FISCAL FEDERALISM AND SUBNATIONAL FINANCE IN INDIA AFTER THE 2008 FINANCIAL CRISES AND COVID-19 PANDEMIC[1]

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ABSTRACT

The world economies in the recent past were affected by two major crises. First, the 2008 global financial crisis and the second being the COVID-19 pandemic. The common effect of these crises was an increase in public spending and high fiscal deficits of all governments in a multi order federal structure. Likewise, Indian federation was no exception. However, the first crisis in India was largely addressed through monetary policy instruments. Though, fiscal deficit of both- the centre and state governments had risen from 2.5 to six percent of GDP and 1.5 to 2.4 percent of GDP from the fiscal year 2007-08 to 2008-09, respectively. The main factors of this rise were both internal and external. Though the internal factors outweigh the external ones in the rise of fiscal deficits of both the centre and states. The second crisis emanated from the medical emergency due to Covid-19 Pandemic The situation of pandemic was largely disruptive in terms of human lives and economic activity. As a result, the GDP in 2020-21 registered a nominal growth of (-) 7.3 per cent as compared to high positive growth in the previous years. In fact, all sectors declined except agriculture which continued to grow at three percent. The negative economic growth had limited the fiscal space of the governments- both the centre and states. But, later on, the situation fairly improved to the extent that India has again become the fifth largest economy in the world in the year 2022-23.

Keywords: Covid-19, fiscal deficit, fiscal federalism, global financial crises, India, subnational finances.

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I. INTRODUCTION

The Indian constitution is based on federal principles, however, Article one of the constitution affirms that *"India, that is Bharat, shall be a Union*[2] *of States"*. In fact, the constitution has all the features of a federal polity, viz. a) statutorily mandated two orders of elected government (increased to three in 1993) with clear assignment of responsibilities to federal and state governments as contained in the union list (97 items), state list (66 items) and concurrent list (47 items) of the seventh schedule in the constitution b) union and states are competent to enact laws, and c) institutions to support a federal polity including techniques for intergovernmental fiscal transfers (IGFT) to correct vertical and horizontal imbalances. The territories of India consist of 28 states and eight union territories including three with legislature.

India is the largest democracy in the world inhabited by about 1.36 billion people over an area of 3287 thousand square kilometers according to an estimate for 2021 based on Census 2011. Out of total population, more than 0.9 billion were eligible to exercise their adult franchise in 2019 general election for the lower house of parliament.

The Indian economy is characterized as a middle income emerging market economy. At the time of India's independence the mainstay of the economy was agriculture which contributed more than fifty per cent to the GDP. The economy consistently registered low growth due to extensive centralized state intervention and protectionist economic regulation. Due to alarming economic crises emanated from high fiscal deficit, mounting external trade imbalances and double digit inflation, broad economic liberalized policies were adopted in 1991. As a result, India moved from low rate of economic growth to one of the fastest growing economies in the world. Consequently, the share of agriculture declined significantly due to prominence that service sector acquired with about 55 per cent share in Indian economy[3].

The 2008 financial crisis has affected Indian economy in many different ways. This includes three channels, namely, financial markets, trade flows and exchange rate. The GDP growth rate immediately declined by 2.5 percent from 2007 to 2008 and approximately $12 billion worth of investors withdrew from the stock market.[4] The exchange rate which was hovering around 42 INR per USD before the crises, gained the pace and got increased to 53 INR per USD in 2012.[5] The impact was further noticed in current account deficit which was -0.27 percent of GDP (taken as the five year average from 2003-2007) and got increased to -3.21 percent of GDP (taken as the five year average from 2008-20012).[6]

The crisis was largely addressed through monetary policy instruments. Though, fiscal deficit of both- the centre and state governments had risen from 2.5 to six percent of GDP and 1.5 to 2.4 percent of GDP from the fiscal year 2007-08 to 2008-09, respectively. The main factors of this rise were both internal and external. The internal factors included farm loan waivers, sharp rise in the salaries of government employees through the sixth pay commission, and the expansion of livelihood security programme of the centre from 200 districts to all 700+ districts. The sharp escalation of

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2. Though the term 'union' is used in the constitution, 'Centre' is interchangeably used in this paper.

3. At sub-national level, composition of state GDP and pattern of economic growth differs significantly across states.

4. https://insider.finology.in/economy/financial-crisis-2008#:~:text=The%20GDP%20of%20India%20fell,prompt%20in%20answering%20the%20crisis.

5. Reserve Bank of India

6. https://stats.oecd.org/Index.aspx?DataSetCode=MEI_BOP6#

international crude oil prices and global financial crises were external factors. It may be noted that India's dependence of crude oil is more than three fourth of its internal demand. Hence, one may argue that internal factors contributed substantially to the deficits of the centre and states and global financial crises was managed through the central bank.

During the period 2014-19, the average GDP[7] (gross domestic product) growth rate in the country was 6.8 per cent against the world's annual average of 3.5 per cent. The per capita GDP in India recorded in 2021 was at US $ 1936.94 which is equivalent to 15 per cent of the world's average. When the figure is adjusted by purchasing power parity (PPP) the per capita GDP in India is estimated at US $ 6592.04 which is equivalent to 37 percent of the world's average.[8] The article further analysis the pandemic and financial crisis

The second crisis emanated from the medical emergency due to Covid-19 Pandemic The situation of pandemic was largely disruptive in terms of human lives and economic activity. As a result, the GDP in 2020-21 registered a nominal growth of (-) 7.3 per cent as compared to high positive growth in the previous years[9]. This contraction in GDP was largely attributed to a very significant contraction in trade, hotels, transport and communication. In fact, all sectors declined except agriculture which continued to grow at three percent. The negative economic growth had limited the fiscal space of the government and made them to revise its fiscal deficit target to 9.3 per cent of GDP in the covid year[10]. But the situation has fairly improved to the extent that India has again become the fifth largest economy in the world after it was pushed back to sixth position in 2020 due to the impact of pandemic. The US $3.4 trillion Indian economy[11] is on its growth path and it is estimated that India's real GDP might go up by 6.9 percent in the fiscal year 2022-23, with the growth being driven by strong domestic demand, government-backed investment in infrastructure, and a buoyant private consumption, especially among individuals with higher incomes.

This paper is an attempt to understand India's fiscal situation during the time of both 2008 global financial crisis and Covid-19 pandemic and its impact on the Indian federal structure. This paper is divided into five sections. Beside the introductory part, the section two provides an insight over how the fiscal powers are divided in Indian governance and types of fiscal transfers. The third section deals with the federal finance and the macroeconomic management of the crisis. The fourth section analyses the fiscal equity and efficiency through deficits and debt of the centre and state and the intergovernmental fiscal transfers. The final section concludes and discusses broader implications of the findings.

7. GDP is the sum of the gross value added at basic prices, plus all taxes on product, minus all subsidies.

8. https://tradingeconomics.com/india

9. Provisional estimate on national annual income released on 31 May 2021 by National Statistical Office, India.

10. Fiscal deficit in the year 2020-21 was set at 3.5 of GDP in the beginning.

11. The GDP of India consist of about 20 per cent primary sector (comprising agriculture, fishing, forestry, and mining & quarrying), about 25 per cent secondary sector (comprising manufacturing, electricity, gas, water supply & other utility services, and construction), and about 55 per cent tertiary sector (services).

II. DIVISION OF FISCAL POWERS IN INDIAN GOVERNANCE[12]

1. The Governance

The constitution has an arrangement for a separate jurisdiction between the parliament and the legislative assemblies of states and union territories to make laws in their respective areas as stipulated in the central and state lists of the constitution. Like parliamentary elections, there is a provision for election, in every fifth year, of assemblies in states and three union territories, i.e. Delhi, Jammu & Kashmir, and Puducherry in India to elect members of legislative assemblies (MLAs). Election Commission of India conducts both the elections. MLAs of the political party having a majority choose their leader who stakes his claim before the governor of the state to form the government. On the basis of this exercise, the governor appoints the chief minister and other ministers, as per the former's advice. The governor is appointed by the President of India for five years or earlier. In other five territories, the president appoints administrator at the advice of the central government. At sub-national level, the state government, headed by the chief minister, has all the powers to a) legislate matters in the state list of the constitution; and b) administer the state through state civil servants.

