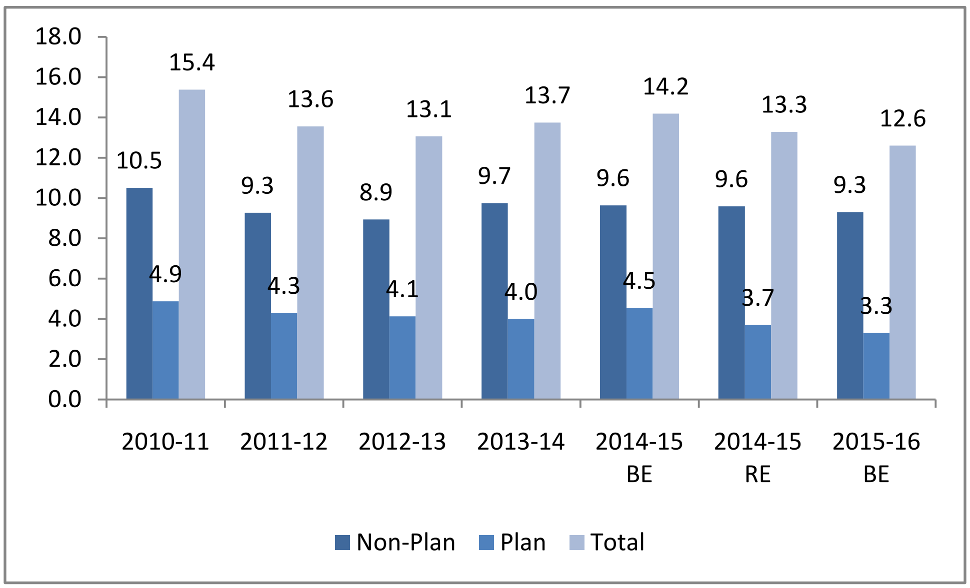
The Myth of Increased Resources for States

Sona Mitra

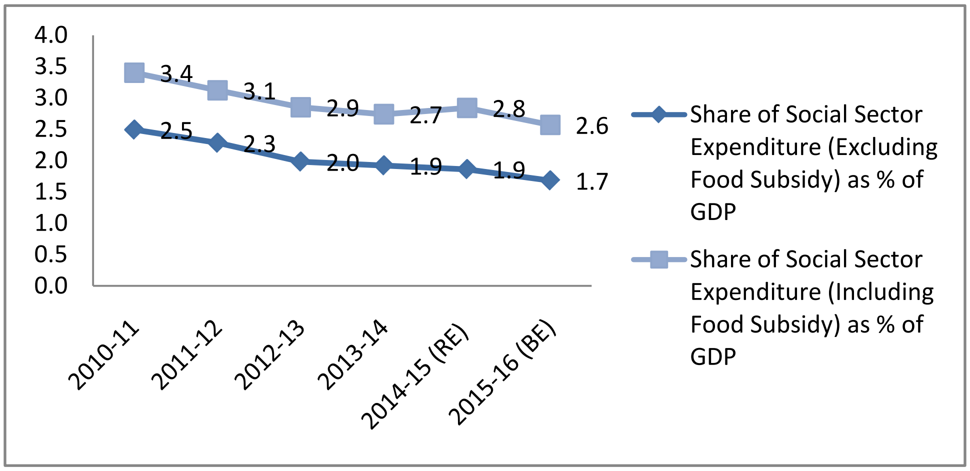
The Union Budget 2015-16 is the first full-fledged budget placed by a government which was elected with a large majority nine months ago. The direction of the Union budget remains fixed at fiscal consolidation with a renewed aggression translating into massive expenditure compression and several concessions announced around tax exemptions, particularly in the realm of direct taxes. The total expenditure of the Union government has declined from Rs.17,94,892 crore in 2014-15BE to Rs.17,77,477crore in 2015-16BE. In nominal terms, the decline in expenditure comes mostly on account of the reduced Plan expenditure of a magnitude of Rs. 1,09,723 crore. However Plan, Non-plan and overall expenditures as percentage of GDP shows a decline, more so for Plan allocations (Chart 1). Further, the cuts in expenditures have been accounted more in the social sector expenditures by select Union Ministries catering to the social sector needs (Chart 2).

