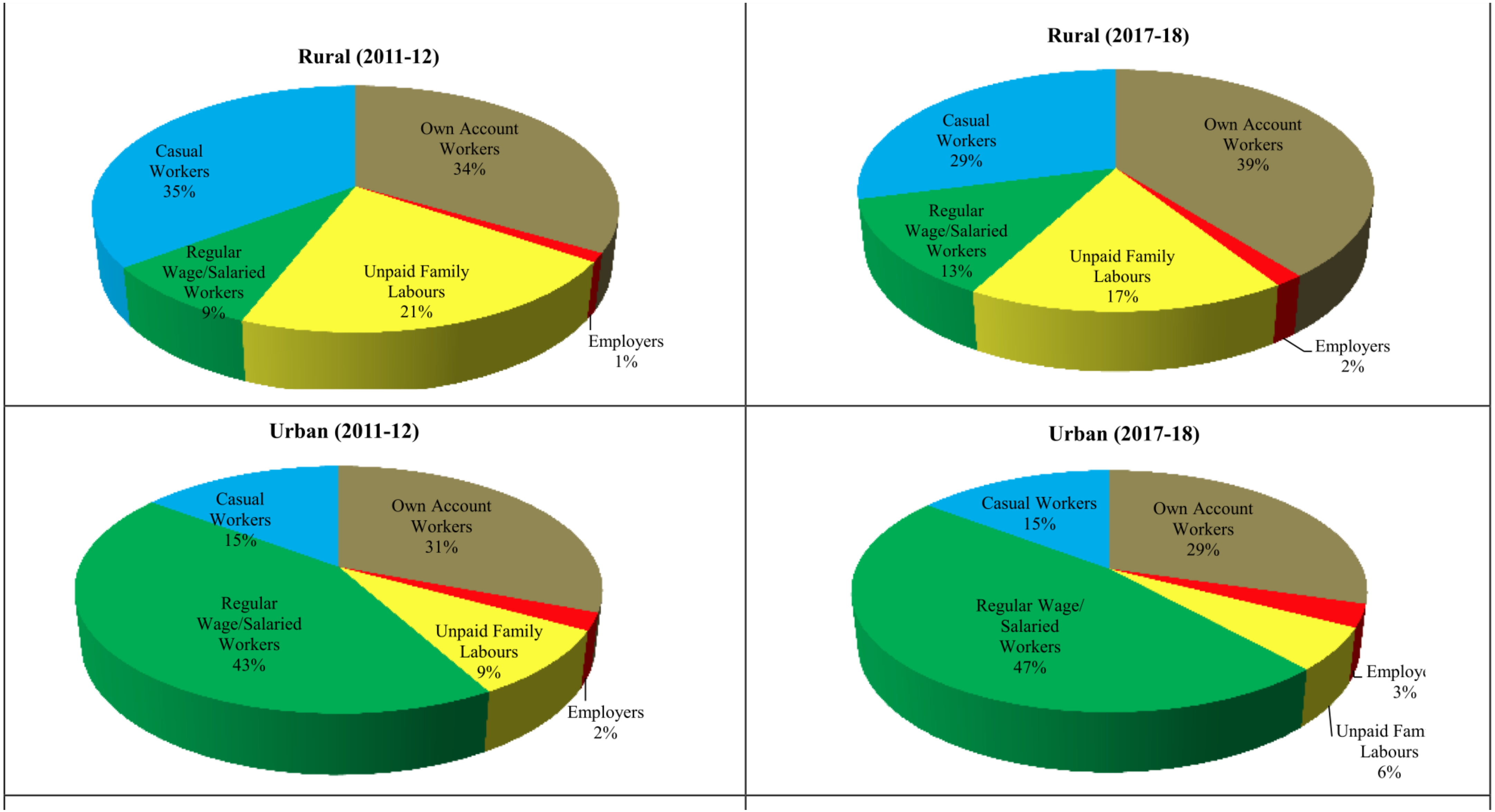
Source: Annual Report, PLFS (2017-18)

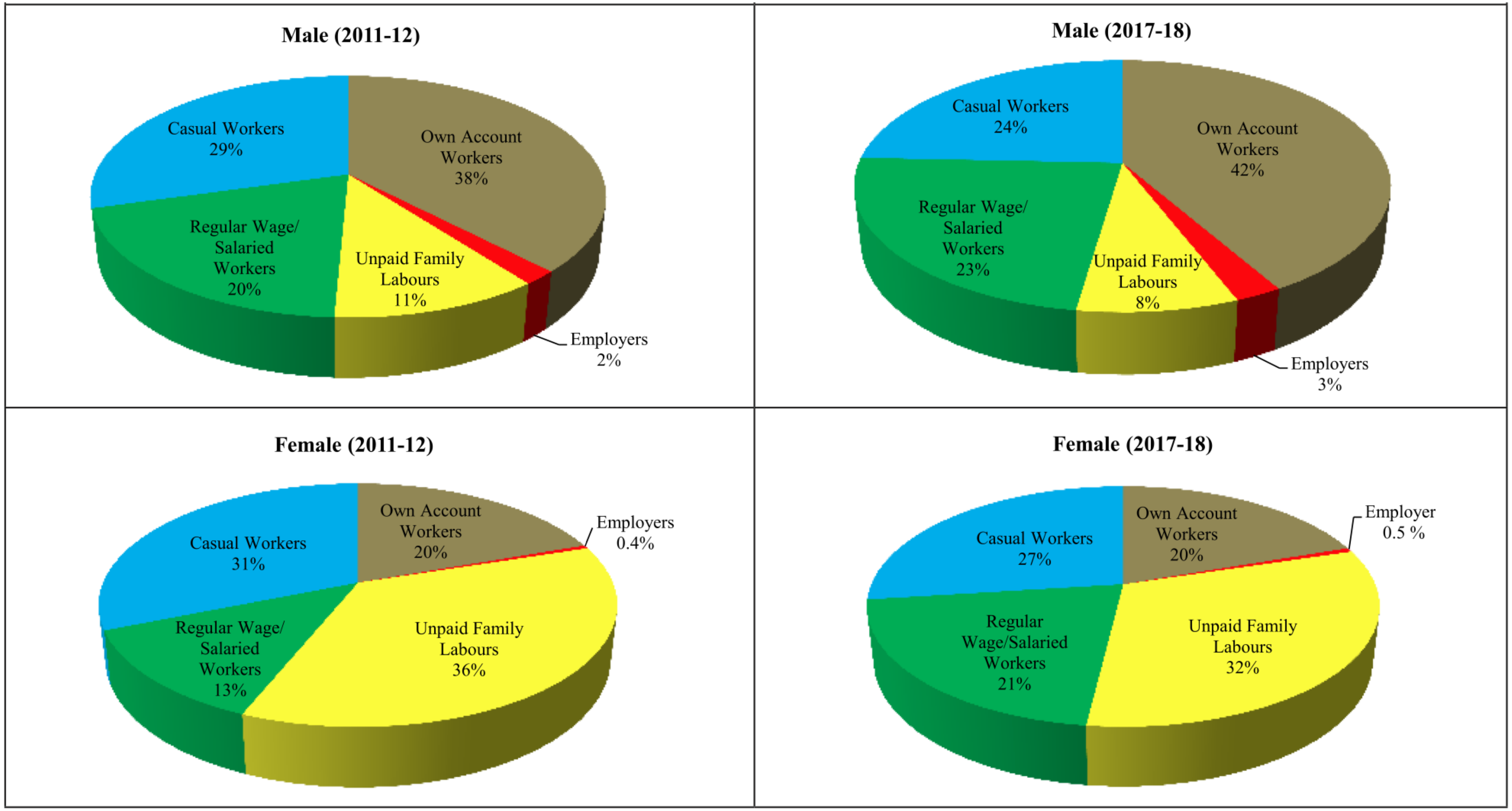
STATUS OF EMPLOYMENT IN INDIA

- As per Periodic Labour Force Survey (PLFS) estimates the share of regular wage/salaried employees has increased by 5 percentage points from 18 per cent in 2011-12 to 23 per cent in 2017- 18 as per usual status
- Remarkably, the proportion of women workers in regular wage/salaried employees category have increased by 8 percentage points with addition of 0.71 crore new jobs for female workers in this category.
- Among the self-employed category (consists of employers, own account workers and unpaid family labour), while the proportion of own account workers and employers increased, the proportion of unpaid family labour (helper) has declined, especially for females. The proportion of total self- employed workers however remained unchanged at 52 per cent.
- The distribution of workers in casual labour category decreased by 5% in rural areas.

Figure-5: Distribution of Workers (principal status plus subsidiary status, all ages) by Sector, Sex and Employment Status in India




Rural (2011-12)
Own Account Workers 34%
Casual Workers 35%
Regular Wage/Salaried Workers 9%
Unpaid Family Labours 21%
Employers 1%
Rural (2017-18)
Casual Workers 29%
Own Account Workers 39%
Regular Wage/Salaried Workers 13%
Unpaid Family Labours 17%
Employers 2%
Urban (2011-12)
Casual Workers 15%
Own Account Workers 31%
Regular Wage/Salaried Workers 43%
Unpaid Family Labours 9%
Employers 2%
Urban (2017-18)
Casual Workers 15%
Own Account Workers 29%
Regular Wage/ Salaried Workers 47%
3%
Labours 6%



Source: Estimated from unit level data of NSO 68th Round Employment-Unemployment Survey (EUS) 2011-12 and Periodic Labour Force Survey (PLFS), 2017-18.
Note: The figures are to be read along with explanatory note for comparability.