Sharp inter-state variations can be seen across all 28 states and eight UTs. Population of Uttar Pradesh, the biggest state is about 340 times than that of Sikkim, the smallest state. The per capita income of Goa, the richest state is about ten times than that of Bihar, the poorest state. Their pattern of economic developments is also different. A few states register double digit economic growth whereas a few others cannot achieve even five per cent. This affects the quality of governance across states. As a result, institutions deciding allocation among states have to take all these factors into consideration.

At the third tier, elections are also held in every fifth year to elect representatives of *panchayats* (rural local governments) and municipalities (urban local governments). *Panchayat* is constituted, through election, in every state at three rungs, i.e. the district, the intermediate and the village[13]. Intermediate p*anchayat* may not be established in a state having a population not surpassing two million. Similarly for urban areas, municipalities are constituted at three levels, i.e. municipal corporation for a large urban area, municipal council for small urban area and *nagar panchayat* for an area having transition from rural to urban[14]. Though these institutions became legal entities through the 74th constitutional amendment act which is a central act but these institutions are defined in the conformity act (state municipal act) based on population, area and activity.

As the local government is a state subject, the state legislature may make their own rules to conduct elections, in every fifth year, through the state election commission. After the election, the group of elected representatives provides leadership to officials in his/her respective local area for delivery of services and preparation of plans for local economic development and social justice as stipulated in the respective state act. There are separate laws in each state for *panchayats* and municipalities. Similarly, separate schedules, eleventh and twelfth, were inserted, among others, in the constitution in 1993 through the seventy-third and seventy-fourth constitutional amendments

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12. This section is drawn upon Alok (2011)

13. See article 243B of the constitution

14. See article 243Q of the constitution.

for *panchayat* and municipalities respectively. These eleventh and twelfth schedules enumerate twenty-nine and eighteen subjects respectively. These subjects are only indicative and not exhaustive. Most subjects in these two lists are state concurrent which lead to overlapping. At any case, it is ultimately the authority of state legislature to make laws on these subjects and devolve functions to local governments.

Hence, election is held at three levels, i.e. parliament, state assembly and local governments. In all the cases, there is an in-built feature of accountability of elected representative. Every fifth year incumbent candidate or party seek re-election for their people who in turn, approve or disapprove them. Accountability of the governments is also fixed through parliamentary proceedings, media, right to information, autonomous audit, ombudsman, vigilance commissions etc.

2. Division of Fiscal Powers

The fiscal powers shared between union and the constituent units, i.e., states in India are mostly stated in the constitution or are specified by the law, like most federations of the world. As mentioned earlier, the powers and jurisdiction of the respective levels of government are set forth in the seventh schedule of the Indian constitution which contains the union list, the state list and the concurrent list (covering areas of joint authority). The residual powers belong to the centre[15]. Therefore, the centre can enter tax fields not classified in the constitution. For example, the central government, under such power, imposed gift tax in the past which was abolished in 1998. Similarly, service tax was also imposed in the beginning of this century under such power. In 2017, the tax has been subsumed under nationwide goods and services tax (GST).

It can be argued that the tax assignment in the Indian constitution is consistent with the theoretical literature on the subject. The special case identified in relation to the power of the states to tax natural resources, like minerals was rectified subsequently by giving dominant power to the Union to levy or regulate the tax on minerals.[16]

However, the Indian constitutional scheme on tax assignment appears to be acceptable on paper, its real working has identified few limitations including the issue of vertical imbalance, despite the fact that considerable number of taxes have been allotted to the states but the buoyant taxes, viz., corporate income tax and personal income tax and custom duties are with the union *(see table 1).* Till 2017, even the central excise duty was also assigned to the centre which has been subsumed under GST. As a result, the union government collects around two-thirds of the combined total revenue. The states along with the local governments[17] collect the rest. Since sub-national governments are assigned two-thirds of expenditure responsibilities (*see table 2*). This requires enormous amount of fiscal transfers from union to state governments (*see table 3*). In any case, vertical imbalance of some degree is viewed as desirable in a federation to guarantee intergovernmental fiscal transfers or redistribution of income to ascertain equity. Such provisions have been designed deliberately by the constitution makers.

15. This provision is contradictory to the principle of subsidiarity under which first choice is given to local government.

16. Mines and Minerals (Development and Regulation) Act, 1957

17. Local governments except municipal corporations collect negligible revenue. For details, see Alok, 2009 and 2019.

Table 1: Tax assignment to various orders of Government*

	Determination of		Collection and administration	Share in combined revenue	
Federal	Base	Rate		Federal	State
Personal income tax (non-agricultural)	Union	Union	Union	6.20	4.06
Corporation income tax	Union	Union	Union	10.74	5.85
Union excise duties	Union	Union	Union	8.03	2.48
Customs	Union	Union	Union	4.72	2.97
Taxes on services	Union	Union	Union	4.59	3.15
Total				34.28	18.51
State or Provincial					
Tax and land and agricultural incomes	State	State	State	0	0.40
Stamp duties and registration fees	State	State	State	0	3.52
Sales tax	State	State	State	0	20.03
State excise duties	State	State	State	0	3.87
Taxes on transport	State	State	State	0	1.71
Electricity duty					1.14
Entertainment tax	State	State	State	0	0.10
Others	State	State	State	0	1.44
Fees, fines. and charges	State	State	State	0	5.56
Total					37.76
Local*					
Property tax User fees on water supply	Provincial Local	Local Local	Provincial Local	N	N

Source: Alok (2023).

Note: Latest actual data are available only for the fiscal year 2015-16. The same is used. Assignment of taxes have undergone changes since the introduction of nationwide Goods and Services Tax (GST) in 2017.

N- Data not available

Table 2: Shares of different levels of government in total expenditures

Item of expenditure	Centre	States	Total	Percent of total expenditure
A. Interest payment	67.0	33.0	100	16.1
B. Defence	100.0	0.00	100	5.5
C. Administrative service	34.2	65.8	100	4.8
D. Social and community cervices	19.5	80.5	100	20.1
i. Education	16.9	83.1	100	10.9
ii. Medical and health	10.4	89.6	100	3.9
iii. Family welfare	55.8	44.2	100	0.9
iv. Others	26.4	73.6	100	4.4
E. Economic services	34.5	65.5	100	24.8
i. Agri. and allied services	32.9	67.1	100	8.7
ii. Industry and minerals	66.8	33.2	100	1.8
iii. Power, irri. flood control	4.1	96.0	100	6.5
iv. Tpt. and communication	52.1	47.9	100	5.5
v. General economic services	74.2	25.8	100	1.8
vi. Public works	13.3	86.7	100	0.5
F. Others	52.5	47.5	100	26.4
G. Loans and advances	5.9	94.1	100	2.2
Total	44.5	55.5	100	100.0

Source: Alok (2023).

Note: Latest actual data are available only for the fiscal year 2015-16. The same is used.

Table 3: Vertical fiscal gaps

(in bn INR)

	Total revenue collected	Total revenue available, after net transfers@ to other level of government	Expenditures
National	27320.93	15846.14	18149.58
State/ provincial	18631.94	30106.73	22853.53
Local	NA	NA	
All orders	45952.87	45952.87	41003.11

Source: Alok (2023).

Note: Latest actual data are available only for the fiscal year 2015-16. The same is used.

@ Transfer to States is calculated @42% from Total Revenue of National Government as recommended by the 14th Finance Commission for the period 2015-20.

NA- Reliable data for local governments are not available

3. Sharing of Central Taxes

In spite of the fact that powers have been assigned to both the union and the states, however, the union cannot appropriate the proceeds of all the taxes collected by them. According to the design of the constitution, revenue from central taxes should be shared with the states to fulfill their necessities.

Since 2000, all union taxes have been brought into a divisible pool and a certain percentage is shared with the states[18]. Historically, only personal income tax and the union excise duties were shared with the states[19]. In addition, the central government used to collect the tax on behalf of the states, under the tax rental arrangements, and then allocated the proceeds among the states on the basis of formula suggested by the successive finance commissions. These were (a) additional excise duties in lieu of sales tax on textiles, tobacco and sugar[20] and (b) grant in lieu of tax on railway passenger fares.

