Memorandum submitted to 15th Union Finance Commission (UFC) (On May 29, 2018)

---

1. We feel that some items of the terms of reference (ToR) of 15th UFC are against the spirit of Indian constitution on role and functions of UFC, devolution of central taxes and duties to States, fiscal autonomy of the State and Central-State financial relations. This is an unhealthy change aiming at centralisation of fiscal powers in the hands of union government and rejecting fiscal autonomy and independence of States guaranteed by the constitution.

   We, therefore, appeal that the commission may follow the constitutional articles on the role and functions of UFC, fiscal devolution of central taxes and other matters ensuring fiscal autonomy of the States. We also request that appropriate fiscal norms may be used to safeguard the fiscal independence of the State relating to revenue deficit, fiscal deficit, borrowing limit and use of borrowed funds outside the budget for development of the State.

2. ToR Item 1 (i)

   The union government has been taking measures to dismantle annual plans, stopping distribution of plan grants, cutting down funds for centrally sponsored schemes (CSS) meant for poverty alleviation, employment generation and social welfare, increasing State share of CSS and shifting financial burden to States, imposing unsuited CSS to States etc. These measures have substantially reduced the plan grants, other grants received from the union government and shifted the financial burden of CSS to State governments. In this context there is a need to increase the share of States in the central divisible pool.

   a) **We request that the share of the States in the central divisible pool shall be increased from 42 to 50 percent.**

   b) **The practice of shifting the financial burden of CSS to the States should be stopped. By imposing financial burden of CSS on States, the union government distorts the fiscal autonomy of the States.**

   c) **CSS are central schemes formulated by union government based on their economic and political interests and they should borne the entire financial burden of the CSS.**

3. ToR Item 1 (iii)

Currently grants-in-aid are given to panchayats and municipalities treating them as similar to district level offices of a State department. Kindly note that they are Local governments (LGs) and are entitled to get a share of central taxes as their right. The commission should treat them as LGs and a share of central taxes should be given to them as in the case of States. The practice of giving grants-in-aid in an arbitrary manner for one purpose is not a healthy practice. The State finance commission's (SFC) assessment about the requirement of the finances of the LGs and their recommendations for various purposes must be taken as the basis. Our request is as follows.

a) **The commission should treat the panchayts, municipalities and other categories of Local bodies as LGs. They should be given a share of total central taxes as in the case of States. The practice of giving performance based fund distribution should be stopped.**

b) **The LGs should be given freedom to fix priority in spending the devolved funds. The funds may be spend for improving the delivery of public services, infrastructure development, plans for local level development, strengthening administrative machinery etc.**

4. Item 2 of ToR

Item 2 of the ToR mentions about sound fiscal management, appropriate deficit levels, debt and need for revenue deficit grants. Regarding this, we wish to submit the following. Kerala State has been facing acute fiscal crisis. The nature and magnitude of the crisis is presented in white paper published by the State government in 2016. Table 1 gives the fiscal situation of Kerala for a period of seven years from 2012-13 and 2018-19. The State is not able to achieve the fiscal targets stipulated by the 14^{th} UFC regarding revenue deficit (RD) and fiscal deficit (FD) (Table 2). We feel that the 14^{th} UFC had fixed the fiscal targets without considering the fiscal realities of Kerala. The State has been facing serious economic problems due to continuous return of large number of migrants from the West Asian countries, fall in migrant remittances, acute crisis of rubber crops and severe distress of farmers, continuous recession in construction sector and consequent job loss, adverse impact created in investment, production and employment in informal sector activities due to demonetisation and introduction of very high tax rate of GST for certain commodities, fall in the rate of growth of State own tax revenue (SOTR) etc. In this context any attempt to reduce the RD, FD and borrowing limit will result in fall in public spending and accelerate recessionary trends in the economy.

As per Indian Constitution, State government is given fiscal autonomy to determine RD, FD and borrowing limit taking in to consideration the fiscal realities of the State. Arbitrary fixing of the fiscal targets and trying to enforce it through conditions and regulations is against the spirit of federal fiscal relations guaranteed by Indian Constitution. In this context we give the following suggestions for your kind consideration.

a) **RD, FD and borrowing limit should be based on the past trends and assessing the growth in fiscal requirement of the State. The UFC may fix appropriate levels of the RD, FD and borrowing limit as norms to be followed by State governments and not as law to be enforced by union government.**

b) **The upper limit of the RD may be fixed as 1.5 percent of GSDP and FD 3.5 percent of GSDP and Debt-GSDP ratio 33 percent during the award period of the 15th UFC.**

c) **The practice of giving revenue deficit grant shall be continued and Kerala shall be given the grant.**

d) **Adequate freedom should be given to State government to mobilise funds including borrowing from outside the budget for development purposes.**

5. ToR item 3 (v)

As a result of implementation of GST, State has lost the power to revise tax rate of the VAT and other taxes resulting in substantial revenue loss. The estimate on revenue loss is not made on a realistic basis based on facts.

