

The severe erosion of fiscal federalism

The Hindu

Paper - II
(Polity)

On February 8, Kerala Chief Minister Pinarayi Vijayan will lead a protest in New Delhi against the Centre for “placing Kerala on a financial embargo”. The Kerala government has accused the Centre of pushing the State into a severe financial crisis by imposing a limit on its borrowings. Kerala has moved the Supreme Court contending that the Centre’s imposition of a Net Borrowing Ceiling (NBC) on the State, which limits borrowings from all sources, violates Article 293 of the Constitution. The wide array of constitutional issues that are now thrown open point at the severe erosion of fiscal federalism in the country.

What is net borrowing ceiling?

The NBC limits the borrowings of States from all sources including open market borrowings. The Centre has decided to deduct liabilities arising from the public account of the States to arrive at the NBC. In addition, borrowings by state-owned enterprises, where the principal and/or interest are serviced out of the Budget, or through assignment of taxes or cess or any other State revenue, are also deducted from the NBC.

Kerala is particularly agitated by the inclusion of debt taken by state-owned enterprises as the State’s own debt. Major infrastructure projects initiated by the State government are funded by the government statutory body called the Kerala Infrastructure Investment Fund Board (KIIFB), primarily through extra-budgetary borrowings. Since the debt of KIIFB is now included in the NBC, the State government claims that it is not even able to fund pensions and meet expenses for welfare schemes. Is the Centre within its constitutional limits to impose such harsh conditions on the finances of States?

Determining State finances

According to Article 293(3) of the Constitution, the State has to obtain the consent of the Centre to raise ‘any loan’, if ‘any part of the previous loan’ extended by the Centre is outstanding. The imposition of the NBC is done by invoking the powers of the Centre under Article 293(3).

On close scrutiny, the Centre’s decision to include extra-budgetary borrowings by state-owned enterprises in the total debt of the State is constitutionally suspect. The Union Finance Minister justified the decision by relying on the 15th Finance Commission Report, which says, “Governments at all tiers may observe strict discipline by resisting any further additions to the stock of off-budget transactions and contingent liabilities which is against the norms of fiscal transparency and detrimental to fiscal sustainability. One very important purpose of our recommendation for higher borrowing limit to the Union and State Government is to foster transparency and to avoid build-up of non-transparent liabilities.” Notably, the Finance Commission has not called for the inclusion of the debt of state-owned enterprises in the NBC.

Parliament does not have the power to legislate upon the ‘Public Debt of the State’ as this finds place in Entry 43 of the State List of the Constitution. Therefore, the power to make laws on, administer and determine aspects of the public debt of the State falls squarely on the State Legislature.

The State government raises another crucial argument that the balances in the public account of the State should not be included in the NBC. The State relies upon Article 266(2) of the Constitution which indicates that the money collected by the Central or State government, which do not pertain to the consolidated fund, can be brought under the head of 'public accounts'. Small savings, security deposits, provident funds, reserve funds and other treasury deposits constitute 'public accounts'. All activities related to public accounts fall within the domain of the State Legislature and the Centre has no power to include the withdrawals from public accounts in the NBC.

State territory

The Kerala Fiscal Responsibility Act, 2003, which is enacted by the State Legislature, spells out the fiscal deficit targets for the State. It says that Kerala shall reduce the fiscal deficit to 3% of the GSDP by 2025-2026. When a State Act provides for budget management and fiscal discipline, it is not desirable to have external supervision on the finances of the State by the Centre. Under Article 202 of the Constitution, it is the State government that is tasked with determining the revenue and receipts and corresponding expenditure and with presenting the Budget of the State before the Legislative Assembly. Budget management of the State is the discretion of the State government. The territory occupied by the State executive and legislature cannot be ceded to the Union executive and Parliament in the name of fiscal management. Even otherwise, Kerala's fiscal deficit is reported to have significantly reduced to 2.44% and revenue deficit to 0.88% of the GSDP. In the Centre's case, the fiscal deficit is estimated to be 5.8% for for 2023-2024.

The KIIFB was a novel idea in Kerala to fund infrastructure and development projects through extra-budgetary spending. But the State's responsibility to fund development work cannot come in the way of it delivering justice to pensioners and beneficiaries. If the Kerala Finance Minister is to be believed, not permitting the State to borrow will affect the State's spending on welfare schemes. This can lead to a catastrophic situation in the revenue-scarce State. The character of India's federalism is moving rapidly from cooperative to one that is destructive and annihilative. The borrowing restrictions are an example of 'annihilative federalism' at play.

Expected Question for Prelims

Que. Consider the following statements with reference to net borrowing ceiling-

1. It is implemented using the powers of the Center under Article 293(3).
2. Recently, Net Borrowing Ceiling (NBC) has been imposed on Kerala by the Centre.

Which of the statements given above is/are correct?

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|------------------|---------------------|
| (a) Only 1 | (b) Only 2 |
| (c) Both 1 and 2 | (d) Neither 1 nor 2 |

Answer : C

Mains Expected Question & Format

Que.: What is the net borrowing limit? What is the current dispute between the Central Government and Kerala regarding this? Discuss.

Answer's Approach:

- ❖ Explain the net borrowing limit in the first part of the answer.
- ❖ In the second part, discuss the current dispute between the Central Government and the Kerala Government regarding the net borrowing limit.
- ❖ Finally give a conclusion giving suggestions.

Note: - The question of the main examination given for practice is designed keeping in mind the upcoming UPSC mains examination. Therefore, to get an answer to this question, you can take the help of this source as well as other sources related to this topic.