The constitution provides for sharing of all central taxes except a) stamp duty levied by the centre but collected and retained by the states; b) integrated goods and services tax (IGST) in course of interstate trade and commerce; and c) surcharge on taxes and duties and any cess levied for specific purposes by the centre. Only net proceeds of tax revenue are shared, after deducting cost of collections.

In 2017, a nationwide goods and services tax (GST) was introduced.[21] The GST replaced a host of indirect taxes being levied by the central and state governments. It subsumed central excise duty, services tax, additional excise duties, central sales tax, additional

18. Following the constitution (eightieth amendment) act, 2000

19.Sharing of the income tax was mandatory under Article 270 while that of the union excise duties was discretionary under Article 272 of the constitution. These Articles have been amended.

20. These commodities were considered to be of national importance and the states did not levy sales tax on these items as per the agreement, in 1956, between the union and the states

21. Through constitution (one hundred and one) amendment act.

customs duty commonly known as countervailing duty, and special additional duty of customs at the central level; and state value added tax/sales tax, entertainment tax (other than the tax levied by the local governments), octroi or entry tax, purchase tax, luxury tax, and taxes on lottery, betting and gambling at the state level.

The basic attribute of GST implemented in India is that it is based on the principle of destination-based consumption taxation contrary to the earlier principle of origin-based taxation. It is a dual GST with the union and the states simultaneously levying tax on a common base. Centre levies and collects the central GST (CGST) and states levy and collect state GST (SGST). Rates of both GSTs are equal. In addition, an integrated goods & services tax (IGST) is imposed by the central government on inter-state supplies of goods and services and on imports. The GST accounts for 35 per cent of the gross tax revenue of the centre and around 44 per cent of own tax revenue of the states, as per the analysis of the 15th FC.

4. Types of Fiscal Transfers in India

Inter-governmental fiscal transfers (IGFT) from the central government to the states in India go as far back as 1919, and have encountered many changes since the Independence of India in 1947. Like most of the nations, globally, there are two purposes of India's fiscal transfer system which includes, first, correcting vertical fiscal imbalances between the union and the states; and second, correcting horizontal imbalances in fiscal capacity among the states. These two aims are not always independent of each other and have both been integrated into the actual operation of the system. The IGFT from the centre to states/UTs can be broadly categorized as finance commission (FC) transfers and other transfer or non-FC transfers. The FC transfers comprise a) devolution to states/UTs from the union tax divisible pool; b) fiscal transfers to local governments – both *panchayats and municipalities;* c) revenue deficit grants to states incurring revenue deficit even after the central tax devolution; d) grants for disaster management and e) other specific grants. These are made primarily under Article 280 of the constitution, but some of the transfers are mandated under Articles 270 and 275.

Non-FC transfers can be ascribed to article 282 of the constitution which empowers the "*Union or a State to make any grants for any public purpose*". These transfers include central sector schemes[22], centrally sponsored schemes[23] (CSS) and compensation to select states/UTs for GST revenue loss (till 2022). Article 282, inter alia, mandated the institution of planning commission to make 'plan transfers' comprising formula-based unconditional transfers and specific purpose transfers some of which were matching grants. The planning commission was abolished in 2015-16 and distinction of 'plan' and 'non-plan' in budgets was also discontinued.

22. Central sector schemes are hundred per cent funded and executed by the central government on subject in the union list of the constitution.

23. Centrally sponsored schemes (CSS) are designed and funded by the central ministries to attain national goals largely on subjects in the state list of the constitution. State government implements each scheme with a matching contribution up to maximum fifty per cent.

Table 4: Transfers from the Union to States as Proportion of Gross Revenue Receipts

(in per cent)

Commission	Finance Commission (FC) Transfers			Other Transfer (Non-FC)	Total Transfers* (4+5)	Ratio of FC to Non-FC Transfers	Total Transfers as %age of GDP
	Share in Central Taxes	Grants	Total FC Transfers				
1	2	3	4	5	6	7	8
FC-XII (2005-10)	22.03	4.35	26.38	21.01	47.39	55.7:44.3	6.03
FC-XIII (2010-15)	23.80	3.96	27.75	20.47	48.22	57.6:42.4	5.76
2010-11	21.68	3.12	24.79	23.87	48.66	50.9:49.1	6.45
2011-12	25.27	4.35	29.62	23.73	53.35	55.5:44.5	6.17
2012-13	24.84	3.86	28.70	19.96	48.66	59.0:41.0	5.74
2013-14	23.79	4.03	27.82	17.93	45.75	60.8:39.2	5.45
2014-15	23.41	4.28	27.70	18.57	46.27	59.9:40.1	5.35
FC-XIV (2015-19)	31.37	4.51	35.88	14.74	50.62	70.9:29.1	6.30
2015-16	29.66	4.96	34.61	13.24	47.86	72.3:27.7	5.93
2016-17	30.57	4.80	35.38	13.04	48.41	73.1:26.9	6.26
2017-18	31.87	4.37	36.24	16.77	53.01	68.4:31.6	6.55
2018-19	32.88	4.05	36.92	15.45	52.38	70.5:29.5	6.39
2019-20 (RE)	26.15	4.93	31.08	18.61	49.69	62.5:37.5	6.10
FC-XV (2020-21 BE)	27.93	5.34	33.27	18.22	51.48	64.6:35.4	6.43

Source: Government of India (2020) Main Report (pg. 90)

Note: RE means revised estimate; BE means budget estimates

*from 12th FC onwards, transfers include direct transfers to State implementing agencies

FC Transfers include the share in central taxes, general purpose grants and specific purpose grants; and Non-FC transfers include matching grants for vertical programs of union government and other grants.

Consequently, as can be seen in table 4, non-FC transfers have been reduced from 18.57 per cent of gross revenue receipts in 2014-15 to 13.24 percent in 2015-16 after the recommendation of the 14th FC which increased the share of the states in union divisible pool from 32 per cent to 42 per cent. In addition, one can note, a shift in enlarging the total transfers as a share to GDP from 5.76 per cent during the 13th FC period to 6.30 during the 14th FC award period.

5. Union Finance Commission (UFC)

The constitution stipulates the appointment of an independent finance commission by the president of India every five years to make recommendations on the devolution of central taxes and grants to be given to the states[24]. The commission has a chairman who is appointed based on his experience and eminence in public affairs. His status

24. See Article 280 of the constitution

is at par with the minister in the union cabinet. There are four other members whose qualifications for appointment are based on their experience and special knowledge in economics, public administration, law and government accounting. The terms of reference (ToRs) of the commission, as per constitutional provisions, are

(i) *the distribution between the Union and States of the net proceeds of Union taxes and the allocation between the States of the respective shares of such proceeds;*

"(ii) *the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India.*

(iii) *the measures needed to augment the Consolidated Funds 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 Commissions of the State; and*

(iv) *any other matter referred to the Commission by the President in the interest of sound finance."*

Under the last item, a number of tasks had been relegated to the commission in the past like setting the fiscal rules and goals for the union and states, measures to be taken for sustainable development and the security of ecology and environment, rescheduling and writing-off of states' borrowings, assessment of public expenditure management framework, review disaster management systems, strategic way to deal with public enterprise reform and giving incentives to the states to undertake tax reforms, doing away with the losses of power sector, proposing measurable performance- based incentives for states at appropriate level of government, encouraging ease of doing business, supporting digital economy etc.

The commission is the agency that suggests the method for allocating the transfers based on revenue sharing. It is not a standing body and is dissolved after it has made the recommendations and submitted the report to the president of India. Till 2021, fifteen UFCs have submitted their reports. The last was the 15th FC which submitted two sets of reports, the first in December 2019 and the second in November 2020 covering the award period 2020-21 and 2020-26 respectively.

