

# Books

**THE RULES OF THE GAME: Indian Fiscal Federalism** by Y.V. Reddy and G.V. Reddy. Oxford University Press, New Delhi, 2019.

THE authors have produced a valuable contribution to the literature on federalism in India. As the title indicates, their focus is on *fiscal* federalism, the institutions and behaviour that determines how governments at different levels raise, spend and transfer funds. This is narrower than federalism more generally, since that would include political and judicial institutions, which determine divisions of powers more broadly, including spheres of legislative and legal authority and action. At the same time, the book's introduction begins, 'Fiscal federalism in India can be viewed, in practice, as a game in politics, economics and public finance played between the Union and States.' As the introduction elucidates, fiscal federalism has to be considered in a broader context, and its rules only specify part of the larger political economy game that takes place in any country, but particularly in one with India's scale and diversity.

The book has many strengths. It is clear and concise, while covering the full range of India's fiscal federal institutions, their historical origins and evolution, and how they have impacted public finances at different levels of government. Each chapter has well defined and clearly titled sections, and almost all include an end-

of-chapter summary that reviews the preceding content. A few specific references are provided at the end of each chapter, rather than being gathered at the end of the book. Because the book comes after a period of significant changes in India's fiscal federal institutions, its timing is particularly valuable. The chapters on the NITI Aayog, successor to the defunct Planning Commission, and the Goods and Services Tax Council, governing implementation of a major recent reform in indirect taxes, represent the first treatment of these developments that is integrated with consideration of the other features of Indian fiscal federalism.

The structure of the book is straightforward and sensible. It begins with the origins of Indian fiscal federalism in the colonial period, then provides an overview of its evolution. This is followed by an excellent summary of the Finance Commission, a core institution of Indian fiscal federalism, including its structure and its performance over the decades. These four chapters are a wonderful introduction to the basics of the subject at hand. The following two chapters consider vertical distribution of funds between the Union and the states, and horizontal distribution across the states, both based primarily on formulaic tax sharing. Each of these chapters provides a clear chronological summary of how successive Finance Commissions handled questions of balance between responsibilities and resources, and issues of equity across subnational jurisdictions.

Chapter 8, as its title (The Detail Matters) indicates, provides more detail on various aspects of vertical and horizontal distributions and of the factors that have influenced the methodologies used.

The intervening Chapter 7 discusses grants-in-aid from the Centre to the states, and the varied and *ad hoc* nature of these grants is reflected, perhaps, in the absence of a summary and of references for this chapter. Instead, the chapter ends with a section titled 'Issues', which tries to come to grips with the multiple and sometimes contradictory goals of these grants. Perhaps the lack of conclusiveness in the discussion reflects the problematic status of grants-in-aid in Indian fiscal federalism, as compared to formula-driven tax sharing.

The topics in the book's first eight chapters represent the core, one might say, 'classic' issues of Indian fiscal federalism. They are slightly more than half the book's length. The next eight chapters, together with an Afterword, provide a more varied consideration of specific topics and recent developments. Chapter 9 tackles what could have been the most important modification (also summarized in Chapter 2) of Indian fiscal federalism in the nation's history, the creation of a constitutionally protected third layer of local governments. The treatment of this topic is again clear and concise, with historical background and a straightforward assessment of the weaknesses of local governments in terms of revenue autonomy and fiscal control. However, topics that could have been given more attention include the differences between urban and rural local governments, the political and constitutional constraints to strengthening local governments, and the reasons for states' varied failures to decentralize effectively. Some of these are mentioned in Chapter 2 but not revisited here.

Chapter 10 considers the Goods and Services Tax (GST) Council as a new institution of 'cooperative' fiscal federalism. Indeed, the authors view the GST Council as 'a shining example' of this cooperation, since the Centre and states were able to come together to share a common tax base. What is important to realize is that the structure and assignment of indirect taxes that had evolved prior to the 1980s was so inefficient that reforms were desperately needed. The various versions of Value Added Tax (VAT), which provides the conceptual underpinnings for the GST, and the overcoming of uncoordinated, cascading sales and other indirect taxes, were a story of bargaining and cooperation that preceded the GST Council, and that could possibly have been described in more depth.