We request that the commission may estimate the actual loss incurred by the State due to the implementation of GST and recommend appropriate compensation.

6. ToR item 4

According to ToR, the commission has to propose measurable and performance based incentives for fund distribution of nine items. They are deepening of tax net under GST, measures to reduce population growth, implementation of CSS, progress made in capital expenditure, increase in tax/non-tax revenue, promoting ease of doing business, provision of grants-in-aid to local bodies, control of expenditure on populist measures and progress made in sanitation.

We feel that the ToR is against the spirit of devolution of central taxes, grant-in-aid etc as envisaged in Indian constitution. We consider that the share of central taxes, grants and other funds transferred to State as per UFC is the right of the State and not as an act of benevolence. We request that all the grant-in-aid and other fund shall be distributed without any conditions.

7. ToR Item 5

The 14th UFC had given 27.5 percent weightage for population. (17.5 present for 1971 population and 10 percent for 2011 population in the total weight of 100 perecent). But total population alone is not a sound indicator due to many reasons. Rapid demographic change will necessitate more public spending on many fronts. For instance rapid urbanisation will cost more public spending for urban administration, maintaining law and order, provision of public services etc, need for modern fire fighting system, waste disposal, sanitation etc compared to rural area. The share of urban population in Kerala increased from 24 percent in 2001 to 48 percent in 2011. Long coast line require more public spending for maintaining sea walls, rehabilitation of coastal people from frequent sea attacks, compensation to destroyed boats and other items, provision for drinking water, housing and other public services to fisher population etc (580 km). A high proportion of old age people require more public spending for social welfare and public health (13 percent in 2011). In this context instead of giving only total population of 2011, it is better to give weightage to different aspects of demography.

We propose that the total weightage given to the population may be raised to 30 percent consisting four components: total population of the State in 2011 (10 percent), urban population (10 percent), coastal population (5 percent) and oldage population (60+ years) (5 percent).

Criteria and weights proposed

Sl. No	Criteria	Weight (%)
1	2011 population	10
2	Share of Urban population 2011 (%)	10
3	Coastal population	5
4	Oldage population (60+)	5
	Total population	**30**

8. Income distance

The 14th UFC had used the distance of actual per capita income of a State from the State with the highest per capita income as measure of fiscal capacity and assigned it 50 percent weight. A three year-average (2010-11 to 2012-13) per capita comparable GSDP has been taken for all the twenty-nine States. Income distance has been computed by taking the distance from the State having highest per capita GSDP (Here Haryana, having the third highest per capita GSDP is selected).

This method of selection of the State having highest per capita income is not a sound criteria due to following factors (1) The States, which are near to the highest per capita GSDP get only a small share of devolution and will be losers. On the other hand the State having the lowest per capita GSDP will be windfall gainers. In order to reduce the wide gap between the highest and lowest GSDP levels, it is desirable to take a medium level GSDP for comparison. The weightage given to this criterion shall be reduced from 50 to 30 percent.

Table 1

Fiscal situation of Kerala

Sl. No	Item	2012-13 (Accs)	2013-14 (Accs)	2014-15 (Accs)	2015-16 (Accs)	2016-17 (Accs)	2017-18 (RE)	2018-19 (BE)
1	Revenue Deficit (-) (₹ crore)	-9351	-11309	-13796	-9657	-15485	-13080	-12860
2	Fiscal Deficit (-) (₹ crore)	-15002	-16944	-18642	-17818	-26448	-22774	-23957
3	Debt Stock (₹ crore)	103561	119009	135440	157370	186454	210789	237266
4	RD / GSDP (%)	2.27	2.43	2.62	1.64	2.51	1.91	1.66
5	FD / GSDP (%)	3.64	3.64	3.54	3.02	4.29	3.32	3.10
6	Debt Stock / GSDP (%)	25.12	25.59	25.75	26.75	30.22	30.71	30.70
7	Nominal GSDP Growth rate (%)	13.26	12.79	13.11	11.85	4.88	11.26	12.59

Accs- Accounts; RE- Revised Estimate; BE- Budget estimate

Source : Government of Kerala (2018). Medium Term Fiscal Policy & Strategy Statement with Medium Term Fiscal Plan for Kerala 2018-19 to 2020-21

Table 2

Fiscal Targets of 14th UFC and achievements

Indicators	Fiscal Targets Proposed by 14th FC				
	2015-16	**2016-17**	**2017-18**	**2018-19**	**2019-20**
RD/GSDP	0.00	0.00	0.00	0.00	0.00
FD/GSDP	3.00	3.00	3.00	3.00	3.00
Debt/GSDP	31.34	30.84	30.40	30.01	29.67
IP/RR	15.70	15.01	14.37	13.78	13.23
	Fiscal Achievements				
RD/GSDP	1.64	2.51	1.91	1.66	-
FD/GSDP	3.02	4.29	3.32	3.10	-
Debt/GSDP	26.75	30.22	30.71	30.70	-
IP/RR	16	16	15	15	-