6. Finances of the Local Governments

In general, the functional responsibilities are closely related to the financial powers given to local government. In reality, there is a significant mismatch between the two, resulting in severe budgetary stress at the local and consequent reliance on inter-governmental fiscal transfers. Even in the progressive states, fiscal transfers, *viz.* revenue sharing and grants are main source of finances for the *panchayats* and municipalities. The state finance commission (SFC), which is an autonomous institution to review the financial position of the *panchayats* and the municipalities respectively, defines these fiscal transfers and make recommendations to the governor of the state on the principles that should govern[25]:

25. See Articles 243 I and 243 Y of the constitution

i. "The distribution between the state and the *panchayats* and municipalities of the net proceeds of the taxes, duties, tolls and fees leviable by the state, and their allocation between the *panchayats* and municipalities at all levels for such proceeds;

ii. The determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by, the *panchayats* and municipalities;

iii. The grants-in-aid to *panchayats* and municipalities from the consolidated fund of the state;

iv. The measures needed to improve the financial position of the *panchayats* and municipalities;

v. Any other matter in the interest of sound finance of the *panchayats* and municipalities".

With few exceptions, the states have verbatim reproduced the constitutional provisions and placed them as the terms of reference for the SFC. However, significant variations are noticed in the approach, methodology and recommendations of the SFCs across states and time. Even though, the following common major heads can be found from these diverse recommendations of about eighty SFC reports attempted at different period of time (Alok, 2021). These are: a) global sharing; b) assignment of revenue; c) horizontal distributions; d) grants-in-aid; e) devolution of functions and functionaries; and f) other measures. The heads emanate from the constitutional provisions and common pattern found in SFC reports:

> In general, the capacity to generate its own revenue is very limited for the local governments. The sources which contribute most to the small kitty of own revenue of local governments are mainly, advertisement tax, professional tax, property tax, taxes on vehicles and animals, theatre tax, developmental charges, fees and fines, rental income from properties, user charges on services, etc. The reliance on fiscal transfers is eroding their autonomy to use resources as per their own priorities.

It is, therefore, the central government's responsibility to transfer sufficient funds to the local government through a) UFC mechanism[26] and b) centrally sponsored schemes (CSSs). UFC mechanism is discussed in previous section. CSSs bring about significant conditional grants to local governments. Developmental ministries of central government design and administer these schemes and assign various responsibilities to the local governments for grass root implementation. The budget provisions to such programs have registered a significant growth and the institutional mechanisms tend to provide key role to the *panchayats* and municipalities in their planning and implementation.

III. FEDERAL FINANCE AND MACROECONOMIC MANAGEMENT OF THE CRISIS

The central government, in Indian federation, has a predominant role in macroeconomic management as dependency of a state on centre is high by design. The resource mechanism is small with the states whereas center has large number of resources. On

26. See article 280 sub clauses (3) (bb) (c) of the constitution

the other hand, states are responsible for all the basic primary services to the citizens. Hence, the coordination between central and state governments in fiscal arrangements decides the fate of the state and its people. But, the liberalized policies initiated in 1991 provided opportunities to states to control domestic and foreign investment (Singh and Srinivasan, 2005; Singh 2007). This has enhanced the autonomy and increased the space of states in designing their own economic policies to compete among themselves and attract corporate investments.

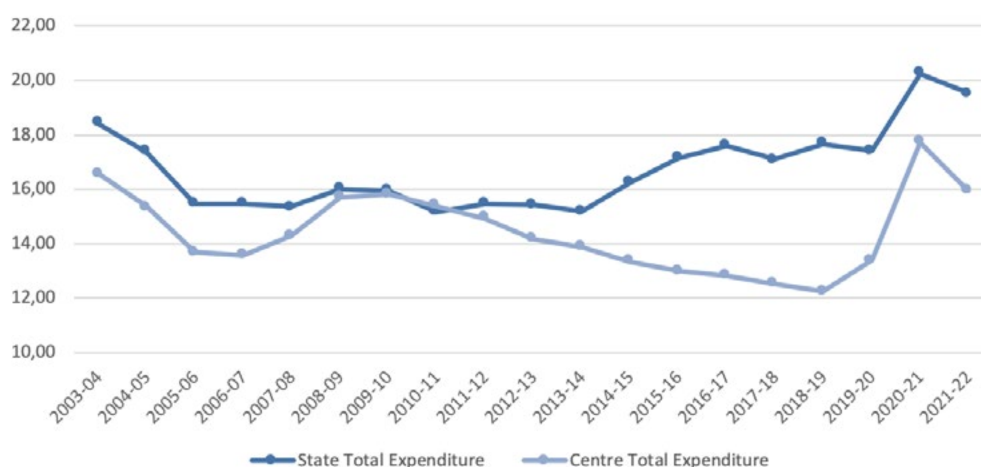
Table 5: Expenditure Pattern of Centre and States

(as % of GDP)

Year	State Total Expenditure	Centre Total Expenditure
2003-04	18.42	16.58
2004-05	17.37	15.37
2005-06	15.46	13.69
2006-07	15.45	13.58
2007-08	15.36	14.29
2008-09	16.00	15.70
2009-10	15.95	15.82
2010-11	15.18	15.38
2011-12	15.47	14.93
2012-13	15.43	14.18
2013-14	15.19	13.88
2014-15	16.25	13.34
2015-16	17.14	13.00
2016-17	17.60	12.83
2017-18	17.11	12.53
2018-19	17.66	12.25
2019-20	17.41	13.38
2020-21	20.23	17.73
2021-22	19.54	15.93

Source: Author’s computation from Reserve Bank of India.
Notes: 1. Data for 2020-21 relate to Revised Estimates while 2021-22 are Budget Estimates.

Figure 1: Expenditure Pattern of Centre and States (as Percentage of GDP)



Source: Author

The changing federal fiscal architecture has enhanced the states' public expenditure. It is the fact that "*total state expenditures as a percent GDP are greater than that of the Union*" (GoI, 2020, p 11) (see figure 1). Such increasing expenditure decentralization is arguably beneficial for macroeconomic performance (Rodden and Wibbels, 2001; Shah, 1999). However, the capacity of state governments in spending on infrastructure is constrained due to their inability to take independent decisions to borrow. States have to take central government's permission for internal borrowing if they are indebted to the latter[27]. As a matter of fact, all states remain in debt to the centre that tends to reschedule the lending. Unlike the centre, the sub-national government can borrow only from internal sources after a prior consent of the parliament. These sources include public sector banks, other state owned financial institutions and national small savings fund comprising largely household savings deposited in post offices[28].

In India, the central government has a larger share of expenditure responsibilities, particularly in areas like defense, external affairs, and major infrastructure projects. However, state governments bear the primary responsibility for delivering essential services like education, healthcare, and law enforcement.

The burden of increase in expenditure was borne by both centre and states during 2008 financial crisis and the covid-19 pandemic. But the total tax revenue as percentage of GDP declined (see table 6) during the same time period majorly for centre. It is observed that post 2008 crisis and covid-19 pandemic, the total central tax revenue declined because of fall in both direct and indirect tax revenues. But the same trend was not observed for state's total tax revenue. In fact, the revenue as percentage of GDP did not declined for the states at the time of crisis mainly because the composition of state's tax revenue comprises of indirect taxes.