Chapter 11 turns to asymmetric federalism, which can have several dimensions, political and cultural as

well as economic. Much of this chapter focuses on so-called Special Category States, which were, to some extent, a creature of the Planning Commission. Divisions of states, particularly that of Andhra Pradesh (AP) into AP and Telangana, have created demands for expanded inclusion in this classification, because of the more favourable terms for transfers from the Centre. Given the demise of the Planning Commission, and the projected extinction of Special Category States, at least in their current incarnation, this chapter might have better followed Chapter 12, which covers the Planning Commission's chequered history.

The issue of the Planning Commission, and its successor, the NITI Aayog (Chapter 13), raise the question of federalism and development. The concepts of 'classic' fiscal federalism, involving vertical transfers and horizontal equity, are often implicitly based on a relatively static perspective on the economy – growth and development are not considered. The Planning Commission, the NITI Aayog, and possibly the approach to Special Category status, all foreground economic development. However, there has never been conceptual clarity in Indian fiscal federalism on how growth considerations should affect the nature of intergovernmental transfers or other aspects of federal institutions. The area of urban infrastructure and local government reform is another example of development related issues in fiscal federalism. It is not clear how a relatively short book could have tackled these issues, but they are worth highlighting. Certainly, if development requires investment, and investment requires targeted public funds, those linkages should be recognized in designing and managing the institutions of fiscal federalism. Perhaps one connection that could have been explored in these later chapters is the proliferation and persistence of various discretionary project or programmatic transfers, such as the numerous 'Centrally Sponsored Schemes'. These are only treated earlier in the book.

Chapter 14, on public debt and the Finance Commission, raises similar issues of conceptualization. The focus of the chapter is on fiscal management, and worries about large or growing deficits and of stocks of debt have been of particular concern for India's states (though less so than for subnational units in some other nations, such as Argentina and Brazil). The underlying issue, of course, is whether public borrowing leads to productive investment and higher growth, which in turn can make it possible to service or manage the higher public debt. Again, the problem is that the fiscal federalism literature has not given developmental issues enough attention, though there are exceptions.<sup>1</sup> Fur-

thermore, as argued here, the practice of fiscal federalism in India has not always dealt clearly with these developmental issues, a point that does not quite rise to the surface in the book.

The final two chapters of the book summarize aggregate transfers from the Centre to the states (Chapter 15), and consider the 15th Finance Commission, which faces unusual challenges (Chapter 16). To some extent, the first of these two chapters sets the stage for the second, since the latest commission's Terms of Reference (ToR) have the potential to roll back some of the increased flexibility and total of transfers resulting from the recommendations of the last commission. The latest commission also has to deal with the consequences of the implementation of the GST and the end of the distinction between plan and non-plan expenditures. Other items in the ToR are consideration of how grants-in-aid are determined; the requirement to use 2011 population figures, which will have horizontal equity implications; conditions for states to borrow; and possible performance based incentives for the states.

The book concludes with an Afterword, subtitled 'The Way Forward'. This is an exemplary summary of the issues that face Indian fiscal federalism at this moment in time, and further increases the value of the book. The authors emphasize the potentially centralizing biases of the current government, both in its vision of national economic development, and in the ToR for the 15th Finance Commission. The Afterword also revisits, or in some cases articulates explicitly for the first time, broader conceptual issues of efficiency and externalities, centralization and decentralization, public versus private goods, and specific issues in the operation of the Finance Commission and the NITI Aayog. Indeed, echoing the analysis in Chapter 13, the latter is seen as lacking sufficient effectiveness and impact. Perhaps one should not be surprised by that, in a situation where the national government itself is operating in a relatively centralized manner, with expertise being drawn from a limited range of sources.

1. For India, see, for example, M. Govinda Rao and Nirvikar Singh, *Political Economy of Federalism in India*, Oxford University Press, New Delhi, 2005; M. Govinda Rao, 'Making Federalism Work for India's Development', Chapter 2, in N.A. Khan (ed.), *Challenges and Issues in Indian Fiscal Federalism*. Springer, Singapore, 2018, pp. 9-13; Nirvikar Singh and T.N. Srinivasan, *Federalism and Economic Development in India: An Assessment*, in N. Hope, A. Kochar, R. Noll and T.N. Srinivasan (eds.), *Economic Reform in India: Challenges, Prospects, and Lessons*, Cambridge University Press, New York, 2013; more generally, see Barry Weingast, 'The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development', *Journal of Law, Economics and Organization* 11(1), pp. 1-31, 1995.

