India's Experiment with Cooperative Federalism – Environment and Development

Policy Brief

BALAKRISHNA PISUPATI

India's Experiment with Cooperative Federalism – Environment and Development

Balakrishna Pisupati

1. Introduction

The 14th Finance Commission (FC) was established by Government of India in January 2013 to make recommendations on distribution between the Union and States of the net proceeds of the taxes, the principles to govern grants-in-aid of the revenues of the States from the Consolidated Fund of India and measures to augment the Consolidated Fund of the States[1].

In making its recommendations, the Commission considered the following:

(i) the resources of the Central Government, for five years commencing on 1 April 2015, on the basis of levels of taxation and non-tax revenues likely to be reached during 2014-15;

(ii) 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;

(iii) the resources of the State Governments and the demands on such resources under different heads, including the impact of debt levels on resource availability in debt stressed states, for the five years commencing on 1

[1] http://finmin.nic.in/14fincomm/14thFinanceCommission.htm (accessed 11 March 2015)

April 2015, on the basis of levels of taxation and non-tax revenues likely to be reached during 2014-15;

(iv) the objective of not only balancing the receipts and expenditure on revenue account of all the States and the Union, but also generating surpluses for capital investment;

(v) the taxation efforts of the Central Government and each State Government and the potential for additional resource mobilisation to improve the tax-Gross Domestic Product ratio in the case of the Union and tax-Gross State Domestic Product ratio in the case of the States;

(vi) 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;

(vii) the expenditure on the non-salary component of maintenance and upkeep of capital assets and the non-wage related maintenance expenditure on plan schemes to be completed by 31 March, 2015 and the norms on the basis of which specific amounts are recommended for the maintenance of the capital assets and the manner of monitoring such expenditure;

(viii) the need for insulating the pricing of public utility services like drinking water, irrigation, power and public transport from policy fluctuations through statutory provisions;

(ix) the need for making the public sector enterprises competitive and market oriented; listing and disinvestment; and the relinquishing of non-priority enterprises; consistent with sustainable economic development; and

(x) the need to balance management of ecology, environment and climate change consistent with sustainable economic development, and

(xi) 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.

In a landmark move to improve cooperative federalism and devolve more resources to the states, the FC suggests, raising the share of states in union government's taxes to 42% from the current 32%.

This means, states will have substantial increases in the amount of resources they will receive. Such allocations are aimed to allow states to greater autonomy in financing and designing of schemes as per their needs and requirements[2].

2. Balancing Environment and Development

An innovative approach was taken by the FC in responding to the consideration on balance management of ecology, environment and climate change (item x above).

[2] http://economictimes.indiatimes.com/industry/banking/finance/finance/finance-commission-suggests-higher-share-to-states-in-central-taxes/articleshow/46354091.cms

The recommendations made by the FC on dealing with balancing environment and development are as follows:

"We recognise that States have an additional responsibility towards management of environment and climate change, while creating conditions on the need to balance management of ecology, environment and climate change for sustainable economic growth and development. Of these complex and multidimensional issues, we have addressed a key aspect, namely, forest cover, in the devolution formula. **We believe that a large forest cover provides huge ecological benefits, but there is also an opportunity cost in terms of area not available for other economic activities and this also serves as an important indicator of fiscal disability. We have assigned 7.5 per cent weight to the forest cover"** (emphasis FC Report, 2014). It also provided the details of horizontal devolution formula that will be used(see graphic) along with a comparison the formula used by the previous FC.

HORIZONTAL DEVOLUTION FORMULA IN THE 13TH AND 14TH FINANCE COMMISSIONS

Variable	Weights accorded 13th	14th
Population (1971)	25.0	17.5
Population (2011)	0.0	10.0
Fiscal capacity/Income distance	47.5	50.0
Area	10.0	15.0
Forest cover	0.0	7.5
Fiscal discipline	17.5	0.0
Total	100	100

Source: Reports of 13th and 14th Finance Commission

(Graphic Source: Business Standard)

Interestingly, the FC in its report mentions that it also recognizes the fiscal implications and regulatory arrangements currently in operation in the country to protect and harness natural resources that have led to shrinking policy spaces for the States. In the same vein, the report also recognizes the need for compensation to States for the forest cover they maintain and need to compensate them for the global public good by recalling the loss States incur in losing income and taxes on account of preserving the forest cover.

This is indeed profound since such an outlook and approach for compensation has not been discussed in the policy spaces in India so far.

The FC calls for establishment of mechanisms that integrate economic and environmental concerns in decision making across different tiers of government.

To further facilitate these actions, the FC recommends in their tax devolution formula the area under forest cover as one of the criteria for states to receive funds from the Union government and urge the new institutional mechanism should become the forum for integrating economic and environmental concerns in decision making.

In other words, the state's share of tax revenues will depend on the forest cover they maintain.

