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THE FIRST FARM LEGISLATION: AN ATTACK ON FISCAL FEDERALISM?

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INTRODUCTION

As per section 6 of the Farmers' Produce Trade and Commerce **(Promotion & Facilitation)** Act, 2020 **['first farm Legislation']**[1] , if any farmer, trader, or electronic trading and transaction platform wishes to trade and commerce in scheduled farmers' produce in a trade area then the respective state government cannot impose any market fee, cess or levy under any state law. With the coming into force of this first farm legislation, the state governments lose the revenue arising from the levy, cess or fee that comes under the existing Agriculture Product Marketing Committee ['APMC'] laws or any state law seems to be violating the spirit of fiscal federalism in India.

Apart from this, in the last 2-3 decades since the beginning of 1991 reforms which liberalized the Indian economy, creation of third-tier of the government through 73rd and 74th Constitutional Amendment Acts in 1992, the introduction of the Fiscal Responsibility and Budget Management Act in the year 2003, the replacement of Planning Commission of India with the National Institution for Transforming India (NITI) Aayog in 2014, and more recently the implementation of Goods and Services Tax (GST) in 2016-17 (depriving states to levy value added and entry taxes), suspension of the Members of Parliament Local Area Development (MPLAD) scheme during Covid-19 pandemic – all points towards the changing dynamics of the fiscal federalism in India. In this short article, let us understand fiscal federalism in India.

WHAT IS FISCAL FEDERALISM?

Fiscal federalism is quite different from political federalism which encompasses a sovereign relationship between different units of a state, whereas fiscal federalism restricts itself to a fiscal relationship between different tiers of the government. A federal state, primarily through a written text (generally Constitution), provides for a clear distinction between central and state's right to tax.

Under the Indian Constitution, the center has been assigned most broad-based taxes. Also, residual tax powers have been assigned to the center. When the fiscal imbalance occurs between two levels of government (such as center and states, or states and local) it is called 'Vertical Fiscal Imbalance'. When the fiscal imbalance occurs between the governments at the same level it is called 'Horizontal Fiscal Imbalance'.

Any change in fiscal federalism reflects the following:

1. The extent of political decentralization.
2. The expenditure priorities and therefore the nature and direction of economic growth.
3. The administrative functioning of the government.

Therefore, it is very essential for a federal country like India to have sound fiscal balance between the center and the states and also among the various states.

Evolution of fiscal federalism in India

In the year 1860, the fiscal division of powers took its birth when the first budget was presented. In 1919, the Government of India (GOI) Act divided the fiscal powers between the center and provinces in the 2 lists. The GOI Act, 1935 divided the powers through 3 lists and consolidated the fiscal federalism idea in the form of sharing of center's revenue and grants-in aid to the provinces.

Finally, post-independence the Constitution of India provided for the provision of division of powers in the seventh schedule with residue powers in favour of the center. Apart from this division, a provision for the constitution of a Finance Commission has been provided under article 280 of the Constitution of India. The Finance Commission shall be reconstituted every 5 years and shall consists of a Chairman and 4 other members to be appointed by the President. It has been vested with duty to recommend President as to the distri-

[1] *For more about the first farm legislation, please refer to "Farm Laws: Issue 2 - Pre And Post - The Farmers' Produce Trade and Commerce Act, 2020" available at http://www.mcolegals.in/kb-view?kb=Farm-Laws:-Issue-2---Pre-and-Post---The-Farmers%27-Produce-Trade-and-Commerce-Act--2020&kid=MjIx.*

bution between the center and the states of the net proceeds of taxes which are to be, or may be, divided between the states of respective shares of such proceeds.

RECENT CHANGES IMPACTING FISCAL FEDERALISM DYNAMICS

The 15th Finance Commission Report

The 15th Finance Commission headed by Mr. NK Singh recently submitted its report for 2021-26 in which it not only failed to address but has also aggravated the country's increasing tendencies towards fiscal centralization. The 15th Finance Commission has seemed to have favoured the central government's neo-liberal tendencies by depriving states of revenue. For example, in 2019 the states lost around Rs.65,000 crores due to center's decision (that too without consulting states) to opt for business friendly measures by providing concessions in corporate taxes.[2] Moreover, the center has several means of making up its own fiscal deficit, which are not available for states. For example, by selling public assets to mobilize receipts, by drawing on special dividends from the Reserve Bank of India (RBI), by growing the reliance on cess and surcharges (which need not be shared with states), and by hiking its borrowing. As far as share of the state governments in the divisible pool of the tax revenues of the center is concerned, the Commission has kept it at 42% (1% less as compared to the 14th Finance Commission recommendations so as to adjust the bifurcation of the state of Jammu & Kashmir into 2 new Union Territories).

The GST fiasco

One of the primary reasons for the country wide consensus on enactment of GST was assurance from the center that any shortfall in the tax revenue of the states shall be compensated. Due to economic slowdown in the economy which was further exasperated by the Covid-19 pandemic, the center has refused to immediately compensate the estimated shortfall of Rs.30,000 crores to the states. In lieu of compensation, the center has offered borrowing option to the states to make shortfall in GST compensation good. Under this option, the center has operationalised a special borrowing window of Rs.1.1 lakh crore of which Rs.30,000 has been already borrowed by center on behalf of the states. For now with the acceptance of the offer by all 28 states and 3 Union Territories (having legislative assemblies), the stalemate seems to have broken.

Article 282 of the Constitution

The Constituent Assembly Debates on article 282 suggests that the objective was to enable the center to deal with unforeseen contingencies. However, this provision seems to have been misused by the center through centrally sponsored schemes in the name of national priorities. Further, the entitlement-based central legislations like Mahatma Ghandhi National Rural Employment Guarantee Act (MGNREGA), right to education, National Food Security Act, et cetera, have unnecessarily burdened the state finances without having much say in the decision making powers.

On top of it, the loss of revenue for states due to this first farm legislations when combined with the center's failure to fulfill the GST compensation promise and also the declining tax collection caused by the Covid-19 pandemic will lead to a potential financial crisis for the states.

CONCLUSION

The market fee, cess and levy are big sources of state revenue for some of the big agricultural states having their own APMC laws. With states not permitted to levy market fee/cess outside APMC areas under the new farm law, states like Punjab and Haryana could lose an estimated Rs.3,500 crore and Rs.1,600 crore each year respectively. But in light of the fact that not all the states in India have their APMC laws and majority of the states apart from big agricultural states are not going to get effected by the first farm legislation's provision to take away the power of states to levy market fee, the central government seems to have sidelined this small issue in order to bring a major agricultural reform. Moreover, the idea behind bringing these legislations is to benefit the farmers of the country and the loss in expenditure collection of few states might not have been the concern for the central government.

[2] *https://www.theleaflet.in/15th-finance-commission-recommendations-favour-neo-liberal-fiscal-centralisation-that-may-affect-states/.*