27. See article 293 of the constitution.

28. The small savings collected through post offices contribute substantially to total household savings.

Table 6: Direct, Indirect and Total Tax Revenues of Central and State Government

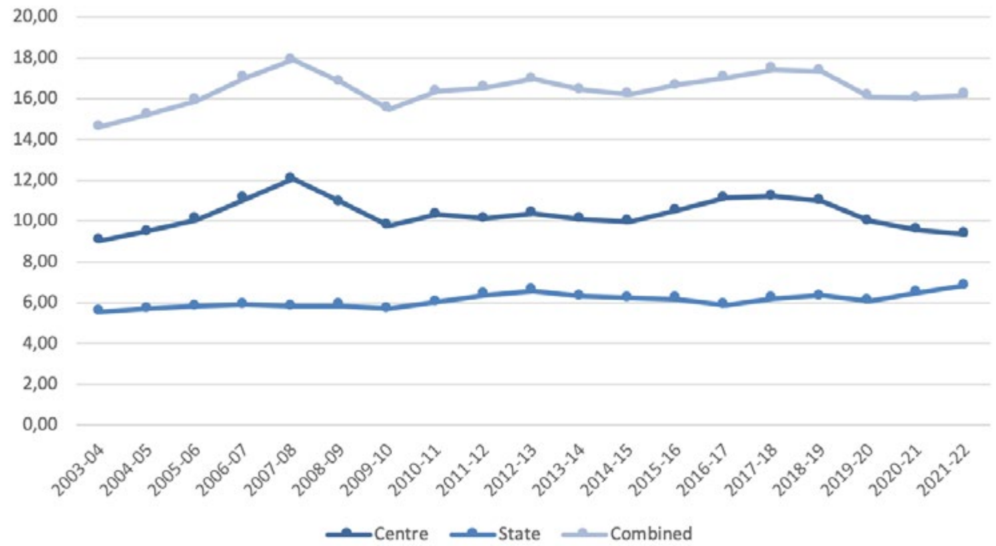
(as % of GDP)

Year	Centre (gross)			States			Centre & States combined		
	Direct	Indirect	Total	Direct	Indirect	Total	Direct	Indirect	Total
2003-04	3.76	5.29	9.05	0.72	4.84	5.56	4.49	10.13	14.61
2004-05	4.17	5.35	9.52	0.75	4.96	5.71	4.92	10.31	15.23
2005-06	4.55	5.49	10.04	0.83	5.00	5.84	5.38	10.49	15.87
2006-07	5.41	5.67	11.08	0.91	5.02	5.93	6.32	10.69	17.02
2007-08	6.37	5.70	12.07	0.89	4.95	5.84	7.26	10.65	17.91
2008-09	6.05	4.89	10.94	0.80	5.05	5.85	6.85	9.94	16.80
2009-10	5.93	3.83	9.76	0.74	4.96	5.71	6.67	8.79	15.47
2010-11	5.84	4.50	10.34	0.82	5.22	6.04	6.66	9.71	16.37
2011-12	5.65	4.48	10.13	0.88	5.50	6.38	6.54	9.98	16.51
2012-13	5.62	4.77	10.39	0.93	5.65	6.58	6.55	10.43	16.97
2013-14	5.68	4.41	10.10	0.79	5.56	6.34	6.47	9.97	16.44
2014-15	5.58	4.38	9.96	0.86	5.39	6.25	6.44	9.76	16.21
2015-16	5.39	5.14	10.53	0.64	5.51	6.15	6.03	10.65	16.68
2016-17	5.52	5.63	11.15	0.71	5.17	5.89	6.23	10.80	17.04
2017-18	5.86	5.34	11.21	0.70	5.52	6.22	6.56	10.87	17.43
2018-19	6.01	4.98	11.00	0.58	5.77	6.35	6.59	10.76	17.35
2019-20	5.23	4.77	10.00	0.83	5.27	6.10	6.06	10.04	16.10
2020-21	4.57	5.00	9.57	0.84	5.63	6.47	5.41	10.63	16.04
2021-22	4.68	4.66	9.34	0.86	5.98	6.84	5.54	10.64	16.18

Source: Author's computation from Reserve Bank of India.

Notes: 1. Data for 2020-21 are Revised Estimates and data for 2021-22 are Budget Estimates.
2. States direct taxes, indirect taxes and total taxes exclude States' share in Central taxes as reported in Central Government Budget documents.

Figure 2: Total Tax Revenues of Central and State Governments (as Percentage of GDP)



Source: Author

In view of the 2008 financial crisis and Covid-19 pandemic, the financial crunch faced by the state governments motivated the central government to enhance the market borrowing limit of states from three per cent to four per cent of state GDP for the year 2021-22. This temporary measure for a year was decided with a rider that a portion of the additional limit was meant for capital expenditure. In the year 2021-22, the states were also allowed to borrow 75 per cent of the limit in the initial nine months of the fiscal. In the year 2020-21 they were allowed to borrow only up to 50 per cent of the annual limit. However, the states, can also secure short term debt of up to 90 days, at low interest rate from the Reserve Bank of India (RBI)[29] which manages the public debt of the central and the state governments and acts as a banker to them. An independent statutory body namely public debt management authority is being contemplated to ease RBI out from this role[30].

29. RBI is the central bank set up on April 1, 1935 and its affairs are governed by a central board of directors appointed by the Government of India in keeping with the RBI Act, 1934. It decides the monetary policy and controls monetary instruments such as bank rate, interest rate, exchange rate, statutory liquidity ratio, cash reserve ratio etc to achieve the goals.

30. https://dea.gov.in/divisionbranch/public-debt-management-cell

Table 7: Revenue Receipts of State Governments

(as % of GDP)

Year	Total Revenue Receipts	Tax Receipts	Share in Central Taxes	Non-tax Receipts	of which	
					Interest Receipts	Grants from the Centre
(a)	(b)	(c*)	(d)	(e)	(f)	(g)
2003-04	11.07	7.92	2.40	3.15	0.28	1.82
2004-05	11.41	8.18	2.47	3.23	0.27	1.77
2005-06	11.87	8.43	2.59	3.43	0.26	2.11
2006-07	12.47	8.76	2.83	3.71	0.28	2.22
2007-08	12.73	8.94	3.09	3.79	0.26	2.22
2008-09	12.60	8.76	2.92	3.84	0.30	2.36
2009-10	12.07	8.29	2.59	3.77	0.24	2.37
2010-11	12.25	8.91	2.87	3.34	0.20	2.14
2011-12	12.57	9.31	2.93	3.27	0.21	2.13
2012-13	12.59	9.51	2.93	3.08	0.24	1.90
2013-14	12.19	9.18	2.83	3.01	0.24	1.83
2014-15	12.77	8.96	2.71	3.81	0.19	2.65
2015-16	13.31	9.83	3.68	3.48	0.13	2.37
2016-17	13.30	9.88	3.95	3.42	0.16	2.31
2017-18	13.58	10.16	3.54	3.43	0.16	2.38
2018-19	13.86	10.38	3.95	3.48	0.17	2.33
2019-20	13.30	9.34	3.24	3.96	0.13	2.66
2020-21	14.10	9.25	2.98	4.85	0.15	3.78
2021-22	14.60	9.65	2.92	4.94	0.11	3.73

Source: Author's computation from Reserve Bank of India
Note : * includes share in central taxes

At the state level, fiscal health depends both on revenues from state taxes as well as constitutional and other transfers from the central government. There is a fiscal transfer mechanism in India. The Indian Constitution provides for mandatory transfer of revenue as percentage share from central taxes on the basis of the recommendation of a union finance commission in every fifth year. Each UFC uses different criteria to transfer funds. In addition, there are optional transfers through various union ministries and agencies. Fund transfers from the central government form a large part of revenue of the state governments.

The trend of receipts of state government over the years may be seen in table 7. The total revenue receipts of the state government declined marginally after the 2008 global financial crisis and this decline continued subsequently. The revenue receipts of the states as percentage of GDP gained pace and reached at 13.31 per cent only after 2015-16. However, the own tax receipts within the total revenue came back on track within two years of the crisis. That shows the fiscal resilience of States. As the states own revenue declined during the financial crises the share in central taxes also declined. Moreover, an effort was made by the central government to increase the grants to the states but this was also not maintained for long instead the grants from centre (as percentage of GDP) started declining from 2010-11 and continued till 2013-14.

During the Covid-19 crisis, the state's total revenue receipts as percentage of GDP increased due to fall in GDP and not because of increase in revenue receipts of states. But, the centre supported states through grants route as the money transferred through share in central taxes could not be increased due to fall in central revenue. Therefore, centre intervened through grants to the states in both the crisis. As tax receipts declined for both the centre and states during the crisis, the situation became difficult for the centre to increase the fiscal transfers to states from the central taxes.

In response to the 2008 financial crisis, the Indian government took several steps to increase public expenditure on infrastructure and social welfare programs. The government prioritized infrastructure development by expediting the implementation of key projects. It may be noted that the rural economy had been affected badly due to the global financial crisis. Hence, the government enhanced spending on rural development programs, i.e. MGNREGA, social welfare schemes like National Rural Health Mission (NRHM), Sarva Shiksha Abhiyan (SSA), and Integrated Child Development Services (ICDS). The government enhanced budgetary allocations for sectors like transportation, energy, irrigation, and urban development. This allowed the increase in public spending on infrastructure projects, leading to job creation, economic growth, and improved public services from the fiscal year 2007-08 to 2008-09.

