Fifty Years of Fiscal Federalism in India An Appraisal#

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I. Introduction

It is a great honour and a privilege to be invited to deliver the Kale Memorial lecture at the Gokhale Institute. More so for one like me, who cannot claim to be treated as an academic having spent the better part of my life in departments of government. Over the years, lectures delivered on this occasion have come to be regarded as an opportunity for scholars to put across new ideas to a wider audience on a wide range of issues in public policy, befitting the memory of the great man to whom these lectures are dedicated. Gokhale Institute deserves to be congratulated for keeping alive the tradition of disseminating the findings of academic research through public lectures in the best traditions of the city of Pune.

The paper I am going to present in the course of this lecture is, as the title indicates, a retrospective of Fiscal Federalism in India during the last fifty years. This is a rather ambitious task and calls for more extensive research than has been possible for me to undertake. Nevertheless, I thought, given the vital role of intergovernmental fiscal relations in a federal polity in shaping its public sector and its bearing on the performance of the economy and the well being of its people, despite its limitations, such an appraisal might be of some interest and use. By way of introduction, a few words on the rationale for federalism and its pre-requisites for success may be in order.

Federalism, it is universally acknowledged, has many virtues. Federal governance promotes efficiency, both economic and political. Economic efficiency is advanced by the division of governmental functions among different levels depending on their comparative advantage. Assignment of matters that concern the nation as a whole, or where there are externalities or large economies of scale, to the government at the centre combined with decentralisation of responsibility to provide services that benefit smaller segments of the country or the

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community to lower level governments, promotes efficiency in the allocation of resources in the economy. What is more, in a federal polity the economy benefits from the operation of a common market facilitated by free flow of goods, services and factors of production within the country.

Federalism is considered efficient from the political angle as well because of the facility it provides for a heterogeneous population to come together under the banner of one nation and acquire strength from unity while allowing the constituents to retain their identity and autonomy over a wide area of public life. Federalism also fosters democratic values and the civic virtues of people's participation in political processes (Inman and Rubinfeld or I-R, 1997). In recent years, it is the economic benefits of federalism that have come to the fore drawing sovereign nations to join together in economic union even while not surrendering their independence. The European Union is a prime example.

A well designed, and more important, well functioning system of federal governance, by virtue of its manifold benefits, plays a key role in promoting the stability and prosperity of nations as the heights attained in development by the leading federations of the world – USA, Canada, Australia and Switzerland – demonstrate. On the other hand, unless carefully crafted, federal systems do not endure as evidenced by the disintegration of many of the federal formations that came into being in the last century, such as Soviet Russia, Yugoslavia, Czechslovakia, Rhodesia, and Nyasaland (Watts, 1999). The art of federalism lies in designing institutions with appropriate assignment of powers and functions among different orders of government and rules to regulate their relationship especially in the fiscal arena that can strike the right balance among different objectives and resolve tensions.

According to many, the Indian political system though supposedly decentralised and federal is too centrist. It is quasi-federal at best (Chelliah, 1991) and does not allow enough room for the states to function freely or decentralisation to come into full play. This, it is alleged, has been the bane of the Indian economy and a major factor responsible for its stunted growth (Mitra, 1975). In China, on the other hand, growth has been propelled greatly by the 'market preserving federalism' practised there allowing autonomy to provinces in running their economies (Qian and Weingast, 1997). Others, however, maintain that in a country subject to strong centrifugal influences as we are, nothing should be done that could weaken the centre and so decentralisation should not be carried too far. The system of intergovernmantal fiscal transfers as it has evolved in India over the years has come under attack on the ground that it has created perverse incentives by putting a

premium on equity to the neglect of efficiency and led to fiscal profligacy at lower levels of government, although, sharp regional disparities persist and have grown sharper, particularly, in recent years. In this background one cannot make out what has gone wrong or what should be the direction of reforms. This survey seeks to provide some tentative answers.

The focus is on the role of the fiscal institutions of India's federal structure on the functioning of the public sector and their impact on the performance of the Indian economy. The three-branch division of the fiscal functions of government formulated by Richard Musgrave in his classic, *The Theory of Public Finance*, viz., resource allocation, stablisation and redistribution provides a convenient point of departure. We investigate by turn what has been the impact of fiscal federalism on the efficiency of the public sector in India in the matter of allocation of the nation’s resources, macroeconomic stabilisation and redistribution across regions and different sections of the community. Finally, we explore the directions for desirable reforms.

The question we address first is: Can India's constitutional structure be regarded as truly federal or is it too centrist to qualify as federal or reap the advantages of federalism?

