Why are states being made to fight for fiscal autonomy?

DH deccanherald.com/opinion/main-article/why-are-states-being-made-to-fight-for-fiscal-autonomy-1137304.html

August 18, 2022

Credit: Special arrangement

Recently, Kerala Finance Minister K N Balagopal wrote a detailed letter to Union Finance Minister Nirmala Sitharaman in the backdrop of the financial crisis affecting state governments in the post-Covid scenario. The letter states that the Union Ministry of Finance has arbitrarily, in the name of off-budget borrowing, made a reduction of approximately Rs 4,000 crore in the net borrowing limits of the state.

According to Balagopal, in all, between reduction in revenue grants and borrowing limits, the Government of Kerala would have to contend with a reduction of Rs 23,000 crore in the financial resources available to it to finance its budget for the current financial year. That, obviously, would seriously impact the state government's ability to finance its welfare expenditure, including for targeted schemes for the poor on housing, education, and healthcare.

The letter raises some serious issues with respect to the governing dynamics of Union-state federal relations when it comes to allowing autonomy to states like Kerala to manage their own fiscal position vis-à-vis the Centre, and with respect to the constitutional interpretation of clauses provided under Article 280, often referred to by the Finance Commissions for regulating sub-national borrowings.

Balagopal says: “Article 293(3) of the Constitution fetters the state’s power to raise loans. Under this provision, if there is still any part of a loan made to the state by the Government of India or in respect of which the Government of India has given a guarantee, state is forbidden from raising ‘any loan’ without the consent of the Union government. The words ‘any loan’ in this chapter must be read considering the accepted canons of Interpretation of Statutes.”

More importantly, Article 293(3) can be legitimately used for “imposing conditions related to a request for borrowing of a state government. This cannot be used to control or administer the borrowing of the state government. Under the Constitution, these are matters that exclusively remain in the domain of the state government”.

This is not the first instance when the Union government has made arbitrary moves to coercively regulate the fiscal powers/autonomy of state governments, particularly in the context of non-BJP governments. Recently, Telangana and Tamil Nadu governments, too, made similar observations about the need to preserve constitutionally safeguarded autonomy of states to be able to manage their own fiscal priorities (including on borrowings).

Another bone of contention for state governments now is how the Union Ministry of Finance has stipulated that along with balances maintained in the Public Account of a state government, all borrowings of state government entities receiving budgetary support from the state budget will also be taken into consideration while setting the borrowing limits of the respective state governments.

While the Union government has failed to share its outlay of fiscal compensation (from GST and other sources) with most states, it is now imposing additional restrictions to minimise states’ fiscal capacity to borrow to finance their needs through differing interpretations of existing constitutional provisions. This while it does not impose any such limits on its own borrowings by considering the borrowings of the agencies set up by it.

The scope of Article 293(3) and (4) are limited to the states as defined under Article 1(1) of the Constitution. It cannot be extended to include the debt of government agencies, including companies and statutory bodies. It must also be emphasised that, under the federal-state financial architecture in the Constitution, the constitutional structure for making any such recommendations is the Finance Commission.

Balagopal adds: “None of the previous 14 Finance Commissions have made any such recommendation that could serve as the basis for the decision made by the Department of Expenditure. It would be (therefore) wrong to interpretatively and selectively use Article 293(3) to undermine the federal character of the Constitution.”

It must be realised that during most of the last two years, despite a pandemic wreaking havoc on almost all states' fiscal positions, exacerbating the public debt levels of the states and the Centre, the Narendra Modi government at the Centre offered little direct support to even the most-affected state governments to meet their financial needs.

During the pandemic, most assistance to states came in the form of liquidity support, with the opportunity to borrow through the RBI or through the Centre. As we see from Balagopal's letter, here too, the loss of (fiscal) autonomy to state governments is likely to make them more sceptical of any support offered by the Union government, which is unfortunate given the troubling macro numbers available on Union and state deficits, debt, and other liabilities.

States have limited sources to generate revenue. In managing the swelling fiscal deficit and public debt levels (including of fiscally weak states), the public expenditure composition and fiscal priorities must be more clearly understood, due to the differing constitutional assignment of functions of the Union and state governments. Most redistributive expenditures -- critical for welfare outcomes -- are in the functional domain of states, not with the Union government.

A contraction in such expenditure at the state level can have adverse distributional consequences, with a regression already being observed in state-level performance outcomes on access to education, healthcare, social security, particularly for the vulnerable and marginalised sections. Welfare driven expenditure needs are not part of 'revadi' politics but are about fulfilling a government's basic responsibility to its people.

Hence, state governments, irrespective of their party affiliation, need all the support they can get at this point to either borrow 'more freely', under a mutually agreed fiscal roadmap, for their developmental needs or be otherwise supported to manage their finances on their own, or through borrowing-financed support offered by the Union government.

In either of the scenarios, fiscal cooperation and transparent functioning is vital to protect states' fiscal space and enhance macroeconomic stability. There is no room for ad hoc or arbitrary decision-making, nor for selective, partisan constitutional interpretations that might trigger more direct confrontations between the states and the Union government going forward.

(The writer is Associate Professor & Director, Centre for New Economics Studies, Jindal Global University)