These kinds of issues bring one full circle to the political and economic 'game' of fiscal federalism. The manner in which democracy functions, the state of the judiciary, the way in which various regulatory institutions work, geopolitics, and social and cultural factors all feed into the manner in which fiscal federalism is conducted in India. What has been of interest in analyzing the Indian experience is how core institutions of fiscal federalism such as the Finance Commission and, somewhat different in categorization, the tax system, have survived the buffeting of these varied forces over many decades. Federal systems tend toward centralization, because of the inevitable dominance of the national authority, but India's scale and diversity have acted as checks on this bias.

The authors have done a remarkable job of producing a lucid, comprehensive, reasoned and up-to-date account of the working of Indian fiscal federalism. I am not sure that they have really come to grips with analyzing the larger political and economic game that continues to go on with respect to Indian federalism. M. Govinda Rao and I attempted something more in that vein, but much has happened since our work was completed 15 years ago. No doubt, others will keep writing on Indian federalism, including fiscal federalism, and hopefully they will revisit these bigger issues and the larger game being played. (Indeed, Dr Govinda Rao, whose work on this topic has been prolific and path-breaking, receives a special acknowledgment from the authors.) But the authors cannot be faulted for limiting their scope, since they have produced a compact, immensely readable volume that should serve as a primary reference for all scholars of the subject, and any policymaker who wishes to understand this critical aspect of governance in India. Even non-specialists will find the book accessible and informative, and I would actively recommend it to anyone interested in the Indian economy in any of its various aspects.

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**UNEVEN SOCIAL POLICIES: The Politics of Subnational Variation in Latin America** by Sara Niedzwiecki. Cambridge University Press, New York, 2018.

IN January 2019, West Bengal Chief Minister Mamata Banerjee declared that her state would stop implementing the prime minister's flagship health insurance





scheme – PMJAY/Ayushman Bharat – which provides up to Rs 5 lakh health cover per family per year.

‘Today we are withdrawing from the Ayushman Bharat scheme. Now, the Centre will have to bear the entire cost of the scheme as we will no longer pay our share of the money. Why should we pay if it [Centre] takes all the credit? The Centre is sending letters to people from post offices saying that it has done health insurance for them. How can they take credit when the state governments bear 40 per cent of the cost for this scheme?’<sup>1</sup>

Similarly in Madhya Pradesh, the new Congress state government led by Kamal Nath decided not to facilitate implementation of the PM-KISAN cash transfer programme, introduced in February’s Union budget as a bid to reverse farmer dissatisfaction ahead of the 2019 Lok Sabha elections. Former BJP Chief Minister Shivraj Singh Chauhan said that the new state government was deliberately not cooperating with the central government’s PM-KISAN scheme by refusing to share its list of farmers with the central government. He said ‘The MP government is not sending the list of farmers as it feels Modi will benefit if the money goes into the accounts of the farmers.’<sup>2</sup>

Attempting to put clear water between the BJP’s national scheme and the state government’s policy, Kamal Nath announced instead that his state government would be rapidly implementing its own loan waiver scheme before the Lok Sabha elections.

Decisions by state governments to either block or hinder the implementation of national policies – even where they are fully funded by the Centre – illustrate the ways in which political competition between the central and state governments can undermine the effective reach of centrally designed social policies.

Sara Niedzwiecki’s new book, *Uneven Social Policies*, explores precisely these dynamics in the context of social policy implementation in federal settings. While Niedzwiecki studies Latin American federations, there are many insights from her work that would be useful for understanding the dynamics in India.<sup>3</sup>

1. ‘Mamata Banerjee pulls out of PMJAY, says Centre taking credit’, *Indian Express*, 11 January 2019 <https://indianexpress.com/article/india/mamata-banerjee-pulls-out-of-pmjay-ayushman-bharat-scheme-says-centre-taking-credit-5532864/> West Bengal eventually agreed to implement the national programme, but under a joint banner with its own scheme – Ayushman Bharat – Swasthya Sathi with the cost shared between the central government and state government on a 60:40 basis.