Chart 1: Plan and non-Plan Expenditure as share of GDP (in %)



Source: Compiled by author from Union Budget documents, various years

Chart 2: Share of Social Sector Expenditure by Select Union Ministries as Share of GDP (in %)



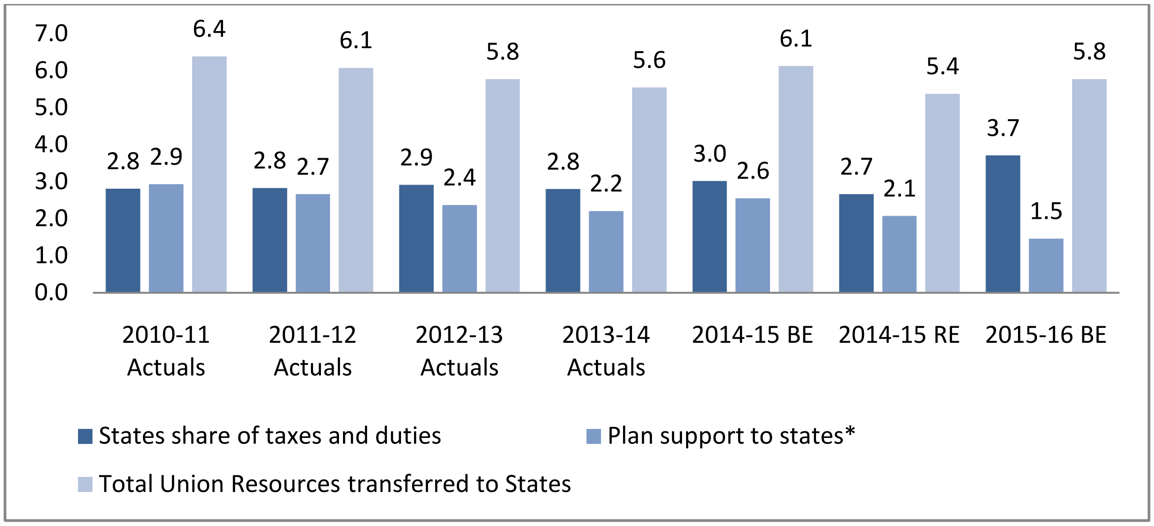
Source: Compiled by CBGA from Union Budget documents, various years

The justification provided by the government for such reduction is on account of the 14th Finance Commission (FFC) recommendations for fiscal devolution to states. One of the recommendations made in the FFC report which was tabled last month and accepted by the Centre, took a major step towards changing the nature of resource sharing between centre and states. The FFC recommended a transfer of 42 percent of the divisible central taxes to the states which amounted to an increase by 10 percent points from its predecessor. The Union budget 2015-16 is the first budget which has been placed following the recommendations of the FFC on Centre-state sharing of resources. The increased share of tax devolution is projected by the government as an increased transfer of resources and also greater autonomy to the states. The government announces this as a first major step towards 'cooperative federalism'.

However a careful examination of the claim of increased magnitude of resource transfer to states proves to be apparently illusory and misleading. Chart 3 below shows that while there has been an increase in the share of taxes devolved to the states as a share of GDP, Total Union resources transferred to states, which comprise of Non-plan and Plan grants, apart from the Central taxes, has marginally declined over the period 2010-11 to 2015-16 BE. While this refutes the first claim of increased overall resources transferred to the states, it also raises a fundamental point about future transfers. Chart 4 shows that the Central Tax-GDP ratio, which actually constitutes the divisible pool of resources, has not improved much in the recent past and has also been projected to increase at a very slow rate. Given this, it could safely be argued that if the size of the overall divisible pool does not increase, merely raising the share of states within it by any amount would not really translate into increased magnitude of resources transferred. It would only occur with substantial increase in the Central Tax-GDP ratio, the forecast for which does not really raise any hope.