Formalisation of Jobs

- It was observed that the proportion of workers in organized sector increased from 17.3 per cent in 2011-12 to 19.2 per cent in 2017-18 with total 9.05 crore workers in the organized sector.
- Total formal employment in the economy also increased from 8 per cent in 2011- 12 to 9.98 per cent in 2017-18 with total 4.7 crore workers in formal employment in 2017-18.
- As per NSO-EUS and PLFS 2017-18 data, the of share of workers in informal sector in non-agricultures and AGEGC (Agricultural sector excluding only growing of crops, market gardening, horticulture and growing of crops combined with farming of animals) also show a decline from 77.5 per cent in 2004-05 to 68.4 per cent in 2017-18, with the decline being more pronounced among females.

Box 4: Steps Taken Towards Formalisation of the Labour Market

- For portability of Provident Fund accounts, EPFO launched a "Universal Account Number" service for contributing members.
- Government is paying 12 per cent of employer contribution to EPFO in respect of the new employees drawing salary up to ₹15,000 per month for the first three years of their employment, under Pradhan Mantri Rozgar Protsahan Yojana (PMRPY). The scheme has ended on 31st March, 2019.
- Mandatory wage ceiling of subscription to EPS increased from ₹ 6,500 to ₹ 15,000 per month. The Code on Wages Act, 2019 to ensure minimum wages to all and timely payment of wages to all employees irrespective of the sector of employment without any wage ceiling, except MGNREGA.
- MUDRA and STAND-UP India for creating formal credit to businesses.
- Rate of ESI contribution reduced from 6.5 per cent to 4 per cent with effect from 1st July, 2019. Employer's share of contribution reduced from 4.75 per cent to 3.25 per cent and employees' share from 1.75 per cent to 0.75 per cent.
- National Career Service (NCS) Project launched in 2015, provides a host of career-related services such as dynamic job matching, career counselling, job notifications and information on skill development courses and rich career content on a digital platform (www.ncs.gov.in). NCS works towards bridging the gap between job-seekers and employers candidates seeking training and career guidance, agencies providing training and career counselling by transforming the National Employment Service.

Female Participation in Labour Market

- According to NSO-EUS and PLFS estimates, female labour force participation rate (LFPR) for productive age-group (15- 59 years) declined by 7.8 % from 33.1 % in 2011-12 to 25.3 % in 2017-18 and rate of decline is sharper in rural areas as compared to urban areas. As a result of this, gender disparity in India's labour market has increased.

Figure 8 A: Female Labour Force Participation Rate (ps+ss, 15-59 ages) by Location (per cent)

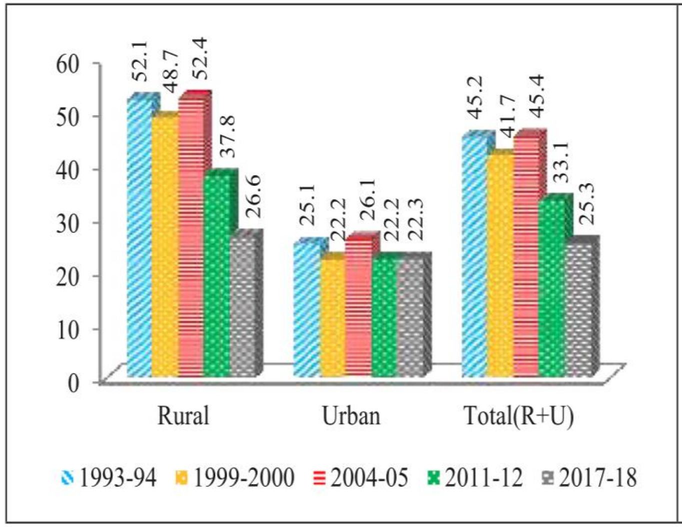
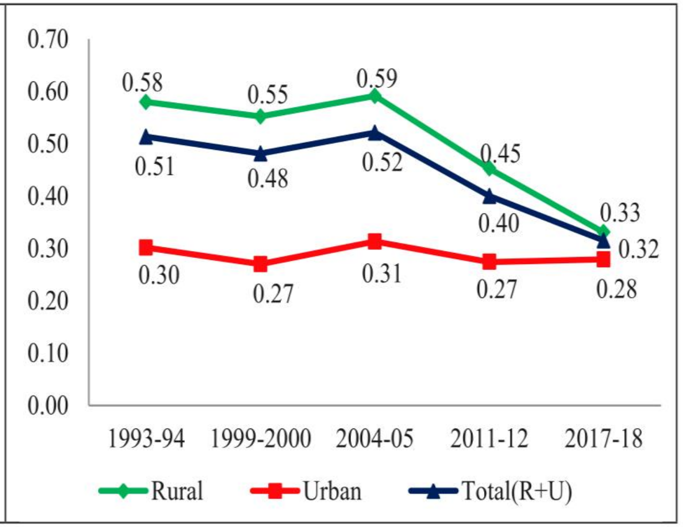


Figure 8 B: Ratio of Female to Male Labour Force Participation Rate (ps+ss, 15-59 ages)



Source: Estimated from unit level data of NSO (EUS) various rounds and PLFS (2017-18)
Note: The figures are to be read along with explanatory note for comparability.

Initiatives to Improve Female Work Participation

- Safety of Women at Workplace
- Mahila Shakti Kendra Scheme
- Provision of safe and affordable accommodation
- Women Helpline Scheme
- One Stop Centre
- Female Entrepreneurship
- Rashtriya Mahila Kosh
- Prime Minister’s Employment Generation Programme
- Deendayal Antyodaya Yojana- National Rural Livelihoods Mission

Factors Influencing Female Labour Force Participation

On the supply side,

- More women in rural areas are now pursuing higher education has delayed their entry into the labour market.
- The household incomes have risen in rural areas on account of higher wage levels.
- cultural factors, social constraints and patriarchal norms restricting mobility and freedom of women.
- Relatively higher responsibilities of unpaid work and unpaid care work . About 60 per cent of working age females are attending to domestic duties only and this proportion has increased over the last two decades.

On the demand side,

- Absence of job opportunities and quality jobs and significant gender wage gap.
- Lack of attainment of appropriate education level/skill set.
- A fall in international demand for products of labour-intensive industries in urban areas.
- Low female wages in agriculture sector.
- The fall in employment in agriculture has not shown concomitant increase in opportunities for women in the manufacturing sector where most women with middle to secondary levels of education and from middle income groups are likely to look for employment
- Structural shift away from agricultural employment, and increased mechanization of agriculture along with decline in animal husbandry in rural areas
- Withdrawal of men from agriculture and shift to the construction sector in urban areas, led to loss of jobs for rural women who were engaged as unpaid labour along with the men.

HEALTH FOR ALL

- The focus of healthcare is on four important pillars - preventive healthcare, providing affordable healthcare, building medical infrastructure and mission mode interventions for maternal health, child health and to combat communicable and non-communicable.

Table 10: India- Select Health Indicators

Sl. No	Parameter	1991	2001	2011	Current level
1.	Crude Birth Rate (per 1000 population)	29.5	25.4	21.8	20.2 (2017)
2.	Crude Death Rate (per 1000 population)	9.8	8.4	7.1	6.3 (2017)
3.	Total Fertility Rate	3.6	3.1	2.4	2.2 (2017)
4.	Maternal Mortality Ratio (per 1,00,000 live births)	NA	301 (2001-03)	167 (2011-13)	122 (2015-17)
5.	Infant Mortality Rate (per 1000 live births)	80	66	44	33 (2017)
	Rural	87	72	48	37
	Urban	53	42	29	23
6.	Child (0-4 years) Mortality Rate (per 1000 children)	26.5	19.3	12.2	8.9 (2017)
7.	Life Expectancy at Birth	(1991-95)	(2001-05)	(2009-13)	(2013-17)
	Total	60.3	64.3	67.5	69.0
	Rural	58.9	63.0	66.3	67.7
	Urban	65.9	68.6	71.2	72.4

Sources: Sample Registration Survey (SRS) and SRS based Abridged Life Tables, Registrar General of India (RGI)

HOUSING FOR ALL

- As per recent NSO survey on Drinking Water, Sanitation, Hygiene and Housing Condition in India 2018, about 76.7 per cent of the households in the rural and about 96.0 per cent in the urban areas had the house of pucca structure.
- Pradhan Mantri Awaas Yojana-Gramin (PMAY-G) and Pradhan Mantri Awaas Yojana-Urban (PMAY-U) are two important schemes for achieving the target of housing for all by 2022.

DRINKING WATER AND SANITATION

- The Department of Drinking Water and Sanitation (DDWS), Ministry of Jal Shakti launched the 10 Year Rural Sanitation Strategy (2019-2029), which focus on sustaining the sanitation behaviour change that has been achieved under the Swachh Bharat Mission Grameen (SBM-G), ensuring that no one is left behind, and increasing access to solid and liquid waste management.
- Jal Shakti Abhiyan was launched to accelerate progress on water conservation activities in the most water stressed blocks and districts of India.

EXTERNAL SECTOR

- According to IMF, Balance of Payments is a statistical statement that systematically summarizes, for a specific time period, the economic transactions of an economy with the rest of the world.
- Economic transactions includes both visible goods (merchandise) and invisible goods (services), assets, gifts, etc.
- All payments are regarded as debits (i.e., outflow of money) and are recorded in the accounts with a negative sign and all receipts are regarded as credits (i.e., inflow of money) and are recorded in the accounts with a positive sign.
- BOP consists of two accounts i) the current account, and the (ii) capital account.

- Current account showing export and import of visibles (also called merchandise) and invisibles (also called non-merchandise). Invisibles take into account services, transfers and income.
- Capital account records export and import of capital from and to foreign countries.
- The current account deficit or surplus can be expressed as the difference between the value of exports of goods and services and the value of imports of goods and services.