2. ‘Congress-ruled Madhya Pradesh focuses on own loan waiver scheme, delays PM Kisan Nidhi’, *Economic Times*, 6 March 2019.

3. For a preliminary discussion of some of the contrasts between Latin America and India in this area, see Louise Tillin and Anthony

Niedzwiecki argues that there are two main types of social policy. First, there are a set of policies that clearly ‘belong’ to the national government and in which the attribution of responsibility for the policy is very obvious to voters. As examples, she uses conditional cash transfer (CCT) schemes such as Brazil’s *Bolsa Família* (family allowance) or Argentina’s *Asignación Universal por Hijo* (universal child allowance). With these programmes there is a direct transfer of cash from the central government to individual beneficiaries on a non-discretionary basis and without the involvement of intermediaries at the state level. It is clear to individual beneficiaries that CCTs are central government policies, and there is evidence that these kinds of policies have helped national presidents get re-elected in countries ranging from Mexico, Brazil to Uruguay.

With such policies, Niedzwiecki argues, there are strong incentives for opposition ruled subnational governments to hinder or refuse to implement them. They have various means of doing so, including refusing to share lists of beneficiaries with the national government, or simply failing to instruct their staff to work on national policies. They can also introduce their own programmes which compete with national programmes.

Second, there are a set of policies in which attribution of responsibility is less clear. This includes the case of social services such as health care, where funding is transferred from higher levels of governments to clinics or health care providers at the subnational level. It is less easy for voters to attribute responsibility for such services to a particular layer of government.

For such services, Niedzwiecki suggests, the quality of implementation is less affected by vertical political alignment between the national and subnational governments. There is still considerable unevenness in how these policies are implemented across space, but the variation is caused by institutional capacity and the nature of subnational policy legacies, rather than by a deliberate attempt by opposition ruled subnational governments to undermine the performance of national policies.

Niedzwiecki tests her theory about the impact of vertical political (non) alignment on the implementation of different types of social policies with a mixture of statistical and qualitative analysis, focusing on the two most decentralized countries in Latin America – Argen-

Pereira, ‘Federalism, Multi-Level Elections and Social Policy in Brazil and India’, *Commonwealth and Comparative Politics* 55(3), 2017; and articles in a special issue of *Regional and Federal Studies* 29(2), 2019 entitled ‘Negotiating Universalism in India and Latin America: Fiscal Decentralisation, Subnational Politics and Social Outcomes’, edited by Andres Mejia Acosta and Louise Tillin.

tina and Brazil. She finds that while the implementation of CCTs is negatively affected by having an opposition governor, the presence of an opposition governor is irrelevant for health policies because attribution of responsibility is unclear.

The author's qualitative research also provides examples of ways in which federal governments can improve policy implementation by sharing credit with subnational levels of government. For instance, in Brazil, some years after introducing Bolsa Família, the federal government invited states to complement the CCT with their own programmes and allowed them to put their state logo alongside that of the federal government on the ATM cards used by recipients to withdraw funds (p. 138).

Unfortunately, Niedzwiecki herself does not consider whether her theory of the politics of social policy extends to India, although she presents evidence to suggest that it holds in the case of the United States. There are, however, plenty of signs to suggest that it would be fruitful to extend her analysis to India in order to explore how national level credit-claiming and attribution affect the implementation of different types of social policy. If India is to move closer towards territorial universalism in welfare provision, it is crucial to understand these issues better.

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**WHY DEMOCRACY DEEPENS: Political Information and Decentralization in India** by Anoop Sadanandan. Cambridge University Press, Cambridge, 2017.

**DEMOCRATIZATION FROM ABOVE: The Logic of Local Democracy in the Developing World** by Anjali Thomas Bohlken. Cambridge University Press, Cambridge, 2016.