II. India's Constitutional Structure and Fiscal Institutions: How Federal?

Basic Character

To all appearances, the constitution that has formed the basis of governance in India since independence, is federal. Though not formally designated as federal — it is proclaimed as a 'Union of states' in its very first article — the constitution has all the trappings of a federal polity, viz., statutorily mandated two (now three) layers of government with specification of their respective powers and functions and also the fiscal institutions that are needed to support a federal structure including mechanisms for intergovernmental transfers to address the vertical and horizontal imbalances that all federations unavoidably face. Broadly in line with the pattern prevailing in other federations (vide Appendix I), subjects like defence, foreign affairs, money and banking, countrywide communications and responsibility for macro-management of the economy are assigned to the centre, while matters of primarily regional or local concern like public order, public health and sanitation, water supply, irrigation and canals, and industries other than those declared by

Parliament to be of strategic interest or necessary for the centre to control in public interest are entrusted to the states. Anticipating a gap between resources that they can raise on their own and their expenditure responsibilities, the constitution provides for transfer of revenues from the centre through the mediation of a statutory body to be set up periodically, i.e. the Finance Commission (FC). The constitution also stipulates the creation of an independent judiciary with the Supreme Court at the apex to adjudicate disputes between the centre and the states and also envisages bodies to resolve interstate issues in the form of an inter-state council.

In terms of their relative size as measured by their share in the total expenditure of the government, states in India do not compare unfavourably with their counterparts in other federations. Of the total expenditure of the government, the states account for over 50 percent (Table 1) as compared to 40 percent in USA (states and local governments combined), and 47 percent in Australia. Revenue receipts of the states from their own sources form around 38 percent of the total government revenues as compared to 34 percent in USA, and 30 percent in Australia (Watts, 1999).

There are, however, several pronounced unitary features for which the credentials of the Indian constitution to qualify as federal have come under question. Dandekar in one of his later writings (Dandekar, 1987) had succinctly summarised them. In particular, what lends credence to characterisation of India's constitution as unitarist or quasifederal (Chelliah, 1991) are:

- A large concurrent list covering wide areas like economic and social planning with residuary powers with the centre;

- Primacy of central laws in the event of any conflict between a state legislation and a parliamentary law;

- Requirement of governor's assent for laws passed by state assemblies and of president's assent for state enactments in certain matters (Article 201).

- Power to parliament with qualifying majority to redraw the boundaries of a state, divide it, and create new ones.

- Power to the centre to take over the administration of a state in certain circumstances and promulgate 'President's Rule' (Article 356).

Each of these points is countered forcefully by Seervai in his monumental work *Constitutional Law of India*. Overriding powers of the centre in exceptional situations are not unusual even in polities universally recognised as 'federal'. Residuary powers are not always vested in the states either, eg., in Canada. Yet, Canada is regarded as a most vibrant federation of the world. Under the US constitution residuary powers belong to the states but the US Supreme Court has left the task of deciding the allocation of state and federal policy responsibilities to the congress arguing that the states' representation in the senate would serve to protect their policy interest.

In any case, the distinguishing characteristic of a federal state defined by scholars like Albert Breton (1995), viz., divided ownership of governmental powers and functions among different levels is quite conspicuous in the Indian constitution. Further, the states in India derive their powers from the constitution and are not a creation of the centre, a point stressed by Dandekar in this context.

That despite all its ethinic, religious, and linguistic diversities besides the underlying tensions, India has held its ground as a nation — almost a miracle according to keen observers of the federal scene around the world (Bird, 1994) — testifies to the strength and robustness of the constitution the country adopted for its governance after independence. India has not only survived as a nation, comprising 25 states (now 28) with elected governments, its *panchayats* numbering over 2,00,000 constituted with 2.5 million elected members, one third women, and over 3,500 elected municipal bodies functioning in urban areas, India has emerged as the largest democracy in the world. Politically, the federal structure seems to have served the nation well.

Centralising Influences

Nevertheless, it has to be recognised that there have constantly been undercurrents of tension and uneasiness arising out of a feeling of excessive concentration of powers at the centre. The feeling stemmed not so much from the legislative and executive supremacy accorded to the centre by the constitution as the manner in which economic policy making was conducted in the first three decades after independence, with the centre assuming a commanding role in crucial areas.

The most important factor that contributed to the accretion of power to the centre was the adoption of planning led by the public sector as the strategy of development post-independence and emergence of the Planning Commission (PC) — a body not envisaged in the

constitution — playing a dominant role in economic policies and also as a dispenser of central funds on a large scale.

Centralisation of economic policy making was complemented by assumption of power by the centre in many areas particularly the power to regulate the development and location of industries, and reservation of most of the basic industries for the public sector with investments coming largely from the centre, followed by nationalisation of insurance, aviation and, in 1969, acquisition of what was called the commanding heights of the economy through nationalisation of major commercial banks. Rule by the same party at the centre and the states facilitated the implementation of this programme without any hindrance.

Centralisation of economic policy making did not show up in any reduction in the share of the states in total government expenditure. In fact, the share increased from 51 percent in 1950-51 to 60 percent in 1970-71 (line 1, Table 1). The expenditure policies of the states however, came to be influenced heavily by the centre as they were required to draw up their plans to subserve the objective of the central plan and have their five-year and annual plans approved by the PC. Annual Plan approval provided the mechanism for central control over state expenditure policies, with central assistance for state plans providing the leverage. Over and above the 'plans' approved by the PC, the states were also required to implement centrally sponsored schemes (CSS) initiated in 'national interest'. Inroads were thus made by the centre into areas that under the constitution belonged primarily to the states, like rural development, health and family welfare. Inclusion of economic and social planning in the concurrent list paved the way for these intrusions, overshadowing if not subverting the functional assignment scheme of the constitution, one of the fiscal institutions that define a federation.

