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Communist Party of India (Marxist)

Note to the Fourteenth Finance Commission

1. The Constitution of India entrusts the Finance Commission with the responsibility of overcoming a basic anomaly in our federal system, namely that while state governments have to undertake substantial development expenditure, their revenue raising capacity is limited compared to the Centre. The Finance Commission has the obligation of ensuring not only *appropriate* but also *unconditional* devolution of resources from the Centre to the States. This unconditionality is important to the democratic tradition, for if no "strings" are attached to such transfers, and different State governments run by different political Parties, representing different social outlooks and political ideologies, are allowed to pursue different development trajectories, only then does the people's electoral choice between them acquire meaningfulness. To discharge this obligation, the Finance Commission needs to stand above the Centre and the States, as an independent overarching Constitutional body.

2. Unfortunately, however the Central government has been systematically attempting of late to undermine this independent overarching role of the Finance Commission, and to make it an instrument for attenuating States' autonomy and imposing upon them

a uniform set of neo-liberal policies which it has chosen to espouse. We hope that the Fourteenth Finance Commission will rise above this Central manoeuvre and reclaim its Constitutional role.

3. The Centre's undermining of the role and independence of Finance Commissions stems from the fact that it unilaterally appoints Finance Commissions, unilaterally decides their terms of reference, effects substantial transfers to states outside the Finance Commission route, and has even prevailed upon Finance Commissions, starting from the Eleventh Commission onwards, to make transfers to the states subject to their fulfilling certain "conditionalities", a procedure whose un-Constitutionality had even prompted a strong dissenting note from one of the distinguished members of the Eleventh Commission.

In our memorandum to the Thirteenth Finance Commission we had proposed that:

> All constitutionally mandated bodies like the Finance Commission, which arbitrate between the Centre and the States, must be formed only after prior consultation with the States and subsequent ratification by the Inter-State Council, where both the Centre and the States are represented.

The Union Government however has persisted with the undemocratic practice of unilaterally constituting the Finance Commission without prior consultation with, or representation from, the states. The National Development Council and the Inter-State Council have been reduced to mere rubber-stamp bodies, where even formal consultations regarding the formation of Finance Commissions are not allowed to occur. We hope that the Fourteenth Finance Commission will not allow its independent and semi-judicial authority to be undermined either by the modality of its formation or by its terms of reference unilaterally determined by the Centre.

TERMS OF REFERENCE

4. We have serious objections to the terms of reference of the Fourteenth Finance Commission. The constitutional provision under chapter 1 part 12, for the vertical and horizontal distribution of the net proceeds of taxes or grants, makes these an unconditional right of the states.

Since the 11th FC, however the Central government has been attempting to make these grants conditional, particularly, the grants for bridging the non plan revenue deficits and other special purpose grants. For the Fourteenth Finance Commission too it is stated:

> The Commission shall review the state of the finances, deficit and debt levels of the Union and the States, keeping in view, in particular, the fiscal consolidation roadmap recommended by the Thirteenth Finance Commission, and suggest measures for maintaining a stable and sustainable fiscal environment consistent with equitable growth including suggestions to amend the Fiscal Responsibility Budget Management Acts currently in force …; and the Commission shall also consider and recommend incentives and disincentives for States for observing the obligations laid down in the Fiscal Responsibility Budget Management Acts.

The "monitorable fiscal reforms program" suggested by the 11th and 12th FC in order to "restore budgetary balance, achieving macro-economic stability and debt reduction along with equitable growth" had been undermined by the onset of the global recession. The 13th FC proposed a revised road map for fiscal consolidation. The 14th FC is being asked to review its progress and make suggestions to amend FRBM acts and "recommend incentives and disincentives for States for observing the obligations laid down". Our party which has been opposing the neo liberal fiscal reforms and the so-called "rule based" uniform FRBM acts sees these terms of reference as a continuation of the Centre's efforts to use devolution of resources as an instrument to enforce compliance with neo-liberal measures.

5. The FRBM Acts which stipulate removal of revenue deficits and restriction of fiscal deficits to 3 percent of GSDP suffer from an inadequate understanding of the term "revenue expenditure", which is interpreted as being unrelated to development and the people's needs. But, according to the accounting principles laid down by the Comptroller and Auditor General of India, all State government grants to the local bodies (panchayats and municipalities), to "aided" schools and colleges, all expenditure on account of salaries of doctors, medicines, etc. are classified as "revenue expenditure". If the States are to achieve the targets of the FRBM Act, then they will be forced to curtail these expenditures which are so crucial for people's well-being.

