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FISCAL FEDERALISM AND INTERPLAY OF REDISTRIBUTION: A STUDY OF TELANGANA STATE'S FINANCES, CAPACITY AND GOVERNANCE

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Introduction

India is a union of states. The Constitution of India clearly demarcates subjects under respective jurisdiction of the Centre and the State governments. Articles 268 to 293 of the Indian Constitution deal exclusively with financial relations between the Centre and the States. Indian federal system was constituted with a strong Centre, the aim here is to focus on redistribution of income and resources to remove vertical and horizontal imbalances. As constitution clearly allocated powers and responsibilities, Dr.B.R.Ambedkar believed that it was Finance Commission's duty to maintain it, the drafting committee recommended Finance Commission to distribute income between States and Centre (Laxman, 2019).Fiscal Federalism is an interplay of politics, economics and public finance (Reddy & Reddy, 2019).The tussle between Centre and the states have been on the grounds of fair redistribution, and non-discretionary transfers of funds. Over the period, the fiscal federalism has garnered increasing importance with regions demanding statehood on the account of backwardness and other political considerations. The article explores the financial relations between central government of India and the newly formed Telangana State. We first begin with a brief literature review limited to our focus of study, we then analyse fiscal transfers mechanisms from Centre to the States with a focus on Telangana State, we move to analyse Telangana State's budget accounts since 2014-15 and its financial relations with the Centre. The aim of the paper is to understand the changing dynamics of redistribution as a policy which is being decentralised, and the limits and priorities set upon governments to pursue economic development.

Literature Review

Fiscal Federalism focusses on economic matters in a multi-level governance, it is particularly associated with the 'assignment' problem i.e., allocation of expenditure and taxation policies in multi-level governance. The problem can be distinguished under the neoliberal (public choice) approach and social democratic (interventionist) public finance

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approach. The former aims to constrain the latter by centralising policy capability, and decentralise aspects relating to redistribution of wealth, expenditure and correcting market failures. It promotes inter-jurisdictional policy competition to encourage or promoteeasy flow of capital. The competition here over a period is institutionalised in constitutional structures. The competition further creates conditions where states workas islands, with siloed relation with Centre, rather thandeveloping an organic unity of being part of a mainland, i.e., cooperation, vertically and horizontally, is compromised. The social democratic public finance approach, on the other hand, seeks to promote policy autonomy, limit harmful policy competition, give scope for cooperation, and importantly allows states to play an interventionist role. (Harmes, 2019)

The Indian federalism is asymmetric. Therefore, the horizontal competencies are different and vertically competencies are shared. Fiscal transfers play a role of equalisation, the associated rules help assess state governments' plan of action towards economic development. In the case of widening disparities, a tussle for resources and policy competition catering towards attracting capital and cheap labour becomes inevitable. That is, over a period, when the strategies pertaining to equalisation fails the consequent disparities will widen capacities of the states to mobilise revenue to boost economic activities. These developments are true across states and also for rural-urban divide within states. While treating unequals equally will never reduce disparities, but a rule-based allocations,seen as autonomy, nonetheless can give states to chart or plan its course of action.

Indian fiscal federalism is on a fiscal consolidation path based on a sound finance principle (Patnaik, 2006), where private finance and public finance are understood to be the same. This is aided by the halt (if not breakdown) of institutional mechanisms in recent years set up for communication or coordination between the Centre and states such Inter-State Council, Zonal Councils, etc. The present NITI Aayog or GST council hardly provide space for states to vent their grievances and lead towards concrete solutions. Therefore, the approach to any broader fiscal agenda is largely top-down, rather than a progressive consensual approach. To this extent, going little back, the states budgeting procedures have begun fiscal disciplining at least since X Finance Commission (FC), and through FRBM Act. On one hand, restrictions and limitations have played an important role in curtailing deficits, and on the other hand the neoliberal rationality restricts states' capacity, including that of Centre's. Given the disparities, these controls and limits hit the poor-resource states unfavourably, and with the sub-regional differences the effect is also on social protection in resource-rich states. The problem is intensified when the transfers to state and local governments do not follow rule-based order, and are not regular. Transfers become all the more important when the states incur 60 per cent of total government expenditure, but their overall share in revenue is only 40 per cent (Reddy & Reddy, 2019).