Balance of Payments

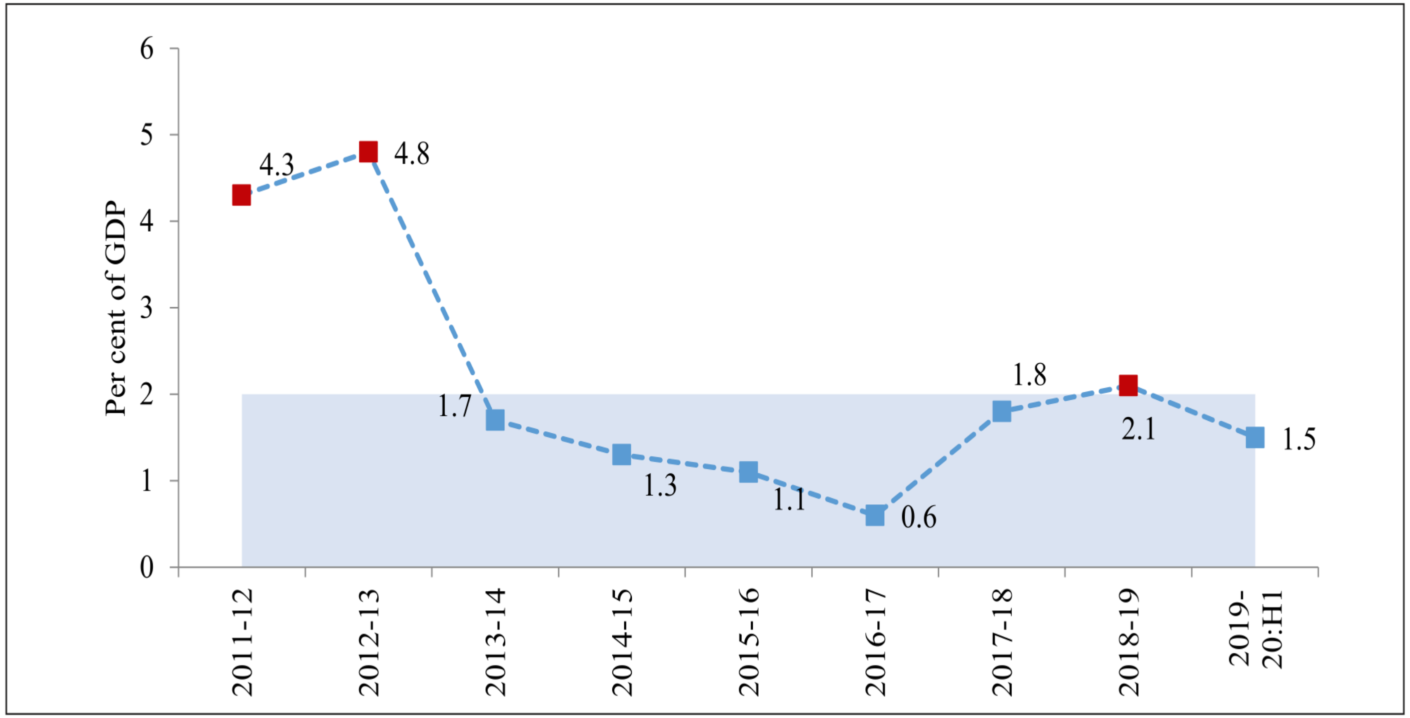
(US$ Million)

Sl No	Item	2014-15	2015-16	2016-17	2017-18	2018-19	2018-19 Apr-Sep	2019-20 Apr -Sep
1	2	3	4	5	6	7	8	9
I	**Current Account**							
1	Exports	3,16,545	2,66,365	2,80,138	3,08,970	3,37,237	1,66,788	1,62,743
2	Imports	4,61,484	3,96,444	3,92,580	4,69,006	5,17,519	2,62,575	2,47,037
3	Trade Balance (1-2)	-1,44,940	-1,30,079	-1,12,442	-1,60,036	-1,80,283	-95,788	-84,294
4	Invisibles (net)	1,18,081	1,07,928	98,026	1,11,319	1,23,026	60,931	63,673
	A. Services	76,529	69,676	68,345	77,562	81,941	38,932	40,474
	B. Income	-24,140	-24,375	-26,302	-28,681	-28,861	-14,363	-14,739
	C. Transfers	65,692	62,627	55,983	62,438	69,946	36,362	37,938
5	Goods and Services Balance	-68,411	-60,402	-44,098	-82,474	-98,342	-51,240	-43,820
6	**Current Account Balance (3+4)**	**-26,859**	**-22,151**	**-14,417**	**-48,717**	**-57,256**	**-34,857**	**-20,621**
II	**Capital Account**							
	Capital Account Balance	**89,286**	**41,128**	**36,447**	**91,390**	**54,403**	**21,391**	**39,935**
	i. External Assistance (net)	1,725	1,505	2,013	2,944	3,413	478	1,913
	ii. External Commercial Borrowings (net)	1,570	-4,529	-6,102	-183	10,416	877	9,767
	iii. Short-term credit	-111	-1,610	6,467	13,900	2,021	1,298	1344
	iv. Banking Capital(net) of which:	11,618	10,630	-16,616	16,190	7,433	10,583	-5,702
	Non-Resident Deposits (net)	14,057	16,052	-12,367	9,676	10,387	6,838	5,034
	v. Foreign Investment(net) of which	73,456	31,891	43,224	52,401	30,094	9,040	28,646
	A. FDI (net)	31,251	36,021	35,612	30,286	30,712	16,983	21,327
	B. Portfolio (net)	42,205	-4,130	7,612	22,115	-618	-7,943	7,319
	vi. Other Flows (net)	1,028	3,242	7,460	6,138	1,026	-885	3967
III	**Errors and Omission**	**-1,021**	**-1,073**	**-480**	**902**	**-486**	**259**	**-211**
IV	**Overall Balance**	**61,406**	**17,905**	**21,550**	**43,574**	**-3,339**	**-13,206**	**19102**
V	Reserves change [increase (-) / Decrease (+)]	-61,406	-17,905	-21,550	-43,574	3,339	13,206	-19,102

Source: Reserve Bank of India.
Note: P: Preliminary

- India's BoP position improved from US$ 412.9 bn of forex reserves in end March, 2019 to US$ 461.2 billion as on 10th January, 2020
- Current Account Deficit (CAD) narrowing further to 1.5 per cent of GDP in the first half of 2019-20 from 2.1 per cent in 2018-19.

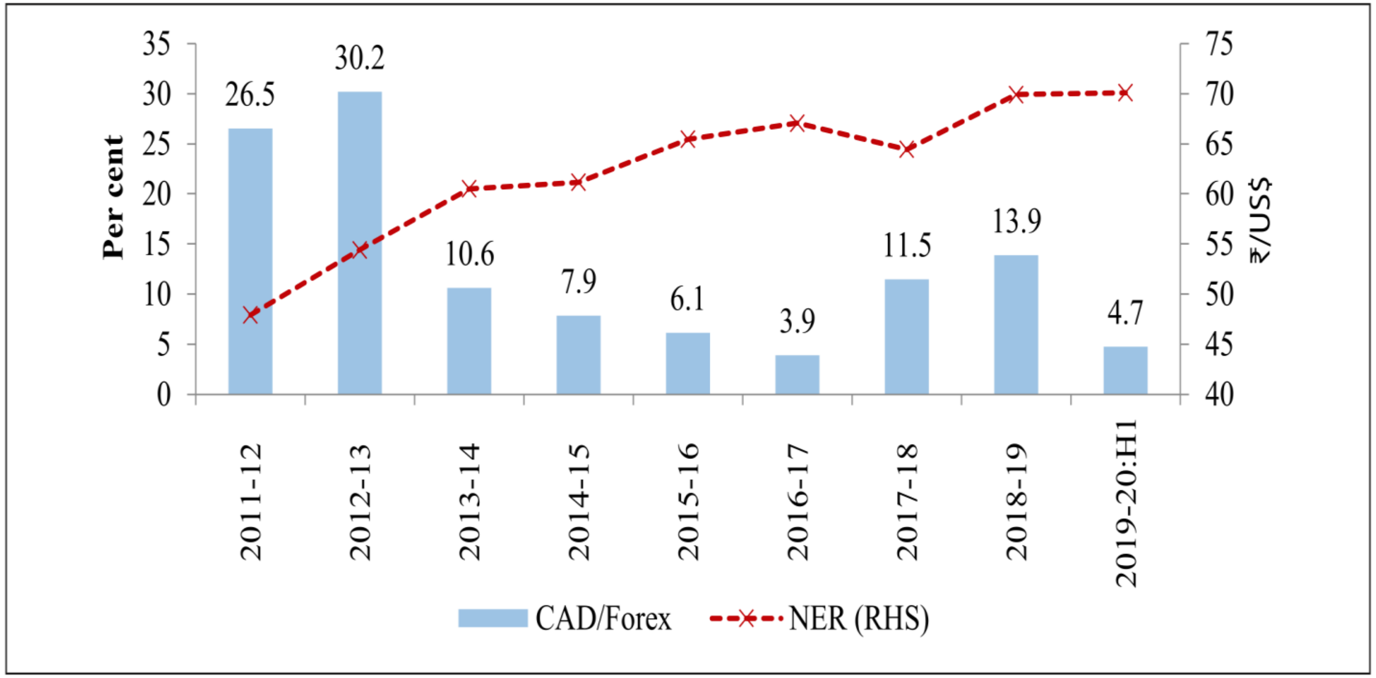
Figure 1: Current Account Deficit (CAD) as per cent of GDP



Source: Reserve Bank of India.

- The backup to CAD is the forex reserves with increase in CAD/forex ratio reflecting the decreasing strength of the backup. The decreasing strength spills into depreciating the currency.
- As the Nominal Exchange Rate (NER) has more or less stayed stable in 2019-20 it appears that the strength of the backup has not changed.