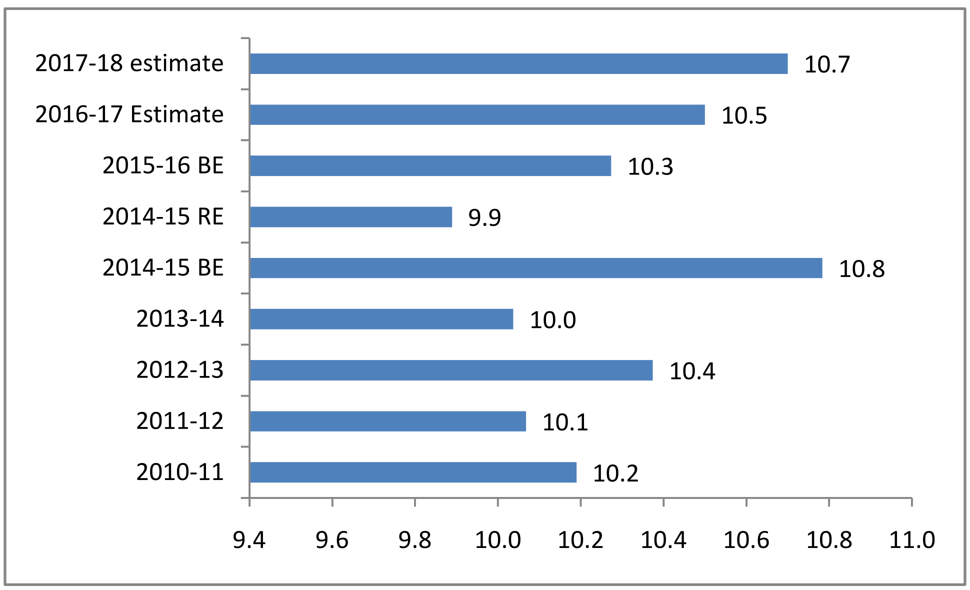
Thus the Union government's argument for reducing Plan support to states due to an increased transfer of untied resources to the states remains unqualified and cannot be an alibi to cut down on important expenditure commitments, specifically those on social sectors. The reduced Plan expenditures by the centre in fact reveal the lack of priority accorded to the social sector commitments of the Union government.

Chart 3: Composition of transfer of resources to states as share of GDP (in %)



Note: *Plan Support to States include CA to State plan, Budget Support for Central Plan and Direct Transfers to implementing agencies till 2013-14, after which the direct transfers were subsumed within the CA to states.
Source: Compiled by author from Union Budget documents, various years

Chart 4: Gross Central Tax Revenue -GDP Ratio (in %)