Fiscal Transfers Mechanism and Trends

For decades, Intergovernmental financial transfers in India went through FC, Planning Commission, ministries, grants and loans. Since 2014, with the replacement of Planning Commission with NITI Aayog, fiscal transfers have turned a new tide, a tide nonetheless. Finance Commission has now become the foremost institution for the fiscal transfers to the states. That is, a rule-based order wherein the transfers would witness transparency, overcoming a system wherein the transfers included bias favouring the party in power. This development in Indian federalism towards statutory transfersis a proxy for autonomy to the states, because such transfers are unconditional. Yet, the rule-based transfer order has witnessed a downward trend, and the fiscal infrastructure has undergone change. We highlight few facts viz., financial transfers to the states and Telangana State:

1. States' share in statutory transfers i.e., share in Central taxes have fallen (see columns G, H of table A; column B of table B). Despite increases in FC grants, the overall share in transfers through FC have declined.
2. There in an increase in grants through central ministries, replacing erstwhile Planning Commission grants (see columnsE, Fof table B).
3. There is an increase in loans from the Centre to state governments (see column I of table B).
4. There is an increase in grants through central schemes and loans, coinciding will fall in statutory transfer of taxes from the centre since Covid-19 lockdown (see columns B, C, I of table B).
5. There is an increase in non-statutory grants (see column H of table B).Non-statutory grants have great scope for discretion.
6. Cesses and Surcharges collected by the Centre are shared with the states (see column D of table A; a comparison of column F, G, H would show us the extent of difference).
7. Statutory transfers to Telangana State have not followed fiscal rules (see columns I, J, K of table A).

Given the above facts regarding the intergovernmental fiscal transfer mechanism in India, the redistribution role of the Centre is negligent if not absent. Yet, we will assume that the Centre's expenditure commitments are absolutely unavoidable, where a compromise in the form of reduction towards states are necessary. However, while considering the status on revenue foregone, it does not provide much to the argument. To state a point, Pranab Bardhan (2022) estimated that tax exemptions, concessions and unwarranted subsidies to the better-off sections amounted to 8% of GDP. For the year 2021-22 this amounts to Rs. 1893171 crores and for the same year allstatescombined fiscal deficit was Rs. 883355 crores (RBI, 2023). To add to the argument, State of Working India (2023) report stated that the real wages growth has been stagnant in the last five years. That is, considering inflation, real consumption is either sticky or has fallen, therefore any increase in indirect tax collections means the poor are burdened the most. Further, MGNREGA funds have been consistently reduced. One can only phrase this as, socialism for the rich and capitalism for the poor. As centre reduced its interventionist role towards social protection, the pressure on the states can only be immense, where attempts towards providing welfare are labelled as populist.

Comparison ofTelangana State Governments' Budgets: From 2014-15 to 2021-22

Telangana State was formed on 2nd June 2014. The state had witnessed growth of its coffers. State's revenue receipts have grown from Rs. 51042 crores in 2014-15 to Rs. 127469 crores in 2021-22. Its capital receipts have grown from Rs. 9657 crores in 2014-15 to Rs. 119100 crores in 2021-22. On similar lines, the state's revenue expenditure grew from Rs. 50673 crores in 2014-15 to Rs. 136803 crores in 2021-22, and its capital expenditure grew from Rs. 11583 crores in 2014-15 to Rs. 113469 crores in 2021-22. Interest rate payments grew from Rs. 5594 crores in 2014-15 to Rs. 19161 crores in 2021-22, which stands at 14% of revenue expenditure for the year 2021-22. Its total Budget grew from Rs. 62256 crores to Rs. 250272 crores.