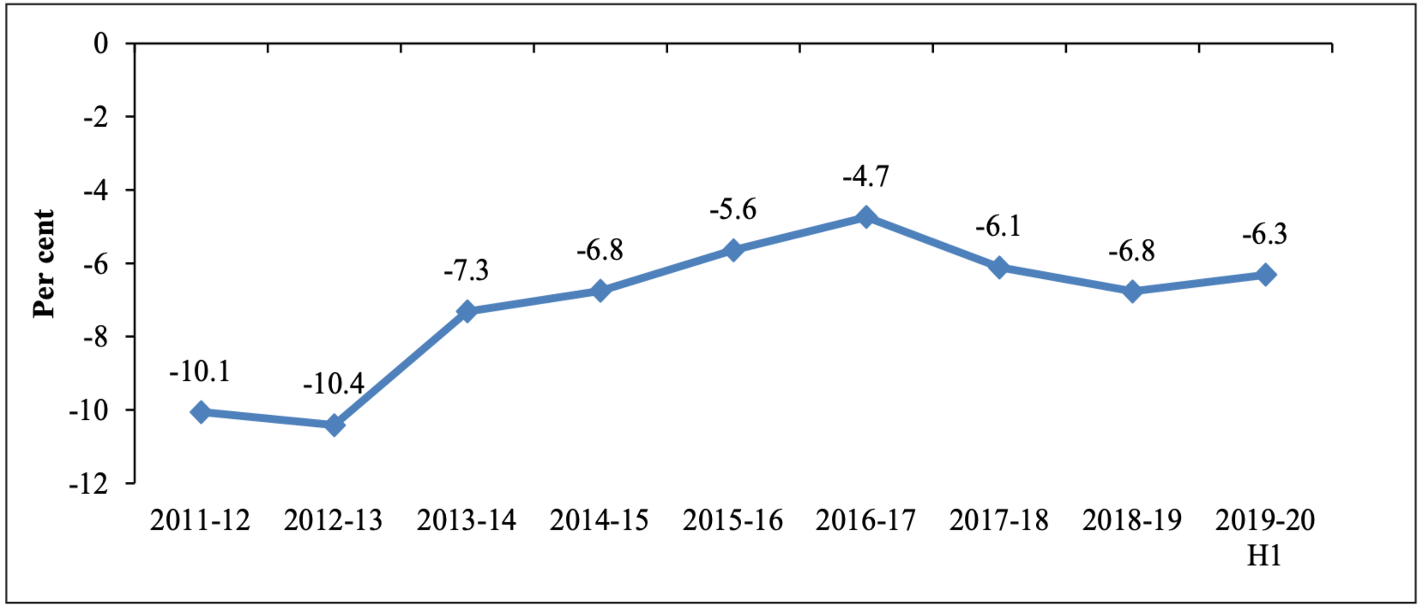
Figure 2: Movements in CAD/Forex and NER



Source: Reserve Bank of India.

- On average, India's merchandise trade balance has improved from 2009-14 to 2014-19, although most of the improvement in the latter period was on account of more than fifty per cent decline in crude prices in 2016-17. Lately the improvement in trade balance has positively contributed to the improvement in BoP position

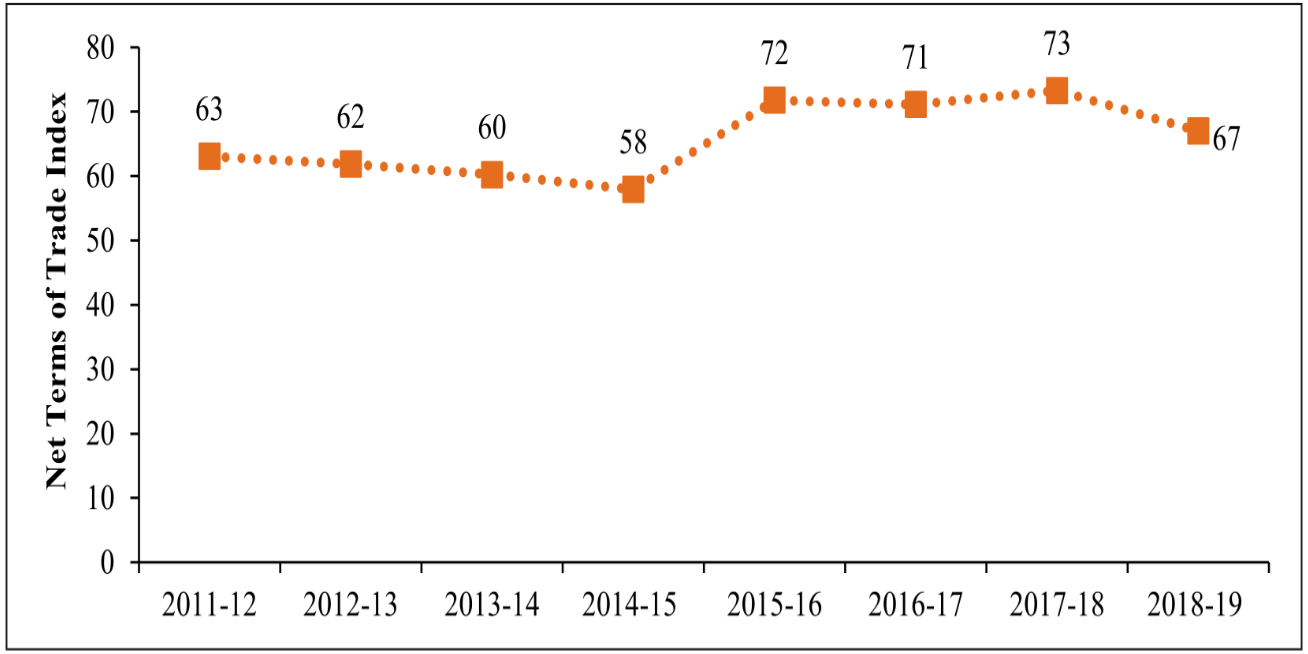
Figure 3: Merchandise Trade Balance as per cent of GDP



Source: Department of Commerce & Central Statistics Office (CSO).

- Country's terms of trade measures a country's export prices in relation to its import prices.
- Since 2017-18 the adverse movement in Net terms of trade (NTT) has started which has contributed to the improvement in trade balance.

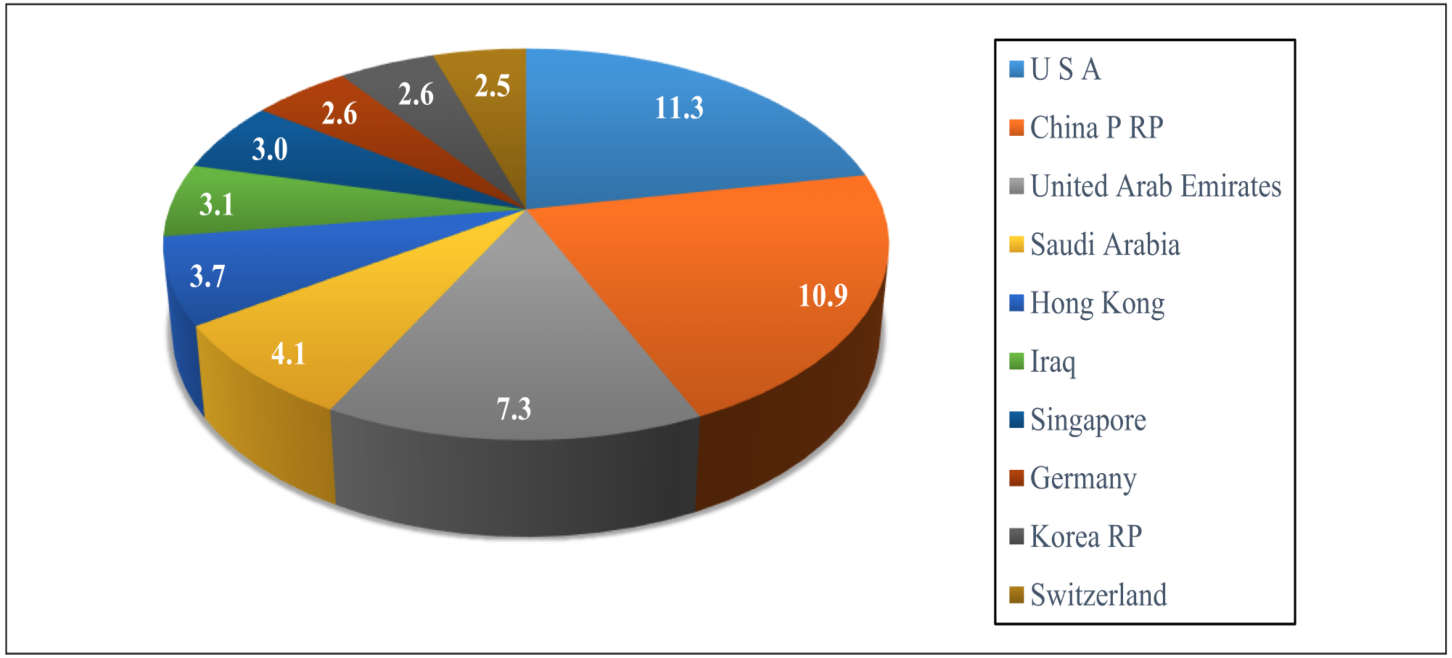
Figure 4: Terms of Trade (Base Year 1999-2000)



Source: Directorate General of Commercial Intelligence and Statistics (DGCI&S), Kolkata.

- India's top 10 trading partners during 2019-20 (April-November) jointly account for more than 50 per cent3 of India's total merchandise trade.
- With two top trading countries i.e. USA and United Arab Emirates, India has consistently run trade surplus since 2014-15.