This would amount to a withdrawal of the welfare and developmental role of the States. Hence, such uniform and universal "fiscal consolidation road maps" are undesirable and unrealistic.

6. In making its recommendations on the above terms of reference, the commission is asked to take into account 11 sub clauses which further attempt to micro-manage the fiscal domain of the state governments. Such a plethora of Terms of Reference is extra-Constitutional, unnecessary and distracting. Many of the Terms of Reference echo the economic viewpoint of the Central Government, which do not necessarily reflect the thinking of several State Governments that are under different political dispensations. In the following paragraphs we express some of our criticisms.

7. Clause 3 (ii) of the ToR requires the 14th FC to consider "the demands on the resources of the Central Government, in particular, on account of the expenditure on civil administration, defence, internal and border security, debt-servicing and other committed expenditure and liabilities." This is an exact replication of the ToR of the 13^{th} FC to which we had raised serious objections. Priority is given here to the "committed expenditure" of the central government and only residual resources are to be shared with the state governments. This is clearly un-Constitutional as it violates Article 280 of the Constitution, which mandates the *entire pool* as divisible between the Central Government and the States. It also privileges the committed expenditure of the Central Government over that of the States, even though States too are burdened with high committed expenditure on interest and salaries, entirely on account of Central policies. In a context where there are legally binding limits on fiscal deficits and aggregate transfers to the states, this asymmetric treatment is not only un-constitutional but also unfair.

8. The above ToR may well imply that the Centrally Sponsored Schemes are also a committed expenditure of the Central Government, converting such Schemes, which are clearly a distortion that needs to be eliminated, into a permanent feature of centre-state fiscal relations. States have been demanding, particularly since the 1990s, the transfer of Centrally Sponsored Schemes, together with funds, to the States; and this was also resolved at the Conference of the Chief Ministers convened by the Prime Minister on May 4, 1996. But there has been no effective resolution of this issue. Not only does the institution of

Centrally-Sponsored Schemes persist, but more and more Centrally Sponsored Schemes, now with neoliberal conditionalities, are being introduced by the Central Government.

9. Clause 3 (vi) specifies that the 14th FC should consider "the level of subsidies that are required, having regard to the need for sustainable and inclusive growth, and equitable sharing of subsidies between the Central Government and State Governments". The FC is here being sought to be utilized to micro-manage even the level of subsidies, which is a policy decision to be made by a state government on the basis of its political ideology and commitment. The ToR are also mischievous in referring to "equitable sharing of subsidies between Central and State Governments". We fear that it is a ploy to shift the greater burden of subsidies to the shoulders of the state governments. This unacceptable trend is very evident if one examines the evolution of the financing pattern of the Centrally Sponsored Schemes, where the Centre has unilaterally kept lowering its share of the expenditure on such Schemes. Having thrust such Schemes on the states which have no say in their design or conception, and hence having diverted state government funds away from other possible Schemes which they could have introduced on their own had there been no CSSs, the Centre then arbitrarily lowers its own share, putting the burden of running such Schemes increasingly on the state governments. Its unilateral decision to lower its contribution to Sarva Shiksha Abhiyan, *against the unanimous appeal of Chief Ministers at an NDC meeting against such lowering*, is indicative of its intent.

10. Clause 3 (viii) refers to "the need for insulating the pricing of public utility services like drinking water, irrigation, power and public transport from policy fluctuations through statutory provisions". Here again the FC is being made into an instrument to insulate the pricing of public utilities from the policy perspective of the ruling political parties at the state level which have been voted into office by the electorate. The way that this sub clause is framed is even more retrograde than the ToR of the 13th FC where the reference was to "the need for ensuring commercial viability of irrigation projects, power projects, departmental undertakings and public sector enterprises through various means, including levy of user charges *and adoption of measures to promote efficiency*" (emphasis added). The pricing of services was then considered to be only one of the measures

to promote viability, while there were others as well. For instance we had suggested in our memorandum "a significant (increase in) investment on appropriate renovation, and modernisation of plants and machinery". The current ToR we fear are part of the agenda of the central government to jack up prices of essential services to the public, and eventually to privatise public utilities.