There are certain trends with which the state finances developed. We present a select few based on the data we presented in the tables, reports and studies:

1. FC recommendations of the divisible pool towards Telangana State has fallen from 14th FC to 15 FC (see table C).
2. The state's fiscal marksmanship is very poor (Ghosh & Chakraborty, 2019), i.e., the difference between budgeted figures and actual figures.Average actual spending is 82.3% of total Budget Estimates for the period 2014-15 to 2022-23 (RE) (Government of Telangana, 2023). Inflated estimates aid in constructing a populist image of the government, and spending is curtailed due to poor estimate of revenue receipts.
3. State's own revenue was Rs. 100128 crores in Rs. 2021-22. However, with the introduction GST, the state's revenue sources are limited. Therefore, the state intensively resorted to excise duties (liquor and fuel) and stamps and registrations (Dharani portal aided) (see table D).The extent and coverage for liquor shops to improve

collections has not contributed to social development. The use of Dharani portal to improve revenue collections has avoided the redistribution of land to the landless question, and has failed to challenge the social structures when seen through landed property as social power. This is further compounded by SGST reimbursements through government orders towards industries and land banks to attract capital.

4. Due to shortfall or gap in monthly revenue collections and irregular transfers of revenue from the Centre, the state has resorted to borrowings from Ways and Means Advances at higher interestrate (Government of Telangana, 2023). Therefore, the pressure on the state finances from rise in interest payments and repayments has been enormous. (see table D).
5. State has extended loans to various departments, but its recoveries are very low. The state's grants to local governments are near zero (see table D).
6. The total accumulated debt amounted to Rs. 389673 crores as on 2023-24 (BE) which is at 27.8% of GSDP i.e., 2.8% over the ceiling set by FRBM Act. Further, the off-budget borrowings amounted to Rs. 282084 crores. The off-budget borrowings went towards mega-infrastructure projects such as irrigation and power sector. (Government of Telangana, 2023)
7. Telangana State's development expenditure as per cent of its GSDP is higher than Centre's development expenditure as per cent of GDP. Further, the state's allocations towards social services are higher than Centre's spending towards social services. The social protection aspect, an important component of redistribution is taken up by the state government. (see table E)

Given the poor redistribute role taken up by the Centre, aided by a centralised revenue policy structure not only limits state's options but pushes for intense exploitation of the options at hand. For Telangana State this intensification has been primarily from excise duties (liquor and fuel), sale of public assets and land, privatisation (in addition to curtailing social spending on education and health), and debt (from market and Centre). Another consequence of the institutionalised fiscal set up is seen in the growth of off-budget accounts and special purpose vehicles. These means have been important to expand social policies and infrastructure, but they came at the cost of transparency, and thereby governance. The governance aspects are critically scrutinised in the recently released white paper on state finances (Government of Telangana, 2023).

Seen in a different light, these developments show that governments' capacities grow, and fiscal transfer mechanisms and targets towards deficits and balances through FRBM Act provide scope for these capacities, or aspirations, to pour outside statutory accounts and treading towards rent seeking. How to bring these capacities into the public domain for regular scrutiny through transparency leading to better governance, andrevisiting FRBM Act limits are important questions. From a political economy perspective, these capacities when seen through state-capital nexus lens and rent seeking i.e., reduction of state's role and unbridled private motives, can further entrench and widen economic inequalities, obfuscating socio-economic policies and governance towards infrastructure projects. Further, given the nature of inter-state competition, with limited public finances and urgent priorities, that is meeting of neoliberal pressures and developmentalism, can push states towards costlier sources of finances, as it is clear with the finances of the Telangana State that without holistic management of state finances, the burden incurred would hurt sustained economic development.

Conclusion

We tried to point to three aspects pertaining to redistribution, policy autonomy and cooperation-competition elements of fiscal federalism to point to the interventionist nature in multi-level governmental set-up. As far as finances are concerned, despite centralising tax policy capacity, the role of redistribution played by the Centre is negligent. The decrease in financial transfers through statutory means (FC recommendations) should be considered as reduced autonomy of states.More importantly, the nature of transfers which is shifting from statutory to discretionary and debt-creating transfers demands a more rigorous analysis. Given the competitive nature of economic growth among states, as state's capacity and purse are restricted, the quest to push developmental agenda came without accountability. That is, as the economic activities or production, say irrigation or energy, occurs outside the statutory budgets of the state government funded and guaranteed by state finances, it is difficult to understand the extent of the use and abuse of public funds. The outcome 'unknown' due to lack of accountability is what the people must appraise carefully the most, because despite a Bayesian belief surrounding such episodes, large projects without critical scrutiny of environmental impact can wreak havoc. Fiscal Federalism in India is truly at a crossroads. Set within neoliberal premise, the relations between Centre and States are therefore ring-fenced around policy and anti-policy, and the need for good governance through transparent budgets and fair redistribution, rather than centralisation and decentralisation.