Another fiscal institution of the federal structure viz. the system of intergovernmental transfers also suffered erosion. Reflecting the states' growing dependence on transfers from the centre increased sharply as the proportion of revenue expenditures they could finance out of their own sources fell dramatically from over 80 percent in 1950-51 to around 60 percent in the seventies, the rest coming from the centre either as grants or loans was extended or mediated by the centre. (line 4, Table 1). A significant portion of the transfers came to be channeled through the PC, bypassing the FC. Right from the beginning 'Plan grants' came to constitute 30 percent or more of the total amount of centre's revenues transferred to the states (Table 2). Although statutory transfers still accounted for over 60 percent of the total transfers, the institution of parallel transfer channels apparently not contemplated in the constitution to be used in a big way, undermined the role of the FC and created

complications in designing the transfers in a rationally integrated manner. As we will see later, both equity and efficiency suffered as a result.

The manner to which the states were subordinated through the mechanism of planning and their ill effects are vividly described by Dandekar in the paper cited above and had been noted earlier by several other observers of the Indian economic and political scene, notably, A.K. Chanda, K Santhanam, P.V. Rajamannar and the Administrative Reforms Commission of the sixties headed by Morarji Desai.

Dissatisfaction with the system surfaced, once the political landscape changed as one party rule at the centre and the states ended and some states went under rule by parties other than that at the centre. Appointment of a high powered panel on *Centre State Relations — the Sarkaria Commission* — followed when the pleas for reversing the centralisation that had marked the initial three decades of federalism in the country became strident and demands were voiced in several quarters for decentralisation. *The Sarkaria Commission*, while reaffirming the need for a strong centre nevertheless made wide ranging recommendations to allow the states more autonomy in the spheres assigned to them under the constitution. These recommendations however, remained largely unheeded until a coalition government — the *United Front* — came to power at the centre. An inter-state council was set up four decades after the constitution had come into effect.

A perceptible shift away from the centre in economic policy making took place only with moves towards liberalisation of the economy initiated in the nineties. With delicensing of industries, the powers of the states over industrial policy were largely restored and they gained more elbow room in pursuing their own social and economic priorities. Constitutional amendments carried out in 1992 paved the way for the emergence of *panchayats* and municipalities with periodic elections were made mandatory as a third tier of democratic governance. The states, particularly those ruled by parties that are members of or aligned to the coalition at the centre, now wield considerable power in the union government. Judicial rulings and the party composition of the upper house have considerably blunted the edge of Article 356. It is no longer very easy for the centre to get an elected state government dismissed. Demand for amending the constitution to allow greater autonomy to the states, however, persists. Appointment of a *Constitution Review Commission* reflects the intent to attend to the difficulties that have surfaced in the working of the constitution of 1950.

Some International Trends

Centralisation marked the evolution of federalism in the last century in several federations that were already well established like in USA, Canada and Australia. USA had a fairly decentralised federal system for the first one hundred and fifty years. Before the Great Depression, of the total public expenditure (forming 10% of GNP) only 30-35 percent was accounted for by the federal government; the share of the states' and local governments taken together formed 65 percent (states 15 percent). In the course of the next thirty years or so, the expenditure-GNP ratio rose to over 30 percent with the share of the federal, states and local governments forming 70, 20 and 10 percent of the total respectively (Buchanan and Musgrave, 1999, p172). Australian federation is also very much centralised with the states collecting barely 30 percent of total government revenues, but accounting for about 47 percent of the total expenditure, signifying a large vertical fiscal imbalance (Collins, 1993)

However, disenchantment set in in all the three countries in question with what was perceived as excessive expansion of the public sector and centralisation. Large governments came to be associated with inefficiency and viewed as a drag on growth while centralisation was seen as a factor inhibiting the initiative of governments at the lower levels and thus the realisation of the fruits of multilevel governance. The closing two decades of the last century saw substantial offloading of responsibilities by national governments to those below both in USA and Canada while a strong body of opinion has emerged in Australia as well asking for decentralisation (Collins, 1993).

The moves to reform the system of intergovernmental relations towards decentralisation across countries have, however, not gone in one direction alone. The signals are mixed. Even with the welfare reforms, the federal government's share in total government expenditure in USA now stands at over 60 percent.

Decentralisation and offloading of central government's responsibilities in Canada also have not gone along consistent lines; there are cross-currents. Pleas have been put forward for a new `mission statement' to set a clear direction for Canadian federalism in the new millennium (Lazar, 2000). In Australia, decentralisation is yet to make tangible progress (Lazar, 2000).

In India too, the signals are mixed. The campaign for decentralisation while securing the recognition of local governments as a third tier of government has met with resistance at many levels. Inroads

made by the centre into areas clearly belonging to the states are yet to be vacated – proposals to reduce the number of CSSs still remain only on paper.[1] While, the states now have more room to pursue their policies the practice of getting the states to have their 'plans' approved annually by the Planning Commission continues with the PC acting as a parallel channel of fiscal transfers. Attempts are also afoot to get the states to implement economic reforms in line with those initiated by the centre through conditionalities attached to federal transfers.[2] The states, on their part, have been lagging in transferring substantial powers or autonomy to local governments. Federalism in India too lacks a clear direction.