Figure 5: Top 10 Trading Partners of India in 2019-20 (April-November)(in Per cent)



Source: Computed from latest data available on Department of Commerce's website, 'https://commerce-app.gov.in/eidb/default.asp'.

Table 3: Bilateral Trade Surplus/Deficit (Sorted on Year: 2018-19)

(Values in US$ Billion)

	Country	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20 (April-November)
Trade Surplus Countries	U S A	20.63	18.55	19.90	21.27	16.86	10.91
	United Arab Emirates	6.89	10.87	9.67	6.41	0.34	0.25
Trade Deficit Countries	China PRP	-48.48	-52.70	-51.11	-63.05	-53.57	-35.32
	Saudi Arabia	-16.95	-13.94	-14.86	-16.66	-22.92	-14.32
	Iraq	-13.42	-9.83	-10.60	-16.15	-20.58	-13.98
	Germany	-5.25	-5.00	-4.40	-4.61	-6.26	-3.09
	Korea RP	-8.93	-9.52	-8.34	-11.90	-12.05	-7.80
	Indonesia	-10.96	-10.31	-9.94	-12.48	-10.57	-6.99
	Switzerland	-21.06	-18.32	-16.27	-17.84	-16.90	-11.97
	Hong Kong	8.03	6.04	5.84	4.01	-4.99	-3.88
	Singapore	2.68	0.41	2.48	2.74	-4.71	-3.15

Source: Computed from latest data available on Department of Commerce's website, 'https://commerce-app.gov.in/eidb/default.asp'.

- An increase in merchandise exports to GDP ratio has a net positive impact on BOP position. Over the years the merchandise exports to GDP ratio has been declining, entailing a negative impact on the BoP position.
- Slowdown of world output (due to escalation of global trade tensions) and appreciation in the real exchange rate have contributed to the declining exports to GDP ratio in recent times.
- Increase in the share of manufacturing exports in total exports is inevitable

Table 6: India's Manufactured exports share in Total merchandise exports

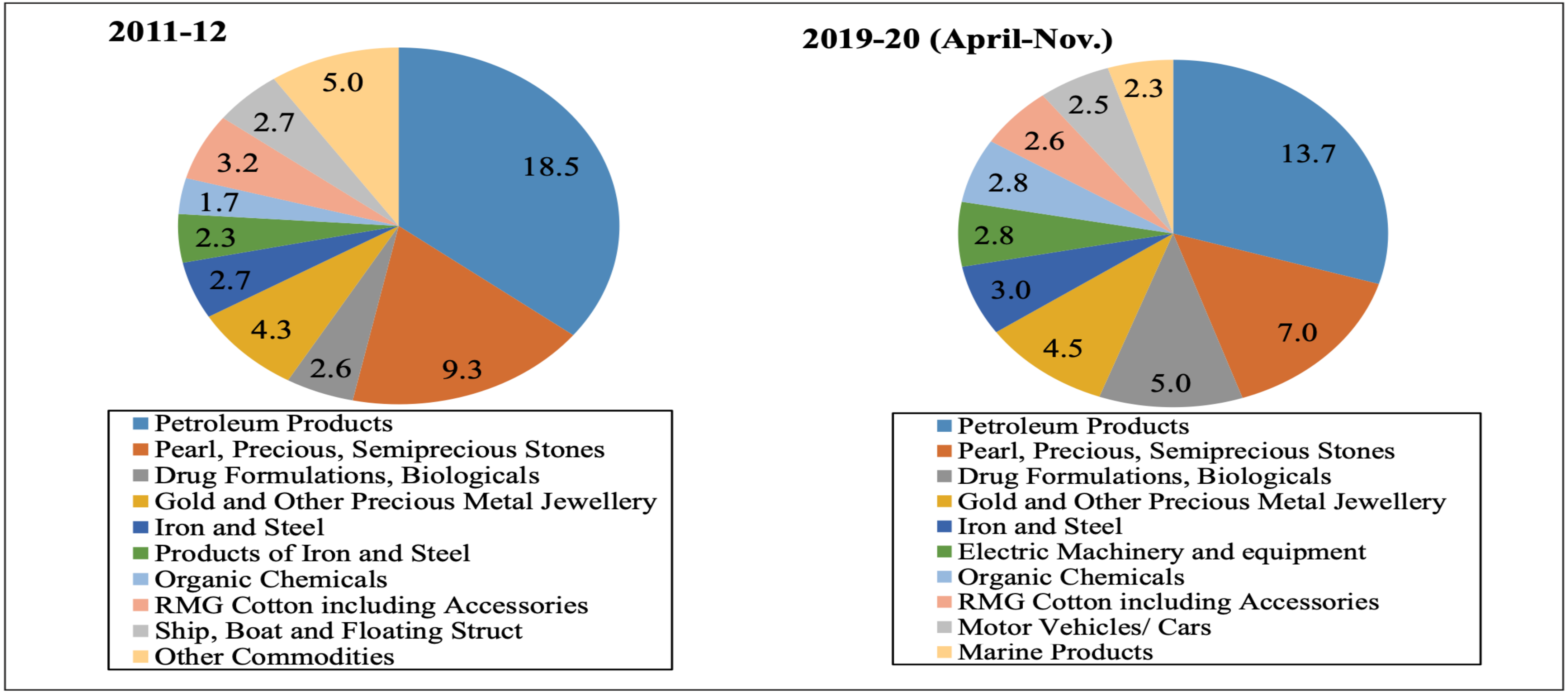
2009-13	2014-18	2017	2018
66.5	72.8	74.4	72.8

Source: Trademap.org.

Note: The years mentioned are calendar years.

- Petroleum, Oil and Lubricants (POL) exports have a dominant share in India’s export basket. Growth in Non-POL exports dropped significantly from 2009-14 to 2014-19.
- In 2019-20 (April-November), in terms of value petroleum products is the largest exported commodity while in terms of growth, it was drug formulations, biologicals.

Figure 9: Commodity-wise Composition of Exports (By Share in Per cent)



Source: Department of Commerce.

- An increase in the merchandise imports to GDP ratio has a net negative impact on the BoP position. Over the years the ratio has been declining for India entailing a net positive impact on the BoP position
- Crude oil imports have a large presence in the import basket that correlates India’s total imports with crude prices.

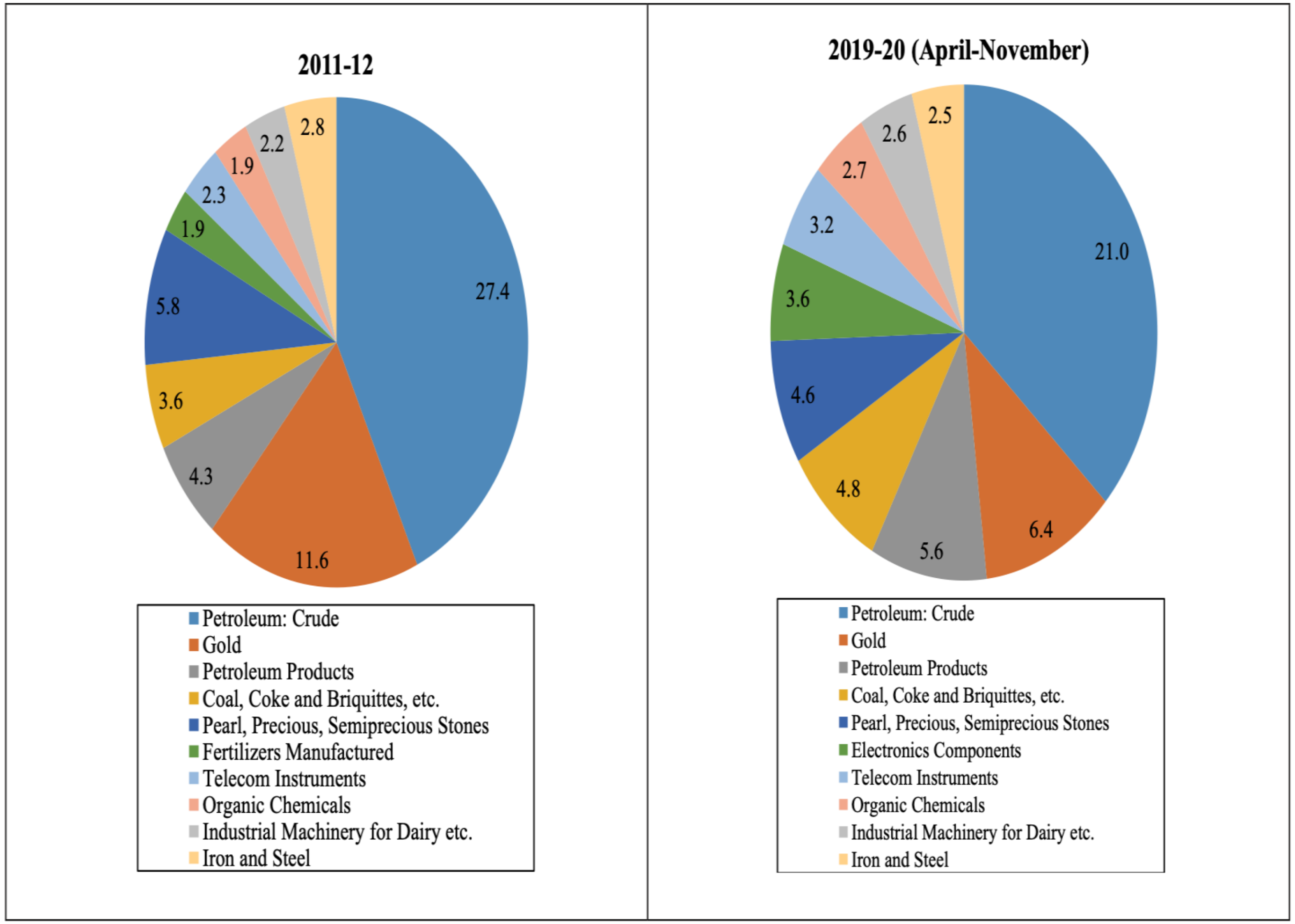
Table 9: Share of POL Import in Total Imports and Crude Oil Price (Indian Basket)

Item	2009-14	2014-19	2018-19	2019-20-H1
Share of POL imports in total imports (per cent)	32.1	25.2	27.4	26.3
Crude oil price of Indian Basket (US$/bbl.)	96.0	60.8	69.9	64.7
Merchandise Imports as percent of GDP	24.3	18.7	18.9	17.6

Source: Department of Commerce and Ministry of Petroleum and Natural Gas.