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Data Sources

- Reserve Bank of India- State Finances: A Study of Budgets (database on Indian economy portal)
- Union Budget Documents (various years)
- Telangana State Budget Documents (various years)
- Economic Survey of India-2023
- Socioeconomic Outlook of Telangana -2023

Appendix (Tables)

Table A: Analysis of Tax Sharing and Finance Commission Recommendations

Year	Centre Gross Tax Revenue* (Rs. crore)	State's share in Central Taxes (Rs. crore)	Cess& Surcharges (Rs. crore)	B-D (Rs. crore)	C as % of B	Actual Transfers (C as % of E)	FC recommendation (%) in Central Taxes	Actual transfers to TS (Rs. crore)	I as % of E	TS's share in central taxes as per FC recommendations (%)
A	B	C	D	E	F	G	H	I	J	K
2015-16	1455648	506193	83998	1371650	34.8	36.9	42	12351	0.90	1.02
2016-17	1715822	608000	126634	1589188	35.4	38.3	42	14877	0.94	1.02
2017-18	1919009	673006	92849	1826160	35.1	36.9	42	14763	0.81	1.02
2018-19	2080465	761454	225849	1854616	36.6	41.1	42	18152	0.98	1.02
2019-20	2010059	650678	159112	1850947	32.4	35.2	42	15977	0.86	1.02
2020-21	2027104	594997	212694	1814410	29.4	32.8	41	12691	0.70	0.87
2021-22	2709315	898392	298943	2410372	33.2	37.3	41	18720	0.78	0.87
2022-23 RE	3043067	948406	390570	2652497	31.2	35.8	41	19668	0.74	0.87
2023-24 BE	3360858	1021448	407788	2953070	30.4	34.6	41	21471	0.73	0.87

Data Source: Union Budget at Glance: receipt statement and transfer of resources to states and UTs statement (various years for column B & C); for cess and surcharges from Union Receipt Budget (various years for column D); Telangana Budget documents (various years for column I); (for column H & K: PRS (2020); *Includes cess and surcharges; FC is Finance Commission; columns E, F, G, J & K are Authors' calculation, and are rounded off to nearest decimal.

Table B: Analysis of Net Transfers to State Governments

Year	As % of Net Transfers to State Governments								
	Finance Commission			Scheme Transfers (Plan Grants)			Other Grants	Central Loans	Gross Transfers
	Tax Devolution	FC Grants	Total	State Plan	Central Schemes	Total			
A	B	C	D	E	F	G	H	I	J
2014-15	51.1	6.6	57.7	30.6	8.7	39.2	3.3	1.8	102.9
2015-16	61.4	7.6	68.9	17.2	8.5	25.7	4.7	1.5	102.4
2016-17	63.2	8.7	71.9	17.1	6.2	23.3	3.9	1.8	102.1
2017-18	60.2	8.1	68.2	3.1	21.8	24.9	6.6	1.9	102.5
2018-19	63.0	7.0	70.1	2.2	18.6	20.7	9.0	2.3	102.4
2019-20	54.9	9.9	64.8	0.5	20.1	20.6	13.9	2.5	102.4
2020-21	43.6	13.4	57.0	0.1	18.4	18.5	15.3	11.4	102.1
2021-22	43.0	13.9	56.8	0.8	27.2	28.0	13.0	4.1	102.1
2022-23 (RE)	43.3	13.6	56.9	0.6	23.8	24.4	10.7	9.7	101.8
2023-24 (BE)	45.8	11.1	56.9	0.5	28.0	28.5	10.9	5.5	101.9

Data Source: Computed from RBI's State Finances A Study of State Budgets (Appendix Table 2);

Note: the list of items is not exhaustive, therefore the difference in the sum totals of Gross transfers. There will be difference in the totals to the sum, inherent, due to differences in the way and time the data is collated by the RBI, this is particular for RE and BE years; the difference between gross and net transfers arises from repayment of loans and interest to the centre by state governments.