In order to tackle the COVID-19 pandemic, the Government of India implemented several measures to increase public expenditure on infrastructure and social welfare programs. The government allocated significant funds for the development of healthcare infrastructure, including the establishment of COVID-19 dedicated hospitals, upgrading existing medical facilities, and enhancing testing and vaccination capabilities. The AtmaNirbhar Bharat Abhiyan (Self-Reliant India Mission) was launched to revive the economy and boost public expenditure. The PM Garib Kalyan Yojana was introduced to provide immediate relief to vulnerable sections of the society affected by the pandemic.

IV. CONCERNS OF FISCAL EQUITY, EFFICIENCY AND INTERGOVERNMENTAL FISCAL TRANSFERS

1. Fiscal Equity and Efficiency Concerns

The effect of two shocks on the centre and state deficits is shown in figures below. As it is evident that GDP declined during both the crisis but the fiscal deficit, revenue deficit and primary deficit of the centre and states increased. During the 2008 crisis, the central government provided financial assistance and support to states to manage the fiscal challenges. This support included debt restructuring, grants, and enhanced devolution of funds. The extent of support from the central government helped states in maintaining their fiscal deficits. But, during the Covid-19 pandemic, the central government provided financial assistance and support to states mostly through various schemes during the pandemic. Since the assistance given was mostly indirect and states were allowed to borrow through provisions made in Fiscal Responsibility and Budget Management Act. Earlier the borrowing limit was set at 3 per cent of the Gross State Domestic Product (GSDP), but it was raised to 5 per cent to provide states with additional funds to tackle the COVID-19 crisis.

Table 8: Major Deficit Indicators of Central and State Government

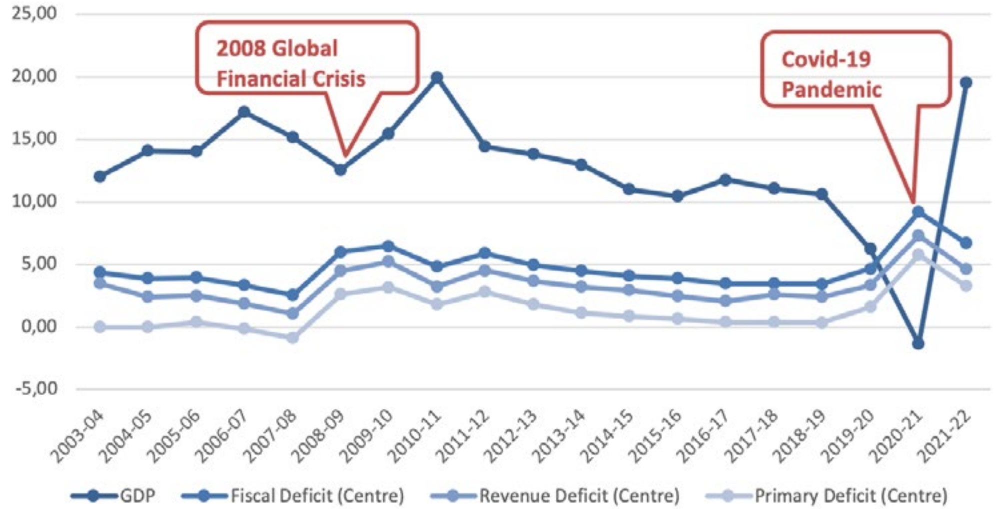
(as % of GDP)

Year	Fiscal Deficit		Revenue Deficit		Primary Deficit	
	Centre	State	Centre	State	Centre	State
2003-04	4.34	4.25	3.46	2.23	-0.03	1.42
2004-05	3.88	3.32	2.42	1.21	-0.04	0.66
2005-06	3.96	2.44	2.50	0.19	0.37	0.16
2006-07	3.32	1.80	1.87	-0.58	-0.18	-0.36
2007-08	2.54	1.51	1.05	-0.86	-0.88	-0.49
2008-09	5.99	2.39	4.50	-0.23	2.57	0.56
2009-10	6.46	2.91	5.23	0.48	3.17	1.17
2010-11	4.80	2.07	3.24	-0.04	1.79	0.47
2011-12	5.91	1.93	4.51	-0.27	2.78	0.36
2012-13	4.93	1.97	3.66	-0.20	1.78	0.45
2013-14	4.48	2.21	3.18	0.09	1.14	0.70
2014-15	4.10	2.62	2.93	0.37	0.87	1.10
2015-16	3.87	3.05	2.49	0.04	0.66	1.50
2016-17	3.48	3.47	2.06	0.26	0.36	1.84
2017-18	3.46	2.40	2.60	0.11	0.36	0.69
2018-19	3.44	2.45	2.40	0.09	0.35	0.76
2019-20	4.65	2.58	3.32	0.60	1.60	0.85
2020-21	9.18	4.72	7.32	2.00	5.75	2.73
2021-22	6.72	3.67	4.60	0.53	3.28	1.71

Source: Author's computation from Reserve Bank of India Source: Author's computation from Reserve Bank of India Notes: 1. Data for 2021-22 are Revised Estimates and data for 2022-23 are Budget Estimates. 2. Negative (-) sign indicates surplus.

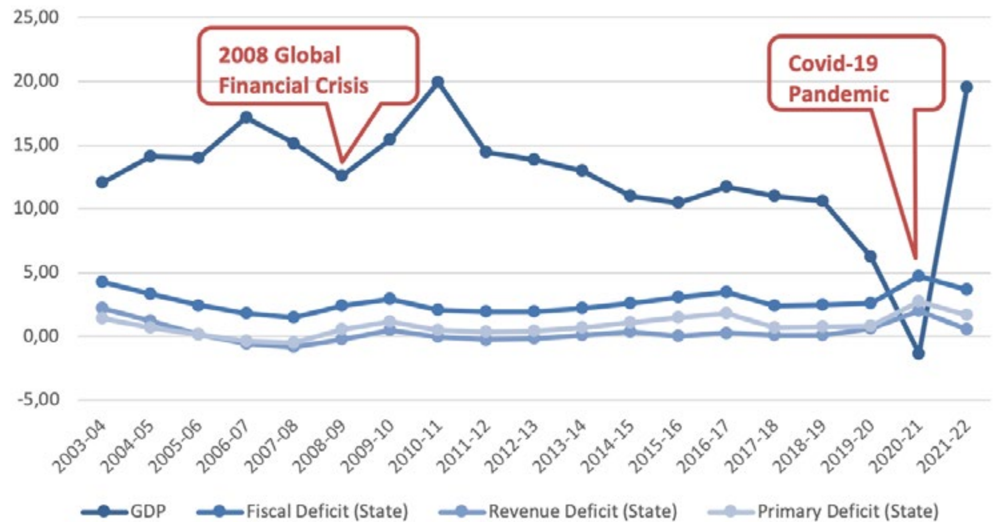
The impact of the crisis is visible on both the central and the state finances. The fiscal burden on centre increased to 9.18 percent of GDP (2020-21) from 4.65 percent of GDP (2019-20). The fiscal deficit of states increased to as high as 4.72 percent of GDP (2020-21) from 2.58 percent of GDP for all the states combined.