- In the import basket of 2019-20 (April-November), crude petroleum had the largest share followed by gold and petroleum products.
- Between 2011-12 and 2019-20, imports of Electronics grew the fastest from a negligible share to 3.6 per cent.

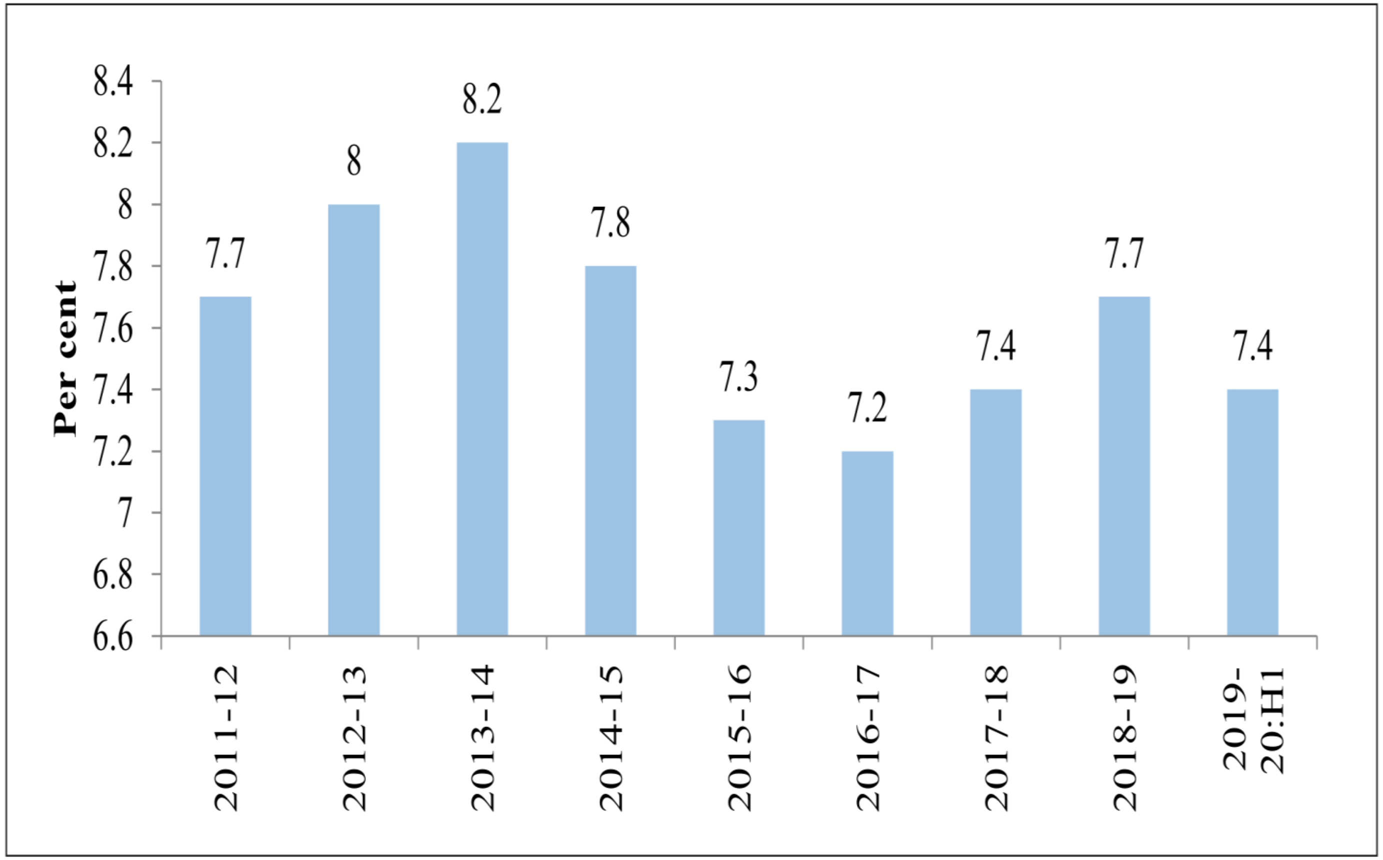
Figure 15: Commodity-wise Composition of Imports in (By Share in Per cent)



Source: Department of Commerce.

- An increase in service exports to GDP ratio has a net positive impact on the BoP position

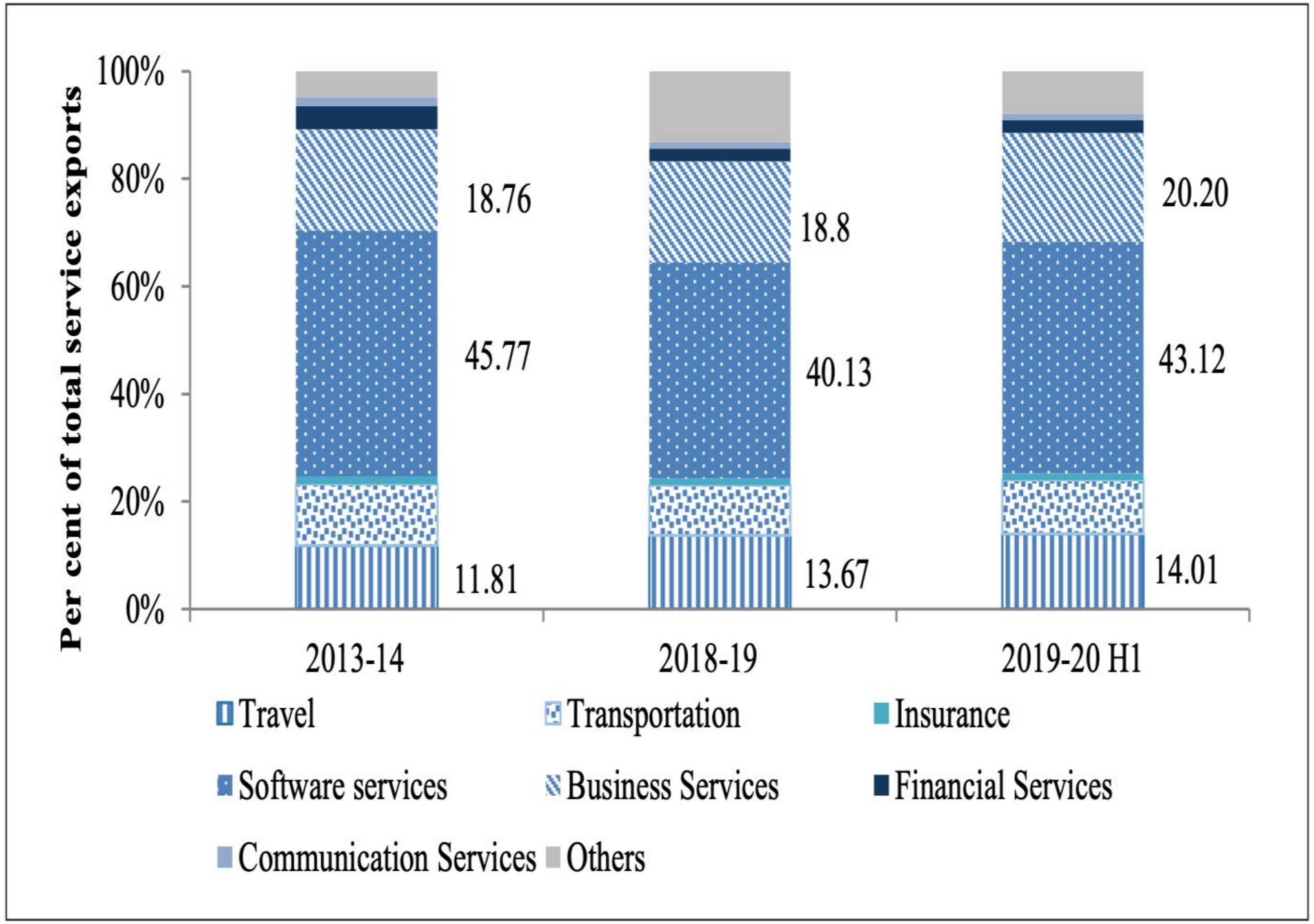
Figure 20: Service exports as per cent of GDP



Source: Reserve Bank of India.

- The composition of service exports has remained largely unchanged over the years. Software services constitute the bulk of it at around 40-45 per cent, followed by business services at about 18-20 per cent, travel at 11-14 per cent and transportation at 9-11 per cent.