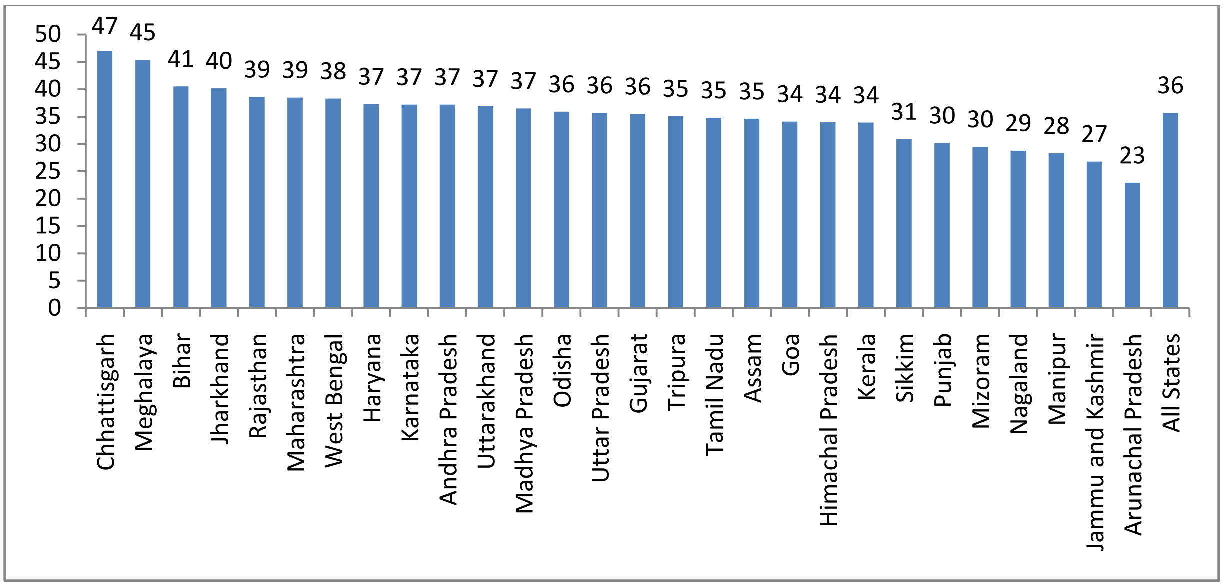


Source: Compiled by author from Receipts Budget, various years and Macroeconomic Framework Statement, Union Budget 2015-16.

The second major claim relates to the increased flexibility and financial autonomy to the states due to a greater share in central taxes. It is of course agreed that with a large magnitude of untied flow of funds from the Centre, the states would definitely enjoy a greater degree of autonomy and flexibility in terms of deciding on their expenditure priorities. However, under the changed fiscal arrangements, the states would act according to the Centre's 'expectations' and raise their social sector expenditures to compensate for the Centre's cuts in the same, only when the availability of overall envelope of resources for the states increase. It would not merely depend upon the flexibility accorded to the states due to raised untied transfers.

The above observation of course follows from two arguments. First, the average overall states' expenditures on social sectors have ranged between 35-40 percent of the total expenditures in the last decade. Chart 5 clearly shows that average social sector expenditures by all states in the last fifteen years have been 36 percent approximately[1]. In order to realise the Centre's expectations of bearing major responsibilities of provisioning for the social sectors, the states would have to undergo massive reprioritization in their spending patterns.

Chart 5: Social Sector Expenditure as Share of Total expenditures by States*
(2001-02 to 2013-14BE)



Notes: * Includes expenditure on social services, rural development and food storage and warehousing under revenue expenditure, capital outlay and loans and advances by the State Governments.
Source: Compiled by CBGA from State Finances: A Study of Budgets, 2013-14, RBI, Mumbai.

It also raises apprehensions about whether all states, specifically the backward ones like Odisha, UP and Bihar are prepared to undergo the reprioritization and planning processes with an immediate effect. This is not to question the capacities of the states to undergo this exercise, but to raise apprehensions for the duration of the gestation period. The ground level evidence available so far has shown that longer gestation periods do imply delays in planning, implementation and distortion in fund flow mechanisms, not to mention further deteriorated social conditions for the poor and marginalized.

Second, much of the states' social sector expenditures were being committed on account of the matching grants in the Centrally Sponsored Schemes (CSS). In the new fiscal arrangement, there also exists a component on restructuring the fiscal arrangements in the CSS. The Union Budget

[1] It is acknowledged that there have been changes in patterns of fund transfers from centre to states, following the recommendations of the different Finance Commissions, specifically from the 10th FC onwards, which has had its impact on the expenditure pattern of the states. In this analysis a broad social sector expenditure trends for all states have been depicted, taking into account all the necessary changes.

2015-16 provides a list of some of the important schemes and programmes dividing them into three distinct categories. It is important to interpret these categories in order to be able to gauge whether the states would be able to redirect and increase their social sector expenditures to the desired extent, given the fixed pool of resources.