To sum up, it will not be correct to say that India's constitution is lacking in federalist credentials. However, in its actual operation, federalism in India has evolved in two distinctly different phases. The first phase spanning the three decades of fifties, sixties, and seventies, was marked by pronounced concentration of economic policy making powers in the centre, while the subsequent two decades saw a trend towards its reversal. Both of the two institutions that constitute the pillars of fiscal federalism — assignment of functional responsibilities along with autonomous revenue sources to different tiers of government and the system of intergovernmental fiscal transfer — suffered erosion during the centralising phase, assignment more than the transfer mechanism. Part of the erosion in assignment was mended in the subsequent phase but the trends are not in one direction alone. The transfer system seems to be in for some harder knocks with conditional transfers assuming increasing importance. In the next two sections, we try to assess how these trends in federalism have impacted on the performances of the fiscal functions of the government viz., allocation, stabilisation and redistribution, and on the Indian economy.

III. Operation of Federalism: Impact on Government's Fiscal Functions and the Indian Economy

Resource Allocation

The performance of the economy of a country is influenced by many factors among which, government policies and institutions play a crucial role. Assessing the impact of any one factor in isolation is a formidable task. Institutions of federalism along with other institutions of governance like the legal system and the civil services bear on the efficiency of the government in performing its fiscal tasks in a variety of

ways. Hence whether or to what extent federalism promoted efficiency in the allocation of resources in the Indian economy, does not admit of a straightforward answer.

Theory says that resource allocation is optimal when the marginal social benefit is equal to marginal social cost of funds transferred to the public sector. Quantification of social costs and benefits is far from simple. It involves figuring out what the economy would have gained at the margin, had resources not been drawn away from the private sector or had the allocation of taxes and expenditure responsibilities between the centre and the states been on a different footing – a counterfactual question. An evaluation of the allocative efficiency of a federal governmental system can still be attempted based on indirect evidence such as the scale of pubic sector expansion, composition of public expenditure and ultimately, the growth performance of the economy. This is what is attempted below.

Between 1950-51 and 1990-91 India's public sector measured by the ratio of government expenditure (centre plus states) to GDP recorded an almost three-fold expansion, from 9.9 percent to about 27 percent. Much of this growth had taken place in the first three decades. The expenditure ratio had reached 24 percent by 1980-81. Around 40 percent of total government expenditure then (sixties and seventies) fell within the 'developmental' category. The ratio of capital expenditure financed through government budgets to GDP went up from 2.3 percent in 1950-51 to 7.2 percent in 1960-61, and the bulk of it was undertaken by the centre (Table 3).

Expansion of government's involvement in the economy is reflected also in the rise in the share of the public sector (considering the undertakings owned or controlled by the government) from barely 11 percent of GDP in the early sixties to 25 percent by the eighties. In some sectors (mining and quarrying) the public sector's share increased tremendously. In electricity, water supply, and gas, the public sector's presence which was already high became almost exclusive. Over fifty percent of the capital formation in the economy took place in the public sector during the entire period (Bagchi and Naik, 1994).

Although there is some evidence that decentralisation tends to exert an upward pressure on government spending (Ehdaie, 1994) expansion of government expenditure that took place in India after independence cannot be ascribed to federalism as such. It reflected the concern of the government of democratic India for the growth of the economy and welfare of its people. The second half of the last century witnessed dramatic increases in government expenditures in advanced

countries too from an average level of 10 percent to 40 percent, in some countries exceeding 50 percent. There was also an impressive rise in income and living standards in those countries during the period. The pertinent question is, did expansion of government in India also help growth and development?

At first there was a remarkable spurt in the growth of the economy. After half a century of stagnation, India's GDP recorded a growth of 3.6 percent per annum in the First Five Year Plan (1951-56), raising per capita incomes by 1.8 percent and the growth momentum gathered further strength through the next five years (1956-61), a performance that was acclaimed almost as 'a triumph' by observers (Eckaus, 1988). However, the momentum was lost thereafter, and the achievement began to pale as the newly industrializing countries of East Asia leap-frogged to be recognised as 'Tigers' and India slogged on with what came to be dubbed the 'Hindu rate of growth'. South Korea provided the starkest contrast; a country that had the same per capita income as India in the early sixties attained per capita income ten times that of India by the eighties and was considered eligible to gain entry into the club of developed nations, the OECD, in another ten years. Although the country made remarkable progress in several fields — space technology in particular — and came to have the largest number of engineers among developing nations — India's record in human development in terms of literacy, infant mortality, housing and availability of safe drinking water — remained dismal. India's share in world trade which was already low, came down to less than 1 percent in these fifty years. The only area where some notable progress was made is agriculture but even there productivity has been comparatively low. Some states still managed to register consistently good growth (e.g., Gujarat), but these were exceptions.

The impressive growth record of the Indian economy in the first ten years of freedom would seem to provide a vindication of the merits of 'economic federalism' favoured by economists for its accent on efficiency. The hallmarks of economic federalism are decentralised local governments combined with a strong central government to provide pure public goods and control intercommunity externalities (I-R, 1997). At the time the country gained independence, the economy lacked the essential ingredients for growth. It was predominantly agricultural with very low productivity, had very little of industry and did not possess the infrastructure required for growth. Rates of saving and investment were both low leaving the country in a poverty trap. The need for the public sector to lead was obvious and that provided the rationale for planning. The externalities of investment and industrialisation argued strongly in favour of centre's direct involvement in economic activities.