11. Clause 3 (ix) refer to "the need for making the public sector enterprises competitive and market oriented; listing and disinvestment; and relinquishing of non-priority enterprises". We suspect that these ToR are targeted against state governments that are attempting to restructure and revive public sector enterprises rather than privatizing them. What the Central Government failed to impose on the Left-led governments through its own efforts, is now being sought to be imposed through the agency of the FC. Resistance to privatization was one of the key slogans of the two day united national strike of the entire trade union movement in India and our party is committed to mobilizing people against the pursuit of any such misguided policy of the central government.

12. The Clause 3 (xi) is about "the impact of the proposed Goods and Services Tax on the finances of Centre and States and the mechanism for compensation in case of any revenue loss". We do not contest the need for the FC to examine the impact of the GST on the finances of the state and central government but we would urge the FC to resist the temptation to examine an appropriate GST structure and rate, as the 13th FC attempted to do with disastrous consequences. The GST in any case constitutes a serious abridgement of the autonomy of state governments in raising revenue through instruments of its choice. If on top of it, even the rates are to be fixed by the FC rather than the empowered group of state finance ministers and union finance minister, then that amounts to adding insult to injury. The 13th FC's suggested rate was significantly lower than the rate reached through consensus in the empowered group. Further the 13th FC also recommended inclusion of goods like petroleum products and alcohol within the ambit of GST which was unacceptable to state governments. The final outcome was that the implementation of GST was stalled.

13. Therefore, we propose the following with regard to the ToR:

The 14th FC must assert its autonomy and reject the additional ToR that make the grants conditional upon acceptance of the policies of the Central Government.

The 14th FC should also recommend that in future, the TOR must be drawn up jointly by both parties through consultation, and be ratified by the ISC.

The 14th FC should maintain its Constitutional position of neutrality between the Central Government and the States, and reject ToR 3(ii).

In case ToR 3(ii) is accepted, the States' committed expenditure on civil administration, debt servicing, salaries and pensions too should be considered as committed expenditure.

ERODING STATES' FISCAL AUTONOMY

14. The Constitution, as mentioned earlier, envisages an autonomous Finance Commission (FC) with semi judicial character to be the corner stone of our federal fiscal structure. This structure has been undermined by the Central government by resorting systematically to transfers outside the statutory devolution recommended by the FC. As the Table below shows for the year 2012-13 (BE), of the Rs 6.5 lakh crores transferred to the states through all the channels only 55 percent are through the constitutional body of FC.

15. The first deviation from the Constitutional scheme of things took place when the Planning Commission was made the channel for transfer of funds for plan assistance to States and UTs; and this was distributed across states on the basis of the Gadgil formula. These days the central plan assistance, instead of being given as block grants, is increasingly channeled through Centrally Sponsored Schemes (CSS) so that the share of central plan assistance in the overall resource transfers to the states has also tended to decline from around 28 percent in 2006-07 to 17 percent in 2012-13. The CSSs have been severely criticized for their lack of sensitivity to regional conditions and lack of flexibility. Further, most of the CSSs contain a matching share from the state plan, whose ratio has tended to go up over time. Thus for example in the case of Sarva Siksha Abhiyan (SSA) initially the share of the state was only 25 percent and it has now been increased to 50 percent. Despite the decisions of the National Development Council and also the position of the Planning Commission in favour of

reduction in the number of CSSs, and of introduction of greater flexibility in the schemes, the situation has only worsened.

16. The further deviation with respect to CSSs has been that these discretionary transfers are today directly going to district authorities and independent agencies bypassing the state budget. Worse still, the state governments are forced to deposit their matching share too with such autonomous implementation agencies, e.g. SSA and National Rural Health Mission (NRHM). This situation is leading to serious misuse of funds, lack of accountability and of regulatory state government oversight. The Central government's bypassing of the state governments through independent organisations and through direct dealings with local governments is a serious challenge to the federal structure of the country. In 2012-13 1.3 lakh crores, ie, 20 percent of the total resource transfer is routed directly, bypassing the state government budgets. This amount is larger than the central plan assistance to States and UTs. The total resources spent by the Centre through Central schemes, CSSs and directly-aided schemes within the functional domain of the state governments is fast catching up with the resources transferred through the agency of the FC.

17. Further, the conditionalities that accompany CSSs often impinge upon the sovereign power of the States. For example, when the JNNURM was launched, the State Governments were unilaterally asked by the Centre to bring down the Stamp Duty rate within five years to a level not exceeding 5 percent. This is a direct intrusion into the fiscal autonomy of the States, since, with respect to taxes in the State list, the Legislative Assembly has full power to prescribed rates.

