Finance Commission's workings need a greater degree of transparency

India's federal structure is under stress on several grounds, particularly tax devolution between Centre and states, and among states. Finance Commissions play a critical role in the devolution process. However, a drawback in their approach has been the absence of an adequate level of transparency on the underlying reasons for significant changes in devolution formulae

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Fiscal transparency of the Finance Commissions in India is a matter of urgent concern. Fiscal transparency refers to the information and data available to the public about the government's fiscal policy making process. Finance Commissions are constituted every five years to decide on the magnitude and criteria of tax transfers. However, the data with Finance Commissions and the tax transfer formula designed are completely opaque to the public.

The processes of deciding the magnitude of devolution and the selection of criteria to decide the tax sharing formula are confined within the Finance Commission, even though recommendations of the Finance Commissions have so far remained "conclusive" as they have been accepted without any amendment by the Union government.

A wealth of data that is beyond reach

Fiscal transparency depends on the “clarity, reliability, frequency, timeliness, and relevance of public fiscal reporting and the openness of such information to public”, as explained by the IMF. Recently, the 16th Finance Commission Chairman Professor Arvind Panagariya made a powerful statement regarding the fiscal transparency of the Commission. He highlighted that there is no mechanism so far that brings together data generated by various Finance Commissions in one place. He highlighted that a lot of statistics are compiled each time by the Finance Commission, and there is a need to preserve this data, creating a data portal.

This suggestion for fiscal transparency is welcome. As Fourteenth Finance Commission report pointed out, “the challenge is to reconcile the objective of comprehensiveness with the need to reduce the voluminous information in these documents in order to make them informative and easily understood by the general public”.

Finance Commissions in India, over the years, have recommended policy suggestions for improving state-level fiscal transparency in budgetary processes and debt-deficit dynamics.

This issue of fiscal transparency gained attention in India in the early 2000s when the country embarked into the fiscal rules and budget management. Professor Indira Rajaraman then noted that “(n)othing is said about the transparency of functioning of the Finance Commissions themselves. Alterations of tax-sharing formulae from one commission to the next are rarely justified, or predicated on research findings on the efficiency and equity outcomes of fiscal transfers from centre to states, which include more than just the statutory transfers prescribed by the finance commissions”. She further noted that “even the database assembled every five years at national expense is withheld from the public domain. The best-kept fiscal secret is how much each finance commission costs the country, aggregating across establishment expenditures by the centre, and expenditures by state governments”.

Professor M Govinda Rao also highlighted in his various research papers, the need to have transparent deliberations about the equity versus efficiency principles of the Finance Commissions. This is all the more relevant for

16th Finance Commission when the “efficient” States with relatively higher per capita income and controlled population growth seek fiscal justice from the 16th Finance Commission while they decide on the tax sharing formula not to shrink their fiscal space.

Uneven flow of information can undermine systemic stability

The origins of fiscal transparency debates in India dates back to 1998, when India became a signatory to adhere to the IMF set of fiscal codes (IMF’s Codes of Good Practices), ex-post to the East Asian financial crisis of 1997. A research paper published by NIPFP examined the various aspects of fiscal transparency and the issues before the 16th Finance Commission.

Fiscal transparency is built on the premise that it is crucial for financial stability and the information asymmetries are a significant cause of financial-fiscal failure.

India received a good score on fiscal codes of transparency, based on the enactment of fiscal rules. These fiscal rules stipulated that the threshold ratios of fiscal deficit to GDP as 3 percent. Phasing out of revenue deficit (golden rule) was yet another. However, the fiscal transparency related to the subnational governments have become a matter of equal concern, and the design of tax sharing is crucial over there.

Schedule 7 of Indian Constitution clearly envisions the assignments of functions across different levels of government. However, over the years, the fiscal codes of transparency relate to intergovernmental fiscal mechanisms including the Finance Commissions, have become matters of debate. We hope that the 16th Finance Commission will take up the fiscal transparency issues positively, and design the tax sharing formulae.

We also hope that 16th Finance Commission will debut the creation of a data portal for wider access. This is all the more relevant when the GSDP data relates to a crucial variable “income distance” in the existing tax sharing formula with 45 percent weightage – to calculate the “distance” of income of the States from the higher income State. It is collated from visits to states and from State specific statistical bodies, but is not accessible to wider public. The reassuring statement by the Chairman of the 16th Finance Commission about data transparency and permanency is welcome.

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