What led to the loss of the momentum for growth acquired by the economy in the initial years of planning and centre's active involvement in economic activities has been the subject of considerable discussion among academicians.[3] Factors primarily blamed for the slowdown and inefficiency of India's economic system are the inward looking policies, like import substitution, and a highly protective environment, regime of controls and also excessive reliance on the public sector. However, there is reason to think that the character of federalism also played a significant role.

One can identify at least two ways in which the operation of federalism impacted negatively on the economy in the two decades following the initial years of good growth. One is the inefficiencies created by the centre's attempt to take on too much and manage the economy at the micro level; the other was the failure of the federal system to ensure the smooth functioning of a common market in the country. Faith in central planning led policy makers to acquire more and more control over the economy, squeezing the economic policy space of the states and also the room for private enterprise which, combined with other policies that severely restricted competition both external and internal, ultimately retarded growth.

Centralisation of economic decision making and heavy reliance on the public sector were apparently driven by a distrust of the market because of its imperfections and exaggerated notions about the external economies of big projects ignoring the possibilities of government failure and the negative effects of inhibiting local initiatives. It also opened up scope for political considerations to prevail over economic logic. For instance, steel plants were set up in the public sector far away from sources of the basic raw material in utter disregard of economic efficiency.

While purporting to correct market imperfections, centre's interventions created new inefficiencies. A glaring example is the enactment of *Urban Land (Ceiling and Regulation) Act of 1976*. This piece of legislation along with the rent control laws are widely regarded as primarily responsible for the urban decay visible in many parts of the country. While rent control was a legacy of the past, the urban land ceiling law was enacted by Parliament even though the matter fell in the state list. This was during the period of emergency and power was acquired for the Parliament to legislate on the subject by getting the requisite number of states to give their consent.

Centre's intrusion into areas earmarked for the states in the constitution harmed the economy in another way viz., by thwarting the

operation of market forces and the growth of a common market within the country. Segmentation of markets that impeded free movement of goods within the country and thereby functioning of a common market came about through central intervention using what Tanzi calls quasi-fiscal instruments and regulations (Tanzi, 1995). Of the numerous controls and regulations that were put in place to administer the regime of planning, the one that had perhaps the most insidious effect on the growth of India's internal market is the *Essential Commodities Act of 1955*, a law enacted by Parliament.

As in other federations, the Constitution of India mandates that, subject to the provisions made in the constitution, 'trade, commerce and intercourse throughout the territory of India shall be free' (Article 301). Comparable to the 'commerce clause' of the US constitution, these provisions should have helped to secure the free functioning of a common market in India. The Indian constitution however stipulates that Parliament may impose restrictions on freedom in 'public interest'. Invoking public interest, both the centre and the states imposed controls on the movement of commodities that play a vital role in the life of the common people like foodgrains, edible oils, and cotton, severely impeding the emergence of an integrated market in the country. The states on their part used 'public interest' to create barriers segmenting the country's market, Maharashtra's *Cotton Monopoly Procurement Scheme of 1971* being a glaring example. The centre is clearly a party to this segmentation which continues even now as the continuation of the scheme requires centre's approval periodically (Godbole, 1999). There was often a multiplicity of control orders imposed on the same commodity and notifications were issued for the same item by both centre and the states, and the centre did not 'always know or keep a record of all the notifications/orders issued on any item' (Dagli Committee, 1979).

Growth of a common market was impeded also by imposition of tax on inter-state trade. Although under the constitution, the states are vested with powers of taxation in several fields, their tax laws have to abide by the mandate of Article 301 that is, must not interfere with the freedom of `trade, commerce and intercourse' within the country. To ensure that taxation does not cause any hindrance to domestic trade, while assigning the power to tax sale or purchase of goods in general to the states, our constitution makers had taken care to hedge the said powers with some restrictions to prevent tax exportation by any state. The states were debarred from taxing any sale or purchase taking place in the course of import/export as also inter-state trade making it clear that only the state where goods were finally delivered for consumption could impose tax on inter-state sales. Presumably, the objective was to make

sure that sales taxation by the states was founded on what has come to be known as the 'destination principle' and constitutes a key characteristic of the value added tax adopted by the EU to facilitate free flow of trade within the Union.

Unfortunately in the absence of appropriate rules required to operate such a system, difficulties arose in its operation. The constitution was amended by Parliament in 1956 to authorise the centre to enact a law to impose tax on inter-state sales – the *Central Sales Tax Act*. However, the centre delegated the power to administer the tax and retain the revenue to the originating states, subject to a ceiling on the rate of tax laid down by Parliament (currently 4 percent). The destination principle which was implicit in the original assignment scheme was thus abandoned almost inadvertently and the origin based taxation of inter-state trade was ushered in paving the way for tax exportation by the states with all its inequities and distortionary effects. Thus, when independent European nations were moving towards a tax regime that avoids distortions caused by origin based taxation, India was moving in the opposite direction.