18. The multilateral and bilateral lending institutions have also started determining state level fiscal policy through their sectoral and structural-adjustment lending. Earlier the Central government used to negotiate the foreign loans which were then routed to the state governments. Since the neo liberal reforms the Central government is encouraging the state governments to negotiate directly with the lending agencies. The state governments are forced by such agencies to accept conditions linked to fiscal reforms as well as to neoliberal sectoral reforms.

19. The policies of the Central Government have also had a serious impact upon the expenditure side of the state budgets. The impact of jacking up Centrally-administered prices, not to mention

Table: Aggregate flow of resources to the states (2012-13 budget estimates)

Sl. no	*Heads*	*Rs crores*	*% GDP*
1	States' share of taxes and duties	301921	2.97
2	Non-Plan Grants	64211	0.63
3	Central Assistance for State & UT (with legislature) Plans	111014	1.09
4	Assistance for Central and Centrally Sponsored Schemes	41592	0.41
5	Total Grants (2+3+4)	216817	2.13
6	Direct release of Central assistance for State/UT Plans to implementing agencies (MPLADS)	3955	0.04
7	Direct release under Central Plan to State/District level autonomous bodies/ implementing agencies	133359	1.31
		656052	8.59

the Centre's general inflation-promoting policies (such as with regard to the APL-BPL distinction in food distribution) is felt on state government budgets via sharp increases in the payment of dearness allowance, and an increase in recurring expenditures such as for transportation. The impact of the pay revision of state government employees effected in consonance with the Centre's decision to implement the recommendations of the Sixth Central Pay Commission has been severe on the finances of the States, leading to serious financial crisis. The demand of the state governments that the Central Government bear a portion of the additional financial burden of the States due to pay revision has not been heeded.

20. The Thirteenth Finance Commission was extremely insensitive on this issue, to the detriment in particular of smaller states like Tripura. Every state, big or small, needs a minimum absolute size of the administrative apparatus. When pay revisions occur, the burden on the smaller states with smaller GSDPs therefore is correspondingly larger than on larger states. They need larger proportionate assistance than the larger states. The Thirteenth Finance Commission however stipulated certain "norms" for administrative expenditure without taking this fact into account, which dealt a heavy blow to the finances, and hence to the capacity to undertake development expenditure, of Tripura, a state seriously threatened by a problem of insurgency. We hope that the Fourteenth Finance Commission will be more sensitive to the needs of such small, insurgency-threatened states.

21. The Central government enters into bilateral and multilateral trade agreements with other countries, which have an immense

bearing on the agricultural sector, without so much as consulting the State Governments, even though agriculture is a State subject. The commitments of the country under WTO, the Indo-ASEAN FTA etc. have adversely affected the agricultural sector in several States resulting in farmer's distress and even suicides.

22. An elementary principle in economics, namely that whenever a policy is adopted which causes gains to some and losses to others, the gainers, if they are better off than the losers, must at the very least be made to compensate the losers, has been abandoned by the Central government. When it signs Free Trade Agreements, or adopts certain macroeconomic policies, that impinge on poorer segments of the population but bring benefits to the capitalists (by way of larger export markets for instance), it should be duty-bound to effect fiscal transfers, through the instrumentality of the state government, from the gainers to the losers. But, this it has never done. It does at present announce occasional "relief packages" for those who are hit by distress caused by its own policies, but such occasional "relief packages", which are completely subject to its discretion, are no substitute for a system of compensation that would be in keeping with the spirit of the Constitution in allocating powers between the Centre and the States. The Fourteenth Finance Commission will play a pioneering role if it takes cognizance of this problem.

23. States are forced to compete with one another for attracting industrial investment by granting tax exemptions, which reduce their own tax revenues. In addition, the Government of India has created a significant distortion in the over-all tax structure by granting Central tax exemption for certain areas, instead of providing direct financial support for infrastructure development for industrial growth in those areas. This has often forced other States to give matching State tax concessions, resulting in further declines in their tax revenues.

VERTICAL IMBALANCE AND DEVOLUTION

24. Against the vertical fiscal imbalance between the Centre and the States that is embedded in our Constitution, the devolution of resources has been woefully inadequate. Thus for example, the total expenditure of state governments is Rs 13.06 lakhs crores as per the budget estimates for the year 2011-12, which constitutes 14.54 percent

of total GSDP. However states' own revenues are only 6.42 lakh crores leaving a gap of ' 6.63 lakh crores. The total transfers from the central government are ' 4.80 lakh crores which constitutes 5.34 percentage of GSDP. This is inadequate to bridge the pre devolution gap of 7.39 percent. Even after devolution the state governments face a gap of 2.05 percent of GSDP which is met by borrowing. These figures, it should be noted, are ex-post; they do not reflect the *requirements* of state governments; even so, the borrowing needs are considerable. The debt crisis of the state governments, we believe, must be seen *inter alia* as resulting from inadequate transfers from the central government.