The Union Budget 2015-16 in its annexure to Expenditure Budget, categorically states that due to the higher devolution of taxes to the states, the Normal Central Assistance, Special Plan Assistance, Special Central Assistance and Additional Central Assistance for other purposes are subsumed in the Finance Commission award itself. The Centre has thus decided to discontinue eight schemes which include important programmes related to the capacity building of the local bodies such as the Rajiv Gandhi *Panchayat Sashaktikaran Abhiyaan* and Backward Regions Grant Funds. The list is provided in Annex Table 1.

As a second category, the government has announced 31 schemes that would continue to be fully supported by the government (Annex Table 2). It needs to be clarified that full support does not imply 100 percent Union government support. Given the way they have been reported in the budget for 2015-16, it could be interpreted as programmes where the centre-state expenditure sharing pattern continues to remain the same. These comprise of the schemes which represent national priorities especially those targeted at poverty alleviation, schemes mandated by legal obligations such as the MGNREGA and obligations for food security, and those backed by Cess collection like the SSA and the MDM. The fourth criteria for this category relate to schemes which are targeted to benefit the socially disadvantaged group which includes SCs, STs, Muslims and physically challenged sections of the population.

Finally as a third category, the government has listed certain CSS to be implemented with a changed pattern of sharing of resources, with States to contribute higher share, details of which will be worked out by administration ministries. The number of such schemes is 24 including the National Health Mission, ICDS, Swacchh Bharat Abhiyaan and others. The list is provided in Annex Table 3. However, there remains a corollary to the explanation for the modified sharing patterns provided in the budget documents. It has been categorically stated in the Union Budget 2015-16 that:

The Centre-State funding pattern is being modified in view of the larger devolution of tax resources to States as per the recommendations of 14th Finance Commission whereby in this scheme, the revenue expenditure is to be borne by the States.

This announcement implies that the capital expenses for the programmes at the state level would be borne by the Union government. Given the fact that capital expenditure by the states on most of these listed programmes are miniscule and they have a much larger revenue component it would then safely translate as states having to bear much larger share of the expenditures. So a modified sharing pattern essentially marks an increase in the share of states for most of the schemes. Further it may be interpreted as a slow phase out of the schemes from the ambit of the Union government in the coming years after the capital expenditure commitments in the programmes get fulfilled. This of course requires much higher resource allocation for social sectors by the states than what they have committed in the past. And hence it also suggests that the resources of the states, if not increased commensurately, some of the important social sector interventions would eventually wither away due to lack of funds.

The above discussion does hint at the long term intention of the Union government to absolve itself from much of the social sector commitments by transferring bulk of it to the states in the pretext of devolving a higher share of taxes. It is undoubtedly a valid apprehension that whether all the states would be willing and prepared to take up such huge responsibilities in the immediate future. It is not to question the States' intentions, or fiscal federalism per se, but reiterating larger questions about the capacity of the backward states to adapt to the rapidly changing institutional patterns. Moreover, in the coming years, with a reduced envelope of post-devolution revenue deficit grant component now available with the Centre and the conditionalities associated with the revenue deficit grants as recommended by the FFC, the states would have to necessarily maintain low revenue deficits. This might affect the spending flexibility of the states according to their social sector requirements (where revenue expenditure components are usually higher) even after getting higher untied funds from the Centre, thus partly contesting the second claim as well.

Given the above, thus increased autonomy and flexibility in spending abilities for the states would yield improved outcomes based only on the singular issue of whether the overall size of the pie improves for the states. At the moment no such symptoms are visible. However, the arguments provided in this commentary could be validated only in the subsequent years, as soon as the actual figures for overall tax revenue collections as well as state level expenditure estimates begin appearing in the public domain.