The distortionary effects of the origin based CST were compounded by a host of other taxes that the states levy on trade. Notable among them is the octroi. Though abolished in some states, octroi still continues in several of them in the form of 'entry tax' which is akin to an import duty on inter-state trade. Some states have even levied 'export taxes' in the form of sale/purchase tax on export of items like rice out of the state (Bagchi, 1998). There are market/*mandi* taxes on agricultural commodities in states where these are produced in large quantities. In Punjab, *mandi* tax and allied imposts on wheat which are largely borne by consumers in other states, according to some estimates, work out to about 11 percent. Levies on commodities like sugar and rice also amount to a tax on trade in these commodities with distortionary effects.

As would have been noticed, almost all of the tax and non-tax barriers to internal trade mentioned above came about during the centralising phase of India's federalism. The centre not only allowed the states to put them up but happened to be a party to their creation. The proviso to Article 304(b) by virtue of which the states could impose restrictions on free movement of goods from their territories requires President's (that is, central government's) sanction in every case.

That economic federalisn with its accent on the central government's role in correcting externalities has its limitations is now well recognised. After examining its pros and cons I-R (1997) conclude: 'the

principle has had only mixed success as a guide to economic policy'. The collapse of the command economies provides the clearest corroboration of its failings. India's experience with centralised planning lends further support to this skepticism.

Where economic federalism failed, it would be unrealistic to expect the internal trade barriers to be removed when the centre's hold weakened and the polity moved into a phase of what is often described as 'cooperative federalism'. That the progress in reform of states' sales taxes and move towards value added tax initiated as part of the economic reforms agenda of the nineties has been tardy should cause no surprise. The deadline for introducing VAT (but without removing CST) has been shifted more than once and is now April 1, 2003*. Meanwhile, the agreement to harmonise the tax rates seem to be in jeopardy as several states (e.g., West Bengal) have been going in for tax on sale of goods in the shape of luxury tax and so on. Similar slippages have occurred in abiding by agreements reached among states in other areas bearing on their budgets, e.g., the decision to do away with supply of free power and irrigation water to farmers. Many of the non-tax barriers to internal trade also continue.

Weakening of the federal fiscal institutions has created problems in another area viz., the stablisation function of the government.

Stabilisation

From the angle of stablisation, India's fiscal federalism with its intergovernmental transfer system seems to have done well in meeting vertical imbalances at least in its first phase. Until late seventies, neither the centre nor the states seemed to experience any serious budgetary problem. The level of fiscal deficits at the centre was moderate, seldom exceeding 3 percent of GDP and the revenue account of the budget usually turned out a surplus, albeit small, every year. The budgets of the states too produced some surplus in the revenue account which could be used for the Plan and their FD remained around 2 percent (Table 4).

Since 1979-80, the centre's revenue budget has been persistently in the red and the level of revenue deficit (RD) reached 3.3 percent in 1990-91. Fiscal deficit (FD) which seldom went beyond 3.5 percent earlier went up 5.3 percent in 1979-80 and further to 8.4 percent in 1986-87. In 1980-81 aggregate FD of the states, for the first time, crossed 3 percent and hovered around that level all through the eighties. In 1990-91 the combined fiscal deficit of the centre and the states

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*Thereafter it was deferred indefinitely.

measured 9.3 percent of GDP, raising alarm all round and presaging the BOP crisis that beset the Indian economy in 1991. In the reform programme undertaken to stabilize the economy in the wake of the crisis, correcting the fiscal imbalances was accorded a high priority. Measures taken in the initial years of reform produced some positive results and the combined FD came down to around 6 percent in the mid-nineties. But the deficits crept up again, crossing 9 percent in 1999-2000.

Out of the combined FD of 9.8 percent in 1999-00, 4.7 percent originated in the states, an all time high. Fiscal consolidation efforts of the centre seemed to be seriously undermined by the state of state finances. The intensity of the fiscal stress is much more acute in many states than these aggregate figures indicate. In 1998-99, 8 out of 25 states had FD of more than 7 percent (EFC Report, June 2000).

As a result of heavy reliance on borrowing, the level of states' debt as a proportion of GDP went up from 16 percent in the mid-seventies to about 20 percent at the end of the last decade (Table 5). In several states, the debt-GDP ratio exceeded 35 percent (Table 6). These do not include contingent liabilities like borrowing of PSEs guaranteed by their state governments or unfunded pension liabilities.

Debt-GDP ratio of the centre had gone up earlier, from 33 percent in 1975-76 to 55 percent in 1990-91. It declined to 51 percent in the latter half of the nineties but because of the growing deficits of the states, the combined debt ratio of the government in India which had climbed to 62 percent in 1990-91 (as against 38 percent in 1975-76) remained at 59 percent at the close of the nineties. As a consequence of persistent debt and deficits and increasingly high cost of borrowing, the interest burden on state budgets went up sharply in the nineties, accounting for over 30 percent of their revenue receipts in several states.

Competitive populism had already enlarged the subsidy budget of the governments. In 1998-99, budgetary subsidies formed nearly 13 percent of GDP of which nearly 9 percent came from the states. Then there were off-budget subsidies and losses of public sector undertakings draining the resources of both centre and the states. The State Electricity Boards in particular turned out to be biggest burden on the state budgets. Their losses now form as much as 40 percent of the revenue deficit of the states.