25. The devolution of Central taxes and grants (net of interest payment by the States on Centrally imposed loans) as a proportion of total revenue receipts of the Centre has been falling between 1990-91 and in 2004-05. *Additionally,* the central government has been forgoing huge amounts of excise and direct taxes. All this has been adversely affecting resource transfer to the state governments. Further, no serious efforts are made to unearth black money. As a result, the actual collection of Central taxes fell significantly short of the amount recommended by the Twelfth Finance Commission, particularly during the years of global recession. The actual amount received by the States has also been substantially less than what was recommended by the Commission.

26. The states have been demanding for long that a fair share of the central taxes should be devolved to the state governments. We consider 50 percent to be a fair ratio. Such a sharp increase in the state governments' share of taxes from its current level would not be debilitating for its finances if the Centre takes the initiative to restructure the channels of resource transfer to the state governments in the spirit of the Constitutional provisions. As can be seen from the table 1, around 45 percent of the resource transfer takes place through channels other than tax share. If a significant reduction is made in the devolution through these channels, particularly the CSSs of different kinds, it should be possible to reach the target of 50 percent share of the taxes to state governments.

27. In this context, our position is as follows:

> At least 50% of the total pool of collection of Central taxes should be devolved to the States.

> The 14th FC should fix a minimum guaranteed devolution of Central taxes from the Centre to the States in absolute terms, on the basis of expected revenue and percentage share for vertical devolution. Any resource mobilization over and above this should be shared in the recommended ratio.

DEVOLUTION AND GRANTS

28. The Constitution has provided for grants to bridge state government's deficits on the non plan revenue account even after the tax devolution. The FC makes an assessment of all revenue receipts (excluding the plan grants) and the non plan revenue expenditure of the state governments for the period of the award. A normative criteria-based methodology to project revenue and expenditure estimates for the States and the Centre has been criticized as arbitrary and heavily biased in favour of the Centre. Estimates based on GSDP growth rates and buoyancy factors were highly ambitious. Non-tax revenue estimates were unrealistically high: five per cent return or dividend on equity in PSUs and recovery of 90% of operation and maintenance costs in irrigation were not only prescribed but also taken as achieved in the subsequent calculations of pre-devolution deficits. This was clearly on the basis of wishful thinking rather than any macroeconomic realism.

Furthermore, non-Plan revenue expenditure (NPRE) was assumed to grow moderately and NPRE projections made by the FC were substantially lower than the experience and estimates of many of the states. The fixing of targets on the basis of these unrealistically high growth rates of tax and non-tax revenue and the underestimation of NPRE has deprived the States of a substantial amount of revenue deficit grant. Instead of the normative approach, an ex ante need-based approach in line with the functional responsibilities of the States should be adopted to evaluate the resources of the States reasonably. The normative approach has meant that the deficit of the States is underestimated, leading to a huge gap in the non-Plan revenue account.

29. We therefore propose that the 14th FC must revert to the earlier practice of accepting the States' assessments of required expenditure and projections of revenue deficits after due examination of their methodology.

30. While in 1950s, the shares of market borrowing of the States and the Centre in the total Government market borrowings were approximately in the proportion of 50:50, this ratio has now fallen to 15:85, with the dominant share of market borrowing being appropriated by the Centre. Consistent with the development responsibilities of the States, the share of market borrowing of the States should be increased from this absurdly low proportion of about 15% to 33.33% immediately and then steadily to 50 % within a period of five year '

31. We propose that State governments should be given concurrent powers for taxation of all services.

DEBT BURDEN OF THE STATE GOVERNMENTS

32. The outstanding debt of all states has risen sharply between 1991 and 2012. Much of this increase in the debt burden took place during the 1990s when revenue account transfers to the states had declined steadily from 5.35 percent of the GDP in 1991 to 4.05 percent in 1999-2000 and the revenue gap of the states had to be financed through larger borrowing. This was also a period when the Centre charged exorbitantly high interest rates which further weakened the finances of the states.