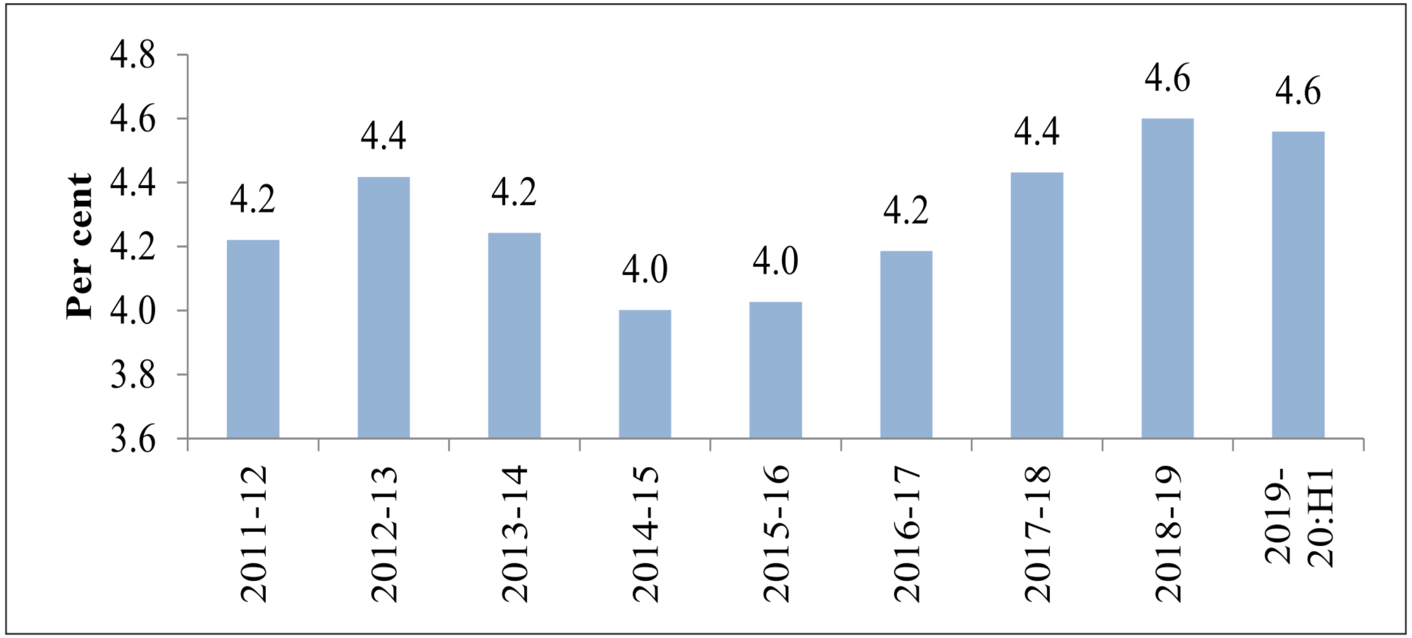
Figure 21: Composition of service exports



Source: Reserve Bank of India

- An increase in service imports to GDP ratio has a net negative impact on the BoP position. Over the years, service imports in relation to GDP has been steadily rising putting pressure on BoP to worsen. However, increase in service imports to GDP ratio is inevitable given a rising level of FDI and a gradual upscaling of the Make in India program.

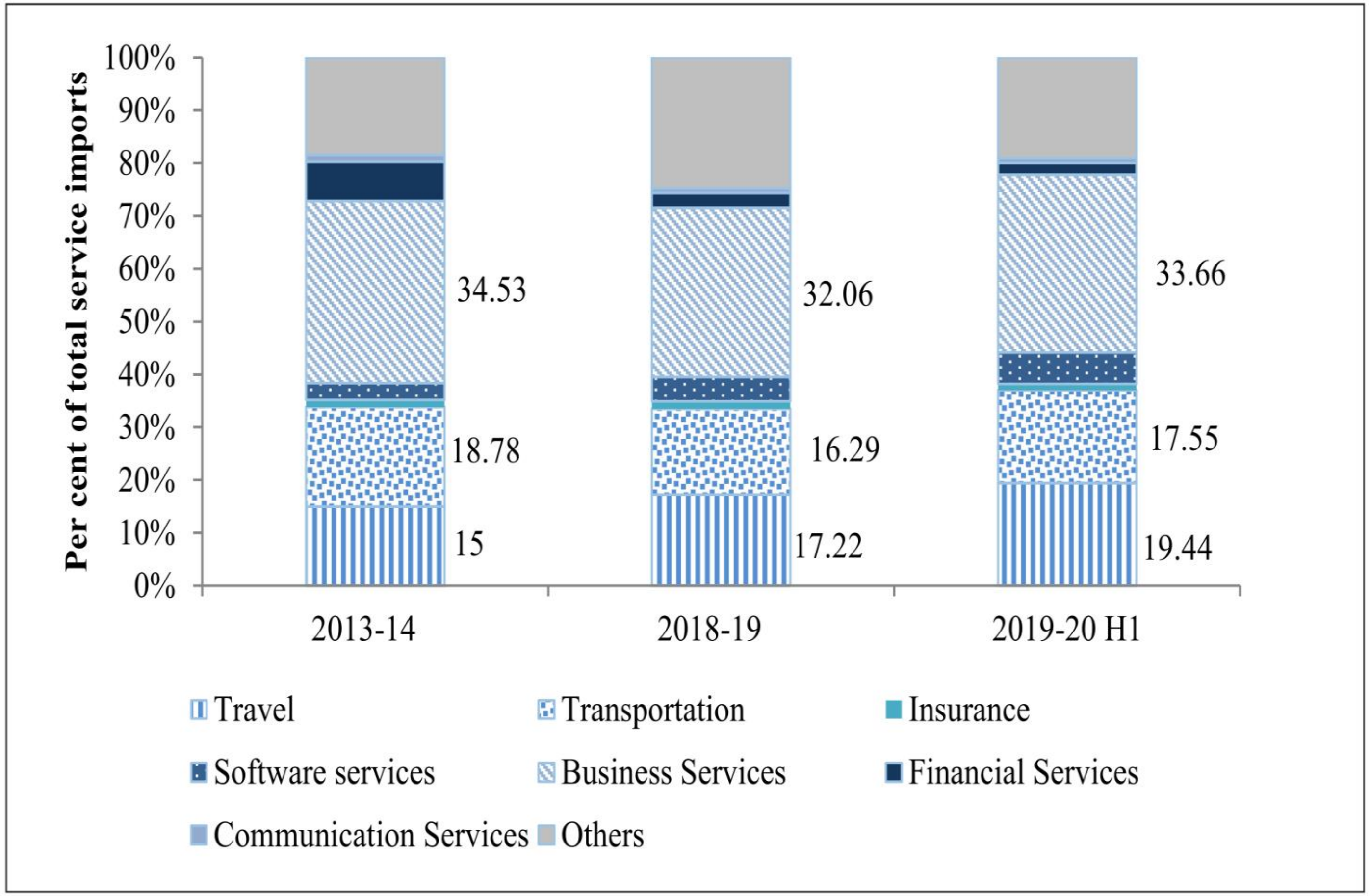
Figure 22: Service imports as per cent of GDP



Source: Reserve Bank of India.

- Business services constitute about a third of service imports and the component of travel services has been steadily increasing reflecting the growing attractiveness of global destinations to the domestic tourists in the country.

Figure 23: Composition of service imports



Source: Reserve Bank of India

- An increase in net remittances improves the BoP position. Net remittances from Indians employed overseas has been constantly increasing year after year.
- The pro-cyclicality of India's remittances with respect to crude oil price movements has been established empirically
- Further, as per the October 2019 report of World Bank, India remained the top remittance recipient country in 2018 followed by China.
- An increase in net FDI improves the BoP position.
- The impressive improvement in BoP position from March, 2014 to March, 2019 is mainly attributed to almost doubling of net FDI into the country from 2009-14 to 2014-19.
- Continuous liberalization of FDI guidelines has been responsible for rising inflows of foreign investment into the country.

- An increase in net FPI flows improves the BoP position.
- FPI is often referred to as “hot money” because of its tendency to flee at the first signs of trouble in an economy or improvement in investment attractiveness elsewhere in the world.
- Portfolio flows in H1 of 2019-20 have turned positive which could be attributed to the dovish monetary policy stance of the US, enhanced liquidity in global markets and reinforced growth prospects for India post budget announcements and reform measures.

- An increase in net ECBs improves the BoP position but it worsened the BoP by turning negative during 2014-19, from a healthy positive level in 2009-14.
- In 2018-19 there was a surge in net ECB inflows which may be attributed to low global interest rates and improved liquidity overseas in addition to a host of measures introduced recently by the government towards liberalization of ECBs.
- An increase in external debt to GDP ratio increases debt servicing and draws down on forex reserves worsening BoP position

Table 20: External Debt (Per cent of GDP)

2009-14	2014-19	2018-19	2019-20 H1
23.9	19.7	19.8	20.1

Source: Reserve Bank of India, Quarterly external debt report, DEA, M/o Finance.

- External debt remains low at 20 per cent of GDP.
- India’s external debt remains low as compared to the average external debt to GDP ratio of all developing countries (25.6 per cent) according to World Bank’s International Debt Statistics, 2020.
- External liabilities (Debt + Equity)/ GDP ratio is a more comprehensive measure of external liabilities as it adds dividend payout to debt servicing. A rise in this ratio draws down to a greater extent the forex reserves and worsens the BoP position.
- India’s external liabilities to GDP ratio has witnessed significant decline during 2014-19 as against 2009-14.
- Net International Investment Position (NIIP) measures the gap between a nation’s stock of foreign assets and foreigner’s stock of that nation’s assets at a specific point in time.

- Changes in NIIP/GDP ratio nets out the impact of investment made by the country abroad from the external liabilities borne by the country thereby measuring the net changes in the debt and equity servicing burden in relation to GDP.
- The surge in net FDI inflows has worsened the absolute NIIP level from 2009-14 to 2014-19.
- However, in relation to GDP the burden has reduced and so has the debt and equity servicing obligations.