Table C: Finance Commission Recommendations on Divisible Pool

State	14th Finance Commission		15th Finance Commission		Difference	
	Share out divisible pool	Share out of 42%	Share out divisible pool	Share out of 41%	B-D	C-E
A	B	C	D	E	F	G
AP	4.31	1.81	4.11	1.69	-0.2	-0.12
TS	2.43	1.02	2.13	0.87	-0.3	-0.15
Total (2 states)	6.74	2.83	6.24	2.56	-0.5	-0.27
Total (All)	100	42	100	41		

Source: PRS (2020)

D. Select Budget Items of Telangana State (in Rs. Crores)

Item	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Receipts								
Revenue Receipts	51042	76134	82818	88824	101420	102544	100914	127469
Tax Revenue	37477	52325	63284	72940	83235	83585	79342	109992
State's Own Tax Revenue	29288	39975	48408	58177	65059	67516	66650	91271
Stamps & Reg Fees	2177	3102	3822	4202	5344	6671	5243	12373
State Duties	2808	3809	5581	9421	10638	11992	14370	17482
Share in Central Taxes	8189	12351	14877	14763	18152	15977	12692	18721
Non-Tax Revenue	13565	23808	19534	15884	18185	18959	21572	17477
State's Own Non-Tax Revenue	6447	14414	9782	7825	10007	7361	6101	8857
Grants from the Centre	7118	9394	9752	8059	8178	11598	15471	8619
Capital Receipts	9657	17585	44975	49291	51028	75595	116645	119100
Internal Debt	9494	16577	43863	48517	50529	75326	113921	114269
Loans and Advances from the Centre	86	921	956	637	433	207	2665	4784
Recovery of Loans and Advances	77	88	156	138	66	62	58	48
Total Receipts	**60699**	**93719**	**127793**	**138115**	**152448**	**178139**	**217559**	**246569**
Expenditure								
Revenue Expenditure	50673	75896	81432	85365	97083	108808	123212	136803
Grants-in-Aid and Contributions	112	140	72	33	5	10	0	0
Interest Payments	5594	7942	8609	10836	12586	14386	16841	19161
Total Capital Expenditure	11583	22027	52391	57768	60068	71307	103789	113469
Capital Outlay	8373	13590	33371	23902	22641	16859	15922	28874
Discharge of Internal Debt	1727	2694	14805	27059	27882	45301	76501	75607
Repayment of Loans to the Centre	0	151	764	412	834	439	490	510

Data Source: Budget documents of Telangana State (various years)

Table E: Select Budget Items (in %) Comparative Picture of Centre and Telangana

Budget Component		as % of GDP (Annual Averages) 2014-15 to 2021-22		as % of GSDP (Annual Averages) 2014-15 to 2021-22
Receipts				
Revenue Receipts*	**Centre**	8.6	**Telangana**	11.5
Tax Revenue (Net)*		7.2		9
Share in Central Taxes				1.8
Cess & Surcharges		0.9		
State Excise Duties				0.9
Non-Tax Revenue		1.5		2.5
Grants from Centre				1.3
Capital Receipts		5.2		6.8
Total Receipts		13.8		18.3
Expenditure				
Revenue Expenditure	**Centre**	12.1	**Telangana**	11.8
Interest Payment		3.2		1.5
Total Capital Expenditure		1.8		7.1
Capital Outlay		1.6		2.6
Debt Repayments				3.7
Total Expenditure		13.8		18.9
Total Defence Expenditure		1.6		
Development Expenditure		6.5		10.5
Non-Development Expenditure		7.4		3.9
Economic Services		4.2		5.2
Social Services		0.8		5.3

Data Source: RBI database; Cess and Surcharges data from Receipt Budget; Economic Survey 2022-23 for GDP figures; State budget documents (various years); socioeconomic outlook of Telangana 2023 for GSDP figures.

Note on data: *Includes cess and surcharges of the centre only; Capital expenditure of Centre excludes public account.

Note on analysis: Authors own calculation. Figures are subject to rounding off to the nearest decimal.