COMPARATIVE political theory of democracy and democratization, which began with a focus on the national and cross-national levels, has now significantly shifted to the local level. In its first phase, this theory almost assumed that democratization at the national level subsumed democratization at the local level as well. By now a second phase of democratic theory has crystallized, which is significantly concerned with the phenomenon of local democracy.

In ancient India and Greece, democracy first began in small communities which subsequently came

to be overtaken by monarchical political formations with bureaucratic or feudal overtones. The reincarnation of democracy in modern and contemporary times has, more frequently than not, been initiated by the national level polity, often coupled with pressures from below, or sometimes above from the international level. In some cases even authoritarian national political elites initiate inauthentic drives to local democratization for ulterior or cosmetic motives.

The two books under review are remarkable pieces of research and theorization on the process of 'deepening of democracy' and the 'logic of local democracy'. Both are focused on India in vigorous comparative perspectives. Interestingly, both the authors are of Indian origin teaching in North America, the birthplace of modern democracy and federalism – presidential or parliamentary. And India happens to be a post-colonial parliamentary-federal democracy of reasonable success in the global South. Incidentally, the USA, Canada and India have a common British colonial past. Moreover, these three countries represent three routes to decolonization – a revolutionary War of Independence, evolutionary transition of a colony to a nation, and a nonviolent freedom struggle. The USA produced the first presidential-federal model; Canada, the first parliamentary-federal model; and India pioneered the Canadian model adapted to its needs in the Afro-Asian world.

Anoop Sadanandan seeks to unravel the 'puzzle' or 'deepening of democracy' in India in the wake of the 73rd Constitutional Amendment (1992) relating to the rural local self-government (Panchayat Raj), which sought to give 'thick' democratic 'constitutional status' to it by way of a more vigorous model of local democracy suggestively outlined in the Constitution and prompting the state legislatures to re-enact their Panchayat Raj laws in its image.

It is important to remember that this amendment is an exercise in constitutional morality, not in constitutional law. For despite this amendment, local government under the Constitution remains a *devolutionary* feature; it does not become a *federal* feature. Local government remains a subject in the State List in the Seventh Schedule of the Constitution, and the status of the 11th Schedule dealing with the 29 subjects devolved to the jurisdiction of panchayats does not become tantamount to the 7th Schedule dealing with the federal division of powers between the Union and the states. This point is also clearly clarified by the Andhra Pradesh High Court in its 3:1 judgement in *Ranga Reddy District Sarpanches Association v. State of Andhra*

*Pradesh*.<sup>1</sup> Only Switzerland, Germany, and the new Constitution of Nepal (2015) give federal status to the local government in the respective countries.

Sadanandan defines 'deepening of democracy' in terms of greater conformity to the 73rd amendment in varying responses of the various states of the Indian Union (28 at the time of this study; now 29 after the creation of Telangana in 2014). He seeks to measure and compare this phenomenon by systematically reviewing the decentralization policies of the 14 states from 1994 to 2008. Eight different indicators of deepening of democracy are used in the study: (i) functional devolution, (ii) decentralized planning, (iii) panchayat autonomy, (iv) integrated decentralization across state and Union programmes, (v) local capacity building, (vi) local institutional strength, (vii) local spending capacity, and (viii) regular, free and fair elections.

The summary interrelations among the various indicators are subjected to statistical factor analysis to yield a composite score for democratic deepening in the states. On this basis, the studied states are classified into three clusters of categories: (a) High democratic deepening (Himachal Pradesh, West Bengal, Karnataka and Kerala); (b) Moderate democratic deepening (Madhya Pradesh, Gujarat, Maharashtra, Andhra Pradesh and Tamil Nadu); and (c) Low democratic deepening (Uttar Pradesh, Haryana, Rajasthan, Bihar and Orissa).

The rest, and the bulk, of the book is devoted to explaining the varying levels/degrees of democratic deepening in the studied states in terms of a variety of hypotheses culled from an enormously large corpus of theoretically oriented empirical researches on India and all over the world.