Things came to a head with pay revision of employees in 1997-98. In a number of states interest, salaries, and pensions now take away more than 70 percent of the revenue (in one state, West Bengal they exceed 100 percent) vide Table 7.

Fiscal analysts are unanimously of the view that the present levels of debt and deficits of the government are unsustainable. Signs of the public sector breaking down are already in evidence. To quote the Approach paper to the Tenth Plan (TPAP):

'In many states we have

- Engineers but no fund for construction or maintenance
- Doctors, but no medicine
- Teachers but no school buildings'. (TPAP, p. 18)

Can it be said that economic federalism in India with the centre in command performed well in the stabilisation function of the government and things deteriorated only with the advent of coalition politics, cooperative federalism and weakening of the centre?

It would be overly simplistic to blame the ills of the public sector on federalism. In the last analysis deterioration in the quality of governance and public services is a reflection of the failure of democratic processes of the country to establish an efficient governmental system *via* elections and expression of public opinion through the media. Although elections are held in India freely and regularly for all levels of government and the media too enjoy a freedom unknown in developing countries, for reasons rooted in our social milieu the political system has proved inadequate to establish effective accountability of governments either for service delivery or for managing government finances prudently. However, it has to be recognised that accountability has suffered also because of flaws developed by the institutions of federalism in their working.

While the constitution provided for a fairly decentralised system of governance over a large area which should have helped to secure accountability of governments, the gap between providers of public services and their beneficiaries has widened as a result of the centralisation that took place in the first three decades. Until now public service delivery at local levels was effectively in the hands of governments above them. Accountability has been weakened also by faults in the system of intergovernmental transfers, to which critics have been drawing attention since long (Rao and Chelliah, 1996, Thimmaiah 1981).

Weaknesses of the Transfer System and Consequences

A fundamental shortcoming of our transfer system pointed out by critics has been the 'gap filling' approach of the FCs whereby grants-in-aid are recommended for states found to be in deficit in their revenue

budget after taking account of their share of central taxes under the FC's devolution formula. This, it is alleged, creates a moral hazard problem and acts as an incentive for improvident budgeting. States showing large deficits in their budget get rewarded while those that manage their finances better, suffer.

Undeniably, there is some truth in this allegation. For although the share of individual states in the devolution of central taxes that constitutes the dominant component of transfers ordained by the FC — the statutory transfers, as they are called — is determined by formulae relying on parameters unrelated to the actuals of their revenue and expenditure (*vide* Appendix II), the manner in which the balance of the statutory transfers, that is the grants-in-aid, are decided can act as a source of fiscal indiscipline. This need not have been the case had the budget gaps of individual states been assessed on the basis of objective norms independently of actuals. Not that the FCs go entirely by what the states project of their revenue and expenditure. Projections are made by the FC, on the basis of growth rates or norms of their own. But the starting point — the base year figures from which the projections start — still rely heavily on history or past actuals. The projections made by an FC are thus of no consequence to its successor. They simply go into the 'dustbin of history' as Chelliah (2000a) puts it. The Ninth FC made an attempt to apply norms for estimating the base year figures based on scientifically derived parameters. The EFC also has made an attempt to do so, but these efforts have not gone very far.

The belief that the absence of a full-fledged normative approach may have weakened fiscal discipline finds some support also from findings of research showing that increase in the grants from the centre to the states have dampened the tax effort of states who benefit most from the 'gap filling' approach of the FCs. According to one such finding, higher the ratio of central grants in total expenditures of a state government, the lower is its tax effort (Jha, et.al. 1999), almost signifying a dependency syndrome among states receiving large amounts of grants from the centre. That such a syndrome may have taken hold of the states is evidenced also by the steady decline in the proportion of revenue receipts from own sources in their revenue expenditure for all categories of states as the following figures would show. Special category states now meet only 17 percent of their current expenditure out of their own source revenues (some, as little as 4 percent), low income states, 38 percent, middle income states, 56 percent and high income states, 67 percent, depending on central transfers and borrowings to finance the rest (Table 8). Borrowings too, it may be noted, form part of centre's dispensation, directly or indirectly.

Summary Table 1
Own Revenue Receipts as Proportion of Revenue Expenditure

Category	1970-71	1980-81	1990-91	1998-99
High income	77.96	83.55	75.23	66.55
Middle income	61.30	69.37	59.31	55.80
Low income	54.26	51.98	44.29	38.30
Spl. Category	24.80	26.96	22.78	17.10

(For statewise figures, see Table 8).

It is not the faulty design of statutory transfers alone that can be held responsible for creating perverse incentives for fiscal discipline among the states in India. For as already noted, substantial funds flow from the centre to the states also through the PC. The PC assists the states with funds in the form of grants and loans for the Plan which in the case of general category states is in the ratio of 30:70, while for those in the special category the ratio is 90:10.

