YV Reddy is an Indian institution in his own right, a man who has served with integrity and wisdom in almost every area of the state and central government, including as secretary in the government of India, governor of the Reserve Bank, and chairman of the 14th Finance Commission.

Not only does he have unparalleled historical knowledge of the rationales for today’s policies, which would otherwise be lost in the past, he also keeps his views informed by the latest research. Perhaps most important, Reddy cares enormously about the course India takes, and is not averse to sending a message to the powers that be when he thinks appropriate.

Sometimes the message is conveyed through a pithy statement, though sugar-coated with humour. When asked about RBI independence, he said “the RBI has full autonomy, I have taken the permission of my finance minister to tell you that”; when asked how he would have reacted to demonetization, he said he would have opposed it, and if overruled, would have checked into hospital and then resigned on grounds of ill health.

Sometimes the message is conveyed in long form. In Indian Fiscal Federalism (Oxford University Press), Reddy along with co-author GR Reddy informs us about Centre-state fiscal relations over India’s history, as seen through the lens of various finance commissions, including the one he chaired.
He analyzes each commission’s functioning in the context of India’s economic problems at that time. Clearly, he does every student of Indian economics a service by drawing out the essence of a vast number of reports, and offering a cogent and very readable analysis of them. But he also sends two related messages.

The first is that India has been trending towards devolving more and more functions towards the state and local government levels. Reddy argues (in my view correctly) that this is a good thing. States should be free to choose more locally relevant policies. To help them do this, Reddy’s finance commission devolved more funding to the states – perhaps less, as he argues, than the dramatic headline numbers of 42% of tax revenues seemed to suggest, but somewhat more than in the past.

As he points out, this simply follows a trend of past Finance Commissions pushing for more devolution. However, and this is the first message, the Centre still usurps too many resources through central schemes that are devised without any inputs from the states. The Centre takes credit for them, even while state governments implement them with little room for discretion. As he argues, one has to simply tally the schemes branded “Pradhan Mantri … Yojana” to know this is not a small matter.

The Planning Commission was seen as the heavy hand of the Centre in the past, which prompted the Modi government to rebrand it as Niti Aayog, and to take away its ability to allocate funds. Reddy worries, however, that it has not morphed into a structure that is seen as an honest broker between the Centre and the states – too many of its activities are still centrally directed.

The second pointed message in Reddy’s book is about the terms of reference (TOR) of the still-deliberating 15th Finance Commission. He worries the terms are set in such a way as to reverse the trend towards decentralization, including alarmingly, to review the devolution recommendations of the 14th Finance Commission. He sees this as an unprecedented (and unwarranted) move. He also worries about Central overreach, for instance in asking the Finance Commission to set performance based incentives for the states, as if the Centre were marking students.

He argues that tax devolution is not a transfer from the Centre out of its budget but a sharing of revenues that are collected by the Centre, and should therefore not be subject to conditions. He is especially concerned about the Centre asking the Commission to reward states that exercise adequate control over their expenditure on populist measures.

He argues there is no objective way to categorize schemes as populist or non-populist – Tamil Nadu’s school midday meal scheme was once derided as populist, while it is now lauded for improving child nutrition and keeping children in schools. Reddy could well ask today’s government mandarins whether the central government’s Mudra scheme is populist or developmental in nature. Almost surely, the answer will depend on its still uncertain outcomes.

As one might expect, Reddy is not always critical. For instance, he supports the directive in the TOR that the 2011 census population numbers be used (instead of the 1971 numbers) to determine allocations of tax revenues to states. The worry if the more recent numbers are used is that more prosperous southern states like Tamil Nadu and Kerala, with slower growing populations, would lose out to poorer northern states like Uttar Pradesh and Bihar, with faster growing populations.

While considerations of interstate equity as well as the need for allocations to reflect actual population would suggest the use of the latest numbers, one cannot ignore the growing political and economic distance between the south and much of the north, and associated concerns about “rewarding” underperforming northern states. The 15th Finance Commission would be wise to heed Reddy’s advice to adopt a “pragmatic approach” to the use of the population criterion so as “to moderate the adverse impact on certain states.”

Finally, Reddy also laments the lack of funding for the third pillar, municipal and village government. Here he faults the states for not taking Panchayati Raj seriously, and for not periodically setting up State Finance Commissions that would allocate funds between the state and its local bodies. States are guilty of doing to their local bodies what the Centre has done to them.
Perhaps, as we come to the end of this very insightful book, there is a broader if unintended message to the governments of the day. India and its states are too big and diverse to be governed entirely from the Centre. Fiscal federalism implies a partnership, a willingness for the more powerful to let go of some of their powers. The cost if we forget that is clumsy, unwieldy, insensitive, and ultimately ineffective, government.

DISCLAIMER: Views expressed above are the author's own.

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