Figure 3: Centre deficit vis-a-vis GDP



Source: Author

Figure 4: State deficit vis-a-vis GDP



Source: Author

Table 9: Debt Indicators of Central & State Government

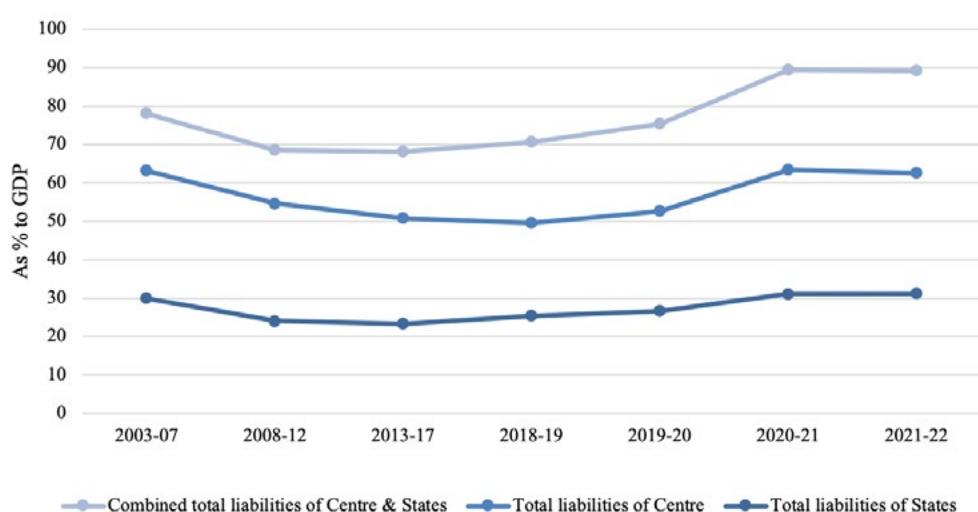
(as % of GDP)

Year (end-March)	Total liabilities of the Centre	Total liabilities of the States	Combined total liabilities of Centre & States
2003-07	63.13	29.94	78.11
2008-12	54.61	24.02	68.48
2013-17	50.83	23.39	68.10
2018-19	49.62	25.33	70.53
2019-20	52.68	26.65	75.33
2020-21	63.32	31.05	89.41
2021-22	62.62	31.17	89.26

Source: Author's computation from Reserve Bank of India

The combined total liability was 75.33 percent of GDP in the pre-pandemic year (2019-20) of centre and states in which the debt of the states was 26.65 per cent of GDP and of the centre was 52.68 per cent of GDP[31]. Though combined public debts have been constantly increasing since 2010-11, but, the extraordinary situation due to pandemic turned this constant increase to a giant leap emanated from shrinking GDP and increasing foregone revenue, public spending and liquidity support. However, this increase is at pace with the current global trend. The situation of combined total liabilities before the 2008 financial crisis was 78.11 percent of GDP (2003-07) which improved to 68.48 percent of GDP post-crisis (2008-12).

Figure 5: Debt Indicators of Centre & State Government



Source: Author

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31. Only central government can borrow from external sources.

Table 10: Major Macroeconomic Indicators from 2003-2022

(In percent)

Year (end-March)	Nominal GDP	Consumer price inflation	Share of public debt in GDP	Share of current account in GDP	Share of Budget revenue	Share of Budget expenditure
2003-07	14.48	4.80	79.35	-0.27	11.28	14.94
2008-12	15.24	9.92	69.29	-3.21	9.70	15.38
2013-17	11.44	5.98	68.15	-1.37	9.24	13.12
2018-19	10.59	3.96	70.78	-2.39	8.81	12.25
2019-20	6.22	3.71	73.72	-1.02	9.62	13.44
2020-21	-1.36	6.63	84.23	1.25	8.54	17.73
2021-22	19.51	5.14	85.16	-1.14	9.21	15.93
2022-23	13.20	6.45	83.47	-	9.43	16.58

Source: Author's computation from Reserve Bank of India, Ministry of Statistics and Programme Implementation, Government of India

The effect of 2008 financial crisis had a huge impact on the inflation rate, i.e., inflation for the post-crisis period increased to 10 percent from 4.8 percent (2003-07) which effected the current account deficit of the country for the same period. However, the case was totally different during pandemic. Due to high government expenditure, the share of public debt in GDP increased to 84.2 percent in 2020-21 from 74 percent in 2019-20. Although the current account deficit became positive (1.25 percent of GDP) after 15 years. This evidently showcases that the nature of crises has different effect on the macroeconomic variables of the country.

The imbalance in expenditure responsibilities can strain the finances of state governments. Therefore, the arrangement of central transfers to the states and local governments has been an effective way to manage the finances in general and during the uncertain times. Although there are certain caveats in the transfers made which has been discussed in the following section.

2. Concerns of Intergovernmental Fiscal Transfers

The allocation of resources between the centre and the states and among the states begins with a discussion on vertical fiscal imbalance and horizontal imbalances. The vertical imbalance between the centre and the states was created through the constitutional assignment of expenditure responsibilities and revenue powers. The central government has more resources and state governments carry more responsibilities. In order to correct this vertical imbalance formula based IGFT from centre to states was envisaged.

In this context, the UFC has been recommending a share from the net proceeds of all central taxes (after deducting cost of collection, cess and surcharges). It started with the recommendation of the 10th FC (award period 1995-2000) which estimated 28 per cent states' share in the divisible pool. Successive UFCs made incremental increase to this share till 32 per cent that the 13th FC recommended for its award period 2010-15. The

year 2015, was the turning point for Indian federal finance when the age old Planning Commission was abolished. The UFC acquired the status of the only institution for IGFT between the centre and the States. Consequently, the 14th FC (2015-20) recommended a quantum jump to this share from 32 per cent to 42 per cent. As explained earlier, a portion of this share was to cover up the discontinuation of various grants that the Planning Commission used to provide. The 15th FC (2020-26) made it 41 per cent after adjusting the central government share that rose due to the additional responsibility for newly carved out union territories of Jammu & Kashmir and Ladakh.

From the states' aggregate share, the UFC distribute the resources among the states to correct horizontal imbalances. This horizontal devolution by successive UFCs has been based on objective parameters reflecting equity and efficiency considerations. In fact, it has been the endeavor of all UFCs to keep a fine blend of equity and efficiency in their formula for horizontal distribution among states that are heterogeneous in their fiscal capacities. However, no two UFCs adopted identical formula. All of them are of different varieties carrying the flavor of the then UFC. The series of these formulas are divided into two phases and summarized in the box given below:

Phases in Horizontal Devolution

Phase 1: From First to Seventh Finance Commission

- Till 7th FC, income tax and union excise duties were shared using different parameters.
- Income tax was broadly shared using population and tax contribution parameters.
- The 3rd FC considered equity parameters like relative backwardness, backward caste/ tribal population, financial weakness etc. for distribution of union excise duty for the first time.
- In the case of distribution of union excise duty, the 7th FC considerably reduced direct weightage of population and increased weightage of equity parameters, like inverse of per capita income, percentage of poor, etc.

Phase 2: From Eighth to Fifteenth Finance Commission

- 8th FC to 10th FC recommended similar parameters, including equity considerations, for distribution of both income tax and union excise duties.
- After the eightieth amendment to the constitution in 2000, a single sharing formula from the divisible pool of taxes was recommended. Parameters used by earlier finance commissions continued in the formulae.
- Weight for equity parameters increased significantly, with a proportionate decrease in direct weight for population.
- The 10th FC introduced fiscal performance criteria for the first time with 10 per cent weight to tax efforts of states. Later, criteria like fiscal discipline and fiscal capacity were used by finance commissions.

Source: Government of India (2020).

Successive UFCs have been constructing formula comprising parameters and their relative weights. These parameters harmonize the attributes of equity, need and cost disability and performance for horizontal devolution of resources. 'Income distance' with high weights (about 50 per cent) has been used for equity consideration[32]. The criterion is acceptable to all states for redistribution of income among states. It makes the formula more progressive and provides higher IGFT to states with lower per capita income. The UFC uses per capita gross state domestic product (GSDP) as a proxy for state's tax capacity. Generally, low per capita income represents poor state (mostly more populous state) in need of resources to provide comparable public services. As can be seen from table 5, it was only the 13th FC which used 'fiscal capacity' instead.