Is democratic deepening attributable to political ideology and party organization? Is it attributable to international factors like the UN and the World Bank or FDI inflows? The author persuasively – by reasoning and evidence – shows that these factors have limited explanatory mileage. Some supportive evidence for their impact is largely negated by equally or more contradictory evidence. A more general and consistent explanation, according to this author, lies with the characteristics of the larger entity on the ground, i.e. the states concerned. These state attributes relate to two dimensions: (i) States with relatively secure socio-economic circumstances (Himachal Pradesh, Kerala and Tamil Nadu) and those with high levels of socio-economic vulnerability (Bihar, Madhya Pradesh,

1. <https://indiakanoon.org/doc/1981313>; accessed 23 February 2019.

Rajasthan and Uttar Pradesh); (ii) States with the salience of local information for national leaders correlated with the states with socio-economic circumstances of vulnerability.

According to the author: 'Attributes of states affect the voter-related informational asymmetries that exist between the state leaders and local politicians. These state-level attributes shape the political value and cost of local information to leaders and, in doing so, they make it more or less likely for leaders to decentralize power and foster local democratization.' (p. 53)

The author thus offers a well elaborated and documented 'information theory of democratic deepening.' A telling and concluding line of the book is: 'Democracy deepens when the central leader's political survival rests on local information.' (p. 157) This local information largely pertains to the political preferences of the local leaders and voters. I feel inclined to add that the quality of democracy may ultimately be premised on the rule of law and constitutionalism, but its immediate survival depends on the minimalist criterion of free and fair elections.

The puzzle of the second book under review is the same as that of the first: the explanation for democratization from above. Bohlken finds that there is a significant measure of variation across the developing world in the degree of democratization the national elites are willing to allow at the local levels of the political systems they govern. What factors are accountable for it? The author suggests that, 'This book offers a theory of local democratization... that rather than being a means of granting *more autonomy* to local actors, local democracy emerges from the need of these government elites to *control* local intermediaries on whom they rely for political support. Thus, the book offers a logic of local democratization that runs counter to the logic of national democratization and to the logic of decentralization.' (p. 3)

Bohlken clarifies that while national democratization theories are mostly defined and theorized as exposing the incumbent elites to democratic contestation and possible electoral turnover of power, the theory of local democratization here offered 'may be implemented as a means of allowing national incumbent to consolidate their power.' (p. 18)

Sadanandan's theory of democratic deepening is more authentically and holistically democratic in intent and content than Bohlken's theory of local democratization, which has a tinge of authoritarian-democratic ambivalence in the motivation of the national elites in allowing local democratization.

It is a moot question whether the former is more idealistic and the latter more realistic. It goes without saying that the motive of manipulative, if not exploitative, use of information and skill of the local political intermediaries by the national elites is germane to both the theories. For, much like Sadanandan, Bohlken also introduces the hypothesis of 'local democratization as a solution to an information problem' and 'local intermediary performance and informational asymmetries' while constructing her 'strategic logic of local democratization.'

Both the studies use a significant amount of qualitative as well as quantitative data (Sadanandan's about 14 states of the Indian Union and Bohlken's about 68 countries with a population greater than 10 million in three continents – Asia, South and Central America, and Africa). In the case of India, the period covered by the latter is 1950 to 2010; and the year of subnational democratization reform is 1992, the year of the 73rd and 74th Constitutional Amendments relating to the rural and urban local governments.

To sum up, in Sadanandan's theory of democratic deepening, the primary causal effects of the socio-economic characteristics of state contexts are intermediated by the intervening causal effects of the need of local information for national leaders who, in the bargain, allow local democratization. In preference for this parsimonious theoretical formulation, other explanatory factors like party ideology and organization or international factors like the UN and Bretton Woods institutions/FDI inflows are rejected by Sadanandan as only partially valid or even spurious.

This kind of parsimonious explanatory clarity seems to elude Bohlken's theory of local democratization in which the complicating effects of alternate causal factors like the nature of political party organizations in India (chapter 3), intraparty competition in Kerala and Tamil Nadu (chapter 6), etc. are not easily shown to be less efficacious than the master explanatory factor of the strategic need for local information for the national elites. The messy causal effects of the primary and intervening/intermediary factors on the dependent or effect phenomenon of local democratization are not clearly disentangled. In fact, come to think of it, the nature of party organization and intra-party competition may well be a dimension or aspect of democratization rather than its cause.