Sona Mitra

[The author works with the Centre for Budget and Governance Accountability. Views are personal and do not reflect those of the organisation. All errors and omissions are of the author]

Annexure Tables

Annex Table 1: Schemes to be Discontinued by the Centre

Sl. No.	**Name of Scheme**
1	National e-Governance Plan
2	Backward Regions Grant Funds
3	Modernization of Police Forces
4	Rajiv Gandhi Panchayat Sashaktikaran Abhiyaan (RGPSA)
5	Scheme for Central Assistance to the States for developing export infrastructure
6	Scheme for setting up of 6000 Model Schools
7	National Mission on Food Processing
8	Tourist Infrastructure

Source: Union Budget documents, 2015-16

Annex Table 2: Schemes that continue to be fully supported by Union Government (Where the sharing pattern continue to remain as in the previous years)

Sl. No.	Name of Scheme
1	Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGA)
2	Multi Sectoral Development Programme for Minorities (MSDP)
3	Pre-Matric Scholarship for children of those engaged in unclean occupation
4	Scholarship schemes (Post and Pre Matric) for SC, ST and OBCs
5	Support for Machinery for implementation of Protection of Civil Rights Act, 1955 and Prevention of Atrocities Act 1989
6	National Programme for persons with Disabilities
7	Scheme for providing Education to Minorities
8	Umbrella scheme for education of ST Children
9	Indira Gandhi Matritva Sahyog Yojna (IGMSY)
10	Integrated Child Protection Scheme (ICPS)
11	Rajiv Gandhi Scheme for Empowerment of Adolescent Girls (RGSEAG)- SABLA
12	National Nutrition Mission (NNM)
13	Scheme for protection and development of women
14	Assistance for schemes under proviso(i) to Article 275(1) of the Constitution
15	Special Central Assistance to Tribal Sub-Plan
16	Sarva Shiksha Abhiyaan (Financed from Education Cess)
17	Mid-Day Meal
18	Schemes of North Eastern Council
19	Special Package for Bodoland Territorial Council
20	National Social Assistance Programme (NSAP) including Annapurna
21	Grants from Central Pool of Resources for North Eastern Region and Sikkim
22	Social Security for Unorganized Workers Scheme
23	Support to Educational Development including Teacher Training and Adult Education
24	Border Area Development Programme
25	Member of Parliament Local Area Development Scheme (MPLADS)
26	Cess backed allocation for Pradhan Mantri Gram Sadak Yojna (PMGSY)
27	Roads and Bridges financed from Central Road Fund
28	Project Tiger
29	Project Elephant
30	Additional Central Assistance for Externally Aided Projects (Loan Portion)
31	Additional Central Assistance for Externally Aided Projects (Grant Portion)

Source: Union Budget documents, 2015-16

Annex Table 3: Schemes with changed pattern of sharing between centre and states (Centre to support only *Capital Expenditure* for these schemes)

Sl. No.	Name of Scheme
1	Cattle Development
2	Mission for Integrated Development of Horticulture
3	Rashtriya Krishi Vikas Yojana
4	National Livestock Mission
5	National Mission on Sustainable Agriculture
6	Dairy Vikas Abhiyaan
7	Veterinary Services and Animal Health
8	National Rural Drinking Water Programme
9	Swaccha Bharat Abhiyaan (Rural and Urban)
10	National Afforestation Programme
11	National Plan for Conservation of Aquatic Eco-Systems (NPCA)
12	National AIDS and STD Control programme
13	National Health Mission
14	National Urban Livelihoods Mission (NULM)
15	Rashtriya Madhyamik Shiksha Abhiyaan (RMSA)
16	Strategic Assistance for State Higher Education - Rashtriya Uchcha Shiksha Abhiyan (RUSA)
17	For Development of Infrastructure Facilities for Judiciary
18	National Land Records Modernisation Programme
19	National Rural Livelihood Mission (NRLM)
20	Rural Housing- Housing for All (IAY)
21	Integrated Child Development Service
22	Rajiv Gandhi Khel Abhiyan (RGKA) (erstwhile Panchayat Yuva Krida aur Khel Abhiyan (PYKKA)
23	PMKSY(including Watershed programme and Micro irrigation)
24	Impact Assessment Studies of AIBFMP

Source: Union Budget documents, 2015-16