While all of the above are lauded widely both by the media and in the social networks, it is important to also recognize that the genesis for the above could be traced to discussions while finalizing the 12th Five Year Plan for India (2012-2017).

The Planning Commission in 2012-2103 held series of discussions to develop a *sui generic* Environmental Performance Index (EPI) with a set of criteria and indicators to facilitate allocation of central government funds to states. This certainly was a complex exercise and needed consideration of a range of parameters for arriving at the EPI.

3. Environmental Performance Index (EPI)

Chandrasekharan et. al. 2013 in Current Science[3] described the methodology and criteria used for developing the Planning Commission EPI (PC-EPI). Using 5 categories of environmental performance and 16 indicators, the PC-EPI calculated the environmental well-being of states and not just forest cover.

3.1 Environmental performance index criteria and indicators

The PC-EPI considers air pollution, forest cover, water quality, waste management and climate change as the 5 criteria to be used supported by indicators such as respirable suspended particulate matter, amount of nitrogen oxide, amount of sulphur oxide, total forest cover, increase or decrease in forest cover, afforestattion efforts, amount of gorwing stock, percentage of domestic waste water and surface water quality, percentage of ground wtarer usage, amounts of municipal solid wastes, bio-medical and hazardous wastes,

[3] http://www.currentscience.ac.in/Volumes/104/04/0435.pdf

preparation of state action plans for climate change, renewal energy sources growth rate including mini-hydros, electricity intensity of state GDP.

3.2 Options for Devolving Funds

Using the criteria and indicators (as 2012 base year), the PC- EPI based devolution suggested two options for consideration, viz., basing 2 % of gross budgetary support on the EPI ranking of states or adding a weightage point of 2 % to the performance indicator of the existing devolution formula based on the EPI.

Under the first option, using the 11th Plan Outlay (2006-2011), the 2 % comes to Rs. 6,357.36 crores.

4. Where to Look from Here

The recommendations of the FC are merely days old now. Though the Government has accepted the same, it is not clear if the increased financial allocations made to states through the new devolution formula would come with some guidelines and/or roadmap for measuring performance of states to achieve the objectives of national and local development.

For long, states were looking to the centre for allocation of resources for governance both through the state specific allocations, centrally sponsored schemes, grants in aid and others. The sudden flow of resources with limited or no mechanism to guide deployment of resources could turn troublesome. State governments in India, in general, are known for substantive allocations for politically savvy schemes and subsidies. The additional allocations should not be a shot in the arm for indiscriminate spending by the states.

Already voices of dissent to the way states would allocate the additional resources are beginning to emerge[4].

The use of single criteria as forest cover to determine the allocation of resources under the environmental performance category also needs a re-look. Other criteria and indicators to measure progress need to be quickly developed if one likes to see the cooperative federalism work in India with specific focus on environment and development.

5. Conclusions

The importance being given to cooperative federalism is a timely and welcome move by the 14th FC and the government. However, ensuring that this move will yield desired results to enhance better cooperation between the central and state governments requires development of suitable monitoring and impact measurement approaches with appropriate guidance frameworks.

In my recent publication on how India can prepare to deal with future of sustainable development, I made the following recommendation with regard to Centre-State links.

"Sustainable development in India needs to be measured using metrics available at state and national levels. Several components of the Goals currently being negotiated can only be achieved if there is concerted collaboration and consolidation of actions at national and state levels.

[4] http://articles.economictimes.indiatimes.com/2015-02-26/news/59541604_1_bengaluru-mahanagara-palike-urban-local-bodies-karnataka-government

For this to happen, it is important to inform and facilitate effective participation of all states in India in deciding on implementation of the SDGs. In addition to dealing with effective local realization of Goals such as food security, education, sanitation, energy needs, environmental management and economic empowerment, States in India offer a spread- out platform for effective and speedy realization of the SDGs and related targets. It may be appropriate for the new planning body created in India, NITI Aayog to focus on this issue[5]".

India's development is not just reliant on how much of resources are available for reform but how the resources will be spent and reach ensured. Developing approaches for these should be a priority for the Government now.

[5] Balakrishna Pisupati 2015 Sustaining Sustainable Development". FLEDGE, PLR Chambers and IICA.

FLEDGE (Forum for Law, Environment, Development and Governance) is a non-profit trust established in 2014 to support human resource development and capacity building on issues of environment and development.

Contacts:
FLEDGE
26 (old), 43 (new) Thathamuthiappan Street
Chennai 600001
Tel: +91-44-24515473
E.mail: info@fledge.in
Web: www.fledge.in

About the Author

Dr. Balakrishna Pisupati specializes on issues of environment and development with focus on law and policy. He was formerly the Chairman, National Biodiversity Authority, Government of India and Chief of Biodiversity, Land Law and Governance Unit at UNEP-DELC in Nairobi. He can be reached at balapisupati@yahoo.com