Table 22: Net IIP (End Period)

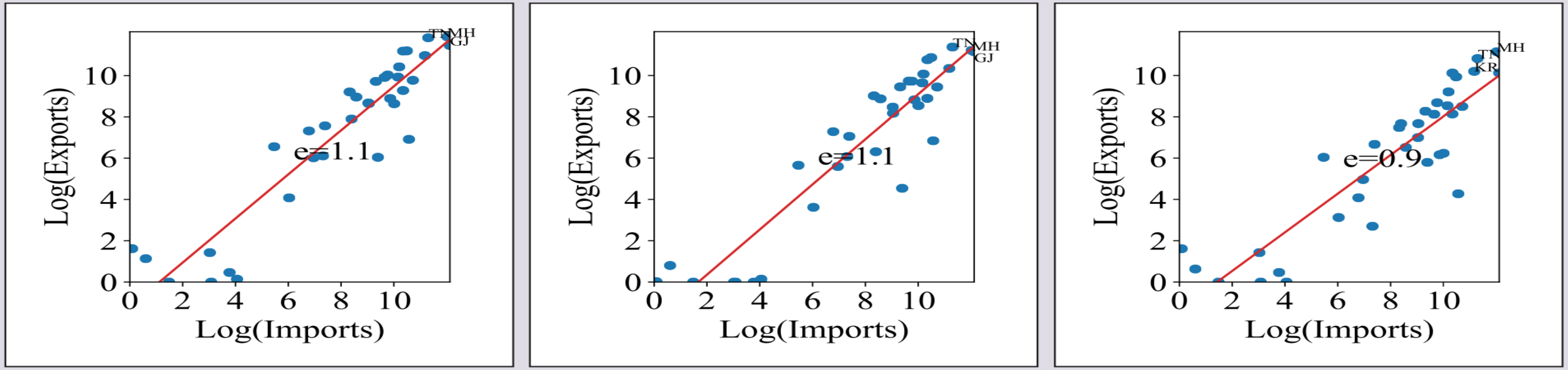
Item	2009-14	2014-19	2018-19	2019-20 H1
NIIP ($US billion)	-340.8	-436.8	-436.8	-436.7
NIIP/GDP	-18.4	-16.1	-16.1	-15.7

Source: Reserve Bank of India

To study relation between exports of finished goods and imports of raw materials and intermediate goods for India it is seen that rise in India's imports of intermediate inputs have every time led to rise in exports of associated consumption goods with an elasticity of greater than 1.

Import elasticity of export

Figure A: Aggregate **Figure B: Consumer Goods** **Figure C: Capital Goods**



Source: E-Way bill data and Survey Calculations.

Note: Based on chapters 10 to 99

Indian Fiscal Federalism at the Cross-roads: Some Reflections

No. 260
30-April-2019
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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 include (i) to make Finance Commissions "permanent" or (ii) to "abolish" the Finance Commissions by making the tax devolution share constant through Constitutional Amendment, (iii) the need for an institution to redress spatial inequalities, to fill in the vacuum created by abolishing the Planning Commission, and (iv) 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 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 Classification Codes: H77

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[1]This paper is an analysis of the issues highlighted on Centre-State financial relations 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.

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.

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

[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

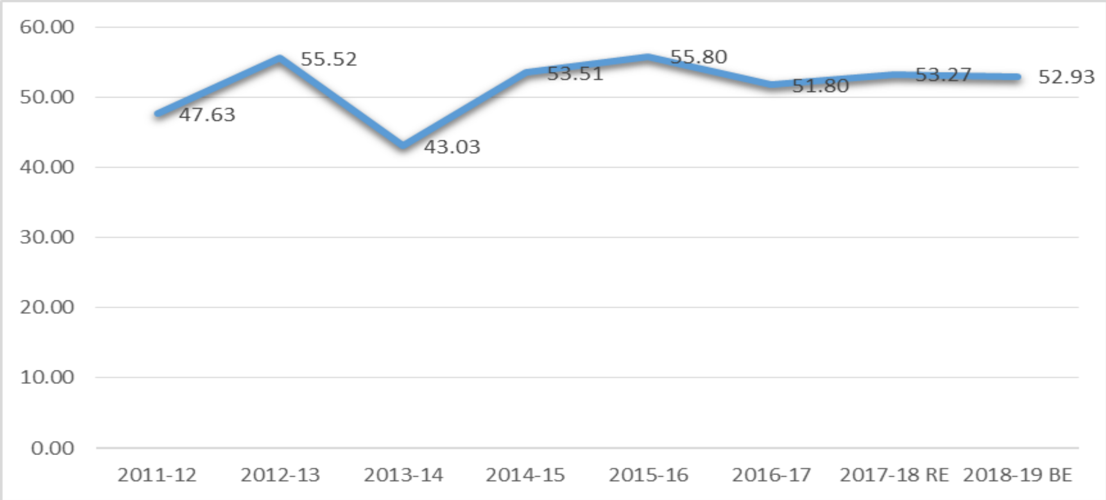
[5] RBI, March 2019. https://m.rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1070

[6] The Hindu, May 14th, 2018. https://www.thehindu.com/opinion/op-ed/an-open-letter-to-finance-ministers/article23874674.ece

[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/

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.

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



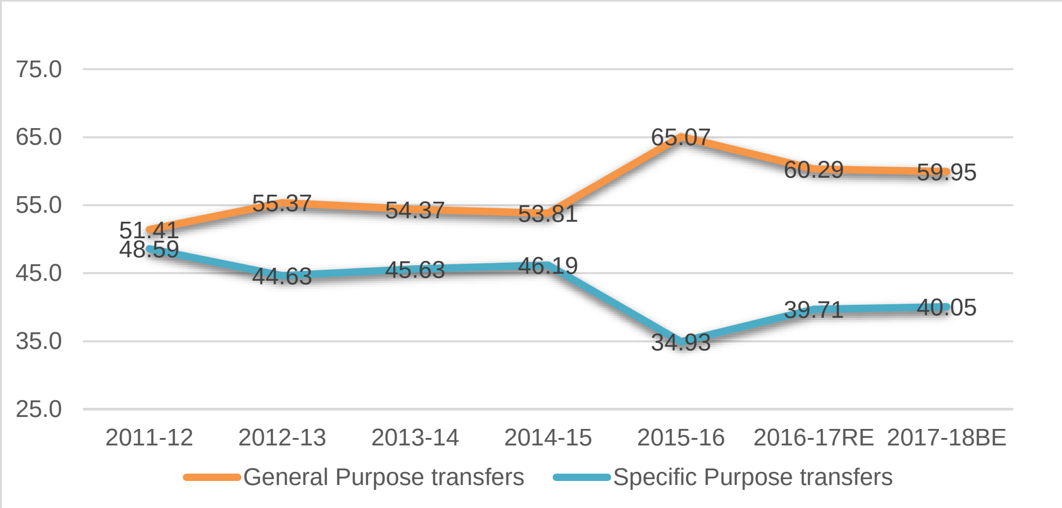
Source: Union Budgets (various years), Government of India

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). Has 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, Pinaki 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 that 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, then you will be earmarking the allocation for health and education, to heath and education. The big problem with the dividing up of revenues as shares is that you are leaving it entirely to states how to "spend" it. 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 Errors

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 this empiric 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.

V. 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

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

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 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).

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).

[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

VI. 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.

VII. 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 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

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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).

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]

VIII. 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*

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[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.

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.

IX. 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). These questions lead us to the political economy of intergovernmental fiscal transfers (IGFT).

It is a debate whether Finance Commissions should be made permanent. The permanency, however, should not make the Commissions recommending "political" awards, or the chances of awards to the States getting politicized through the bargaining mechanism of the States needs to be avoided in the permanent mechanisms of tax sharing.

In Pakistan, the Finance Commission Members consist of the Finance Ministers of all Provinces. There is a debate in Pakistan regarding the revenue-sharing formula giving significant weightage to population as a criterion. Though the significance of per capita income distance is acknowledged in fiscal federal discussions, due to paucity of GSDP data at subnational government levels, it is difficult for Pakistan to incorporate the "equity" variables in IGFT criteria. Yet another debate is "population" in which form needs to be incorporated in the IGFT formula, in "absolute terms" or the "density" of population as large provinces with sparse population should not get affected through financial devolution, and in turn exacerbate the regional inequalities. In that way, the role of Finance Commissions in "holding a country together" towards a path of development, through strengthening regional convergence to growth equibrium is crucial. Indeed, financial devolution alone cannot lessen the regional inequalities, if macro-fiscal policies are not designed appropriately.

We have to analyse whether such composition of "political" members in Finance Commissions make the financial awards to the States "inconclusive". The evidence from GST Council in India is that debates are less political, and the Council is more "federal" in nature.

Another example from South Asia, having permanent Finance Commission is Sri Lanka; and we get other cross-country examples of permanent Finance Commissions from the African region. However, the mandate of these permanent Finance Commissions is not explicitly "tax sharing", they are more into "internal revenue allocation" through fiscal equalization grants and natural resources sharing mechanisms.

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. The 14th FC has not included a performance-based criterion in the devolution formula, they have emphasized on "equity" through per capita income distance, along with population (both 1971 and 2011 with relative weight differentials), climate change variables etc. The relative weightage of equity based variables in the revenue sharing model compared to efficiency based variables is an ongoing debate, and Finance Commissions usually take a call on this, against the backdrop of the feedback they have received from the State visits, which is mandatory to all Commissions.

Drabu (2019) eloquently put 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 (2019) urged why cannot the TOR of Finance Commissions be drafted by the GST Council or at least the Empowered Committee of Finance Ministers.

X. 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

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

and criteria of tax transfers; and the debt-deficit dynamics at the subnational level (Chakraborty, 2019).

XI. 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 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.

The relevance of Planning Commission.2 or permanent Finance Commission deserve an informed debate prior to further institutional reforms in fiscal federal relations in India or any Constitutional Amendment(s) to make the awards Constitutionally fixed by abolishing the Finance Commissions.

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