The case of small savings illustrates the point. The Centre charged interest rates on small savings mobilized within a state and given to the state government that were far in excess of the rate given to the small savers themselves. The rate charged to the state governments at one time exceeded even 16 percent, which was above the GSDP growth rate and contributed greatly to the debt build-up of state governments. Even to this date the interest rate charged on such loans to the States has remained significantly higher (often by more than 2 percentage points) compared to the rate of interest paid to depositors of the Small Savings Scheme.

33. A new problem has recently arisen due to the rate of interest on bank deposits becoming much higher than the rate of interest on small saving schemes, resulting in an erosion of small savings collection. In this backdrop it is imperative to re-align the interest rate on small saving schemes to its previously attractive position relative to bank interest rates.

34. There are certain important national level and inter-State issues, such as major irrigation projects, erosion of major rivers, Central investment in CPSUs, railways, national highways, ports, airports, etc, which fall within the territorial jurisdiction of states, and where, even though Central investment is required, the interests of both Centre and States are involved. It is necessary in these cases to ensure inter-State balance while taking decisions. *It is also important to ensure that the Cente does not demand concessions on a competitive basis from states for locating its investment projects.* Of late the railways and AAI, both profit-making bodies, have been demanding concessions from state governments, making them compete against one another exactly the way that private capitalists do, for locating projects in the states. This is a betrayal of the objective with which the public sector was created in the country, and is totally unacceptable.

35. Similarly, there is an urgent need to augment and expand the Public Distribution System in co-ordination with the States, as well as to strengthen the Essential Commodities Act and ensure effective regulatory measures. It is also necessary to revise the royalty rates on coal (and other minerals) more frequently and fix them on an ad valorem basis, and to ensure that coal royalty is paid at the latest revised rates without any discrimination among the States. The present scheme of the National Calamity Relief Fund also needs to be changed in order to increase the corpus of funds for the States.

36. We propose that:

The central assistance to states should not have any loan component except back to back external aid. But if the commission decides to continue with the existing pattern, the prevailing grant – loan ratio of central assistance of 30:70 ratio should be enhanced to 50:50 which is more reflective of the average revenue component of plan expenditure of state governments.

Central loans are a relic of the past as the Centre no longer provides direct loans to states. States have increasingly become dependent upon market borrowing. In fact the states have over the years paid to the Centre, by way of interest and repayment of principal, an amount which is far in excess of what they borrowed. *Therefore, FC may recommend waiver of all past central loans and interest thereon*.

As regards NSSF loans, if our proposal in para 33 is accepted, and collections pick up, then the rates of interest on fresh loans should be so fixed, and on past loans so realigned, that they reflect rates given to depositors after adjusting for the cost of collection. If fresh NSSF loans continue to be marginal, then the FC should consider complete waiver of past loans.

The anomalies resulting from differential interest rates faced by Centre and States should be removed forthwith.

STRENGTHENING THE LOCAL SELF GOVERNMENTS

37. Clause 1 (ii) of the ToR is regarding *"the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State"*.

The devolution by the FCs to local governments started with the 10th FC which recommended an ad hoc grant of Rs.' 5380 crores, The 11th FC raised the Local Government grant to Rs.10,000 crore for five years, i.e. 1.56 percent of the total transfer to the states. The 12th FC raised the grant to Rs.25,000 crore for the local governments. Even though it was a substantial enhancement, in 2007-08 the ratio of local government expenditure to the total expenditure of all the three tiers of government worked out to only 7.15 percent. As a proportion of GDP, the ratio was only 2.3 percent. The ratio for India is one of the lowest among the developing countries and much lower compared to the developed countries: for the OECD countries, for instance, the comparable figure of the ratio of local government expenditure to total government expenditure was 28 per cent and to GDP 12.75 percent.

The 13th FC earmarked 1.5 per cent of total revenues as a basic grant for PRIs and a performance grant commencing at 0.5 per cent in 2011-12, rising to 1 per cent over the next three years; thus, untied grants over the period as a whole averaged out to 2.28 per cent of the divisible pool. The expectation was that this would provide approximately Rs. 60,000 to PRIs over the five-year period.

38. *While this increase in the provision of resources to PRIs is welcome, the tendency to provide grants to PRIs directly, over the heads of the state governments and outside of the consolidated fund of state governments, is a Constitutionally questionable procedure.*

39. We propose the following with respect to transfers to local governments:

The 14th FC should double the allocation for local governments from the present share of 2.5 percent of the national revenue pool to around 5 percent.

The devolution must be through the consolidated fund of the state governments.

The devolution to the local governments must not be considered a part of the tax share of the state governments from the divisible pool.

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