32. The 15th FC assigned 45 per cent weight to this criterion.

Table 11: Criteria and weights assigned for horizontal Distribution (For States)

Criteria	11th FC	12th FC	13th FC	14th FC	15th FC
Population	10	25	25	17.5	15.0
Income	62.5	50	-	50	45.0
Area	7.5	10	10	15	15.0
Index of Infrastructure	7.5	-	-	-	-
Tax Efforts	5	7.5	-	-	2.5
Fiscal Discipline	7.5	7.5	17.5	-	-
Fiscal Capacity	-	-	47.5	-	-
Demo Change	-	-	-	10	12.5
Forest Cover	-	-	-	7.5	10.0

Source: Reports of various Union Finance Commissions, India

Note: FC means Finance Commission

Table 12: Criteria and weights assigned for horizontal Distribution (For Local)

Criteria	11th FC	12th FC	13th FC	14th FC	15th FC
Population	40	40	50	90	90
Area	10	10	10	10	10
Distance	20	20	20	-	-
Decent/Devolution Index	20	-	15	-	-
Revenue Efforts	10	20	-	-	-
Deprivation Index	-	10	-	-	-
Grant Utilization	-	-	5	-	-

Source: Reports of various Union Finance Commissions, India

Note: FC means Finance Commission

'Population' and 'area' of a state represent the 'need' factor. All UFCs used population as a criterion which is simple and transparent. The 15th FC has assigned 15 per cent weight to this indicator. 'Area' of the state is another indicator which reflects need for simple reason – the larger the area, the higher is the resource requirement for public services. The 14th FC and the 15th FC assigned 15 per cent weight to this indicator. 'Forest cover'

for the first time was used by the 14th FC in the formula. The 15th FC retained it and assigned even higher weight due to the merits of this indicator. It serves two purposes. First, the state needs to be compensated for this 'cost disability', and second, it is considered beneficial for environment purpose in the interest of the nation or even the world.

In order to incentivize fiscally prudent states, criteria such as 'tax efforts' and 'fiscal discipline' were used. These criteria reflect performance and efficiency and intend rewarding states for efficient tax collection. This is important as tax evasion and avoidance are high in states. Likewise, 'fiscal discipline' encourages states to adhere to the targets set by the 'fiscal responsibility and budget management act', under which revenue deficit, fiscal deficit, public debt, etc. need to be contained. In addition, the 15th FC used 'demographic performance' as a criterion which reflects performance of states in their efforts to move towards the replacement rate of population growth. Such states also get better outcomes in health, the 15th FC believes.

The IGFT arrangements between the states and their local governments stipulate every state to constitute, at regular interval of five years, a state finance commission (SFC), and assign it the task of IGFT to *panchayats* and municipalities from state's kitty. However, state government is not as serious about SFC as the central government is about the UFC. This conclusion can be drawn based on the following general treatments to SFC. First, SFC is not constituted at a regular interval of five years in some states; second, loyal retired civil servants and side lined politicians are made members of SFC; third, SFC reports sometimes are not placed in the legislative assembly, and fourth, if the report is accepted, the money is not released. These practices weaken the institution of SFC (Alok, 2021).

A review of the SFCs' reports suggests that IGFT design by SFCs takes into considerations the following fiscal attributes: equity; fiscal needs and cost disability; fiscal efforts and efficiency. Various indicators reflecting these attributes have been used. These include total population, ratio of backward and tribal population, population below poverty line, population density, population per hospital bed, area, backwardness of the area, remoteness index, distance from state capital, length of road, literacy rate, sex ratio, index of infrastructure, income distance, own income efforts, tax efforts, etc. (Alok, 2021).

Local governments receive a large amount of resources from UFC. As mentioned in table 12, six UFCs, so far, have recommended fiscal transfers to the local governments and attempted to: a) equalize basic civic services, b) provide incentives for strengthening accounts and audit and c) set rules to strengthen SFCs. The recommendations have been subject to considerable criticism mainly on the following grounds:

- The grants provided are too small to make any difference to the functioning of about quarter million local governments.
- The formula used for the allocation among the states were needlessly complicated and proved to be ineffective in promoting the cause of decentralized governments.
- Contours of decentralization across states have never been very clear and each UFC adopted *ad hoc* approach that too of different variety breaking the continuity. For instance, the fiscal transfers to local government that the 13th FC recommended was not in the form of lump sum *ad hoc* grant but a share in the central tax divisible pool so that the local government could share the revenue buoyancy of central taxes. This practice, based on its inherent merits, could have been followed by the successive UFCs, but the 14th FC discontinued it without assigning convincing reasons.

- UFCs attempted, though half-heartedly, to enhance capacity of local governments by making conditional grants. These conditions had been formed based on practices prevalent in a small southern state. It remained difficult for almost all states to fulfil those conditions and claim conditional grants. The next UFC complicated the issue further by recommending different set of conditions to claim performance grants.

Table 13: Union Finance Commission Grants to Local Governments

(in bn INR)

<table>
<tr><th>Finance Commission</th><th>Panchayats</th><th>Municipalities</th></tr>
<tr><td>10th [1995-00]</td><td>43.81</td><td>10.00</td></tr>
<tr><td>11th [2000-05]</td><td>80.00</td><td>20.00</td></tr>
<tr><td>12th [2005-10]</td><td>200.00</td><td>50.00</td></tr>
<tr><td>13th [2010-15]</td><td>630.51</td><td>231.11</td></tr>
<tr><td>14th [2015-20]</td><td>2002.92
(for village Panchayats only)</td><td>871.44</td></tr>
<tr><td>15th [2020-21]
First report</td><td>607.50</td><td>292.50</td></tr>
<tr><td rowspan="2">15th [2021-26]
Final report</td><td>2368.05</td><td>1210.55</td></tr>
<tr><td colspan="2">Health sector grants to local governments = 700.51</td></tr>
</table>

Source: Reports of various Union Finance Commissions, India

Note: bn = billion; INR = Indian Rupee

V. CONCLUSION

The 2008 global financial crisis led to a decline in tax revenues of the Government of India and states due to reduced economic activity and consequent fiscal stimulus that lead to a widening fiscal deficit. Increased public spending on infrastructure and social welfare programs were parts of fiscal stimulus. These measures aimed to revive economic growth and mitigate the negative impact on public finances.

On the other hand, the COVID-19 pandemic had a severe impact on India's economy and public finances. To contain the spread of the virus, the government implemented strict lockdowns, resulting in a significant decline in economic activities and output loss. This led to reduced tax revenues, increased public expenditure, and a consequent surge in fiscal deficit of the centre and states. The government introduced a fiscal policy involving relief packages to support affected sectors and income support to vulnerable populations. This enhanced the economic recovery of the country. These measures included direct cash transfers, enhanced healthcare spending, and loan moratoriums. However, the increased public spending and lower revenue generation caused a strain on public finances, resulting in a widening fiscal deficit and increased public borrowings.

The robustness of Indian federalism was put under test during the 2008 financial crisis and covid-19 pandemic. The center acted as bulwark during the crisis as it was observed

that state liabilities were not much impacted in comparison to liabilities of the centre (see table 9). The effect of 2008 financial crisis had a huge impact on the inflation rate, i.e., the inflation for the post-crisis period increased to 10 percent from 4.8 percent (2003-07) which effected the current account deficit of the country for the same period. However, the case was totally different during pandemic. Due to high government expenditure, the share of public debt in GDP increased to 84.2 percent in 2020-21 from 74 percent in 2019-20. Although the current account deficit became positive (1.25 percent of GDP) after 15 years.

Overall, both the 2008 financial crisis and the Covid-19 pandemic had adverse effects on India's public finances. The government implemented expansionary fiscal policies to support economic recovery and mitigate the impact of these crises. However, these measures also led to increased fiscal deficits and higher borrowing levels due to fall in revenues and increase in expenditure (see table 5 and 6). Interestingly, it is observed that after the 2008 crisis the average central and state debt for the period 2008-12 declined from 63.1 and 30 percent of GDP to 54.6 and 24 percent of GDP, respectively. On the other hand Covid-19 pandemic had an immediate adverse impact on both centre and state, as the debt increased to 63.3 and 31 percent of GDP from 52.7 and 26.7 percent of GDP, respectively.

The long-term consequences of these crises on India's public finances may require sustained efforts to restore fiscal stability and achieve a sustainable growth trajectory. This evidently showcases that the nature of crises has different effect on the macroeconomic variables of the country. In order to strengthen the intergovernmental fiscal relations among centre, states and local governments issues related to equity, transparency, accountability, ownership need to be addressed. They are considered as growth inhibitors and create political tensions among different levels of governments.

It is essential to recognize that in order to handle an uncertain situation, a continuous evaluation of the evolving global and domestic fiscal landscape is required. Flexibility, adaptability, and proactive policy measures with equitable distribution will be crucial in addressing any economic crises of any kind.

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