Since 1969, that is, when the *Gadgil Formula* was adopted, plan assistance is allocated among the states out of the total amount set apart in the Union budget as 'gross budgetary support for the Plan', on the basis of a formula. Population carries the maximum weight in the formula followed by factors like relative position of a state in terms of income levels (Appendix III). Some weight is attached also to factors like tax effort. While this imparts a measure of transparency and an incentive for better tax effort, the actual amount allocated to a state is decided through bilateral negotiation through the Annual Plan discussions. Approval is accorded to state Plans in terms of their proposed 'outlay' broken down under their principal sources like 'balance from current revenues', surpluses of public sector enterprises, market borrowings and so on. There is no indication of the revenue and capital components in the approved Plan and so no attempt is made to match the available resources from current revenues with the revenue expenditures contemplated under the Plan although the revenue component constitutes over 50 percent of the Plan in almost all states. According to the Tenth Finance Commission this has been one of the main causes of 'the endemic fiscal disequilibrium' of the states (TFC Report, p. 6).

The point to note is that the borrowing programmes of the state always had the imprimatur of the PC. While according approval to the state Plans, the PC sets limits on a state's borrowing from all sources including the centre, as also from domestic financial institutions and accretion to small savings. There is no evidence that debt sustainability

of individual states was analysed in the process. Even history does not seem to have been taken sufficiently into account. One thus finds the PC giving approval to large state Plan even when the state failed to achieve the targets set in the preceding year by a large margin (Anand et.al. 2001).

The system of mediation of the states' borrowings by the centre aggravated the ill effects of this system of Plan budgeting. Until recently, loans from the centre constituted the largest component of borrowing by the states. Even now central loans meet about 40 percent of the states' deficit (Table 9), the rest coming from the market, small savings, and employees' provident fund.[4] When the market loans are mediated by the center the lending FIs take little care in assessing the creditworthiness of a borrowing state. Until recently, loans were extended by FIs at uniform rates of interest and maturity to all states. Temporary accommodation is available in the form of ways and means advance/overdraft from RBI. The limits on time and size set for ODs help to exercise some discipline in the matter of short-term cash management but has not helped to prevent improvident budgeting by the states which is facilitated by their access to borrowing irrespective of the debt-servicing capacity of their budgets.

Faced with relatively limited access to tax sources and having the facility to borrow with or without centre's 'blessings', it is not surprising that the states turn to borrowing when under pressure to spend or when their revenue accretion suffers because of a drop in central tax revenue growth as happened in the nineties. Ironically, the pressure originates not merely from the populist agenda of the state governments themselves but also from the spending decisions of the centre such as the CSSs that leave a component to be met by the states and a legacy of expenditure liability for them on a longer footing. Unfunded mandates like rural electrification and the fallout of salary revision of employees by the centre, grants to MPs for local area development programmes and so on, also generate pressures on the states to spend.

Article 293 of the Constitution empowers the Union government to deny a state access to borrowing so long as it has any debt or guarantee outstanding to the centre. There are ways in which the states can bypass the constraint such as by borrowing through enterprises set up by them, off-budget borrowings as they are called. The practice of passing on to the states the bulk of the accretion to small savings on origin basis provides another channel of states' borrowing over which Article 293 does not apply. Of course, the centre could still exercise restraint over the states' borrowing by limiting its own lending or lending

by FIs to states that are already heavily indebted. But the centre does not seem to have exercised the powers it can on the states borrowing available under Article 293. Otherwise, it is difficult to explain how the borrowing of the states during the Ninth Plan could mount to over Rs.2,00,000 crore when under the Plan the deficits in the balance from current revenue were put at no more than Rs.20,000 crore (Planning Commission, 2001).

Bailouts extended by the centre from time to time in the form of debt forgiveness, rescheduling,[5] special accommodation etc. also weaken whatever inhibition the states might otherwise have in resorting to borrowing. Ultimately it is the expectation of being bailed out by the centre that underlies the tendency on the part of a subnational government (SNG) to incur expenditure beyond its available revenues and resort to improvident borrowing.

Bailouts, however, are the manifestation of the weakness of political and not merely fiscal institutions of a federation. Studies on subnational debt in some of the OECD countries show that the political composition of the central government often played a significant role in their decision to bailout SNGs. Even fiscally irresponsible SNGs were able to obtain bailout from the centre because of their relationship with the ruling party (or coalition) at the centre. This sometimes becomes blatant when the central government happens to be a 'loose coalition of logrolling regional interest groups' - as was seen in Brazil and is found occuring in India (Rodden et.al. forthcoming).[6]

The sub-national fiscal woes that assumed crisis proportions in India towards the close of the nineties would seem to corroborate the views of critics of decentralisation like Tanzi (1995) that whatever be its other virtues, decentralised governance is not conducive to stability as it creates hurdles for the centre in fiscal coordination. However, Indian experience shows that economic federalism with a strong centre running the country almost like a unitary state, provides no guarantee of prudent fiscal management. The practices of improvident plan budgeting with the centre looking on and putting Article 293 almost in cold storage, followed with periodic episodes of bailouts, had started even at a time when the centre was in full command. The disease had set in before financial liberalisation came; only the symptoms were suppressed. Heavy doses of monetised deficit and high rates of inflation in the seventies and eighties and chronic imbalances in the central budget were the manifestations of the malady. Imbalances were incipient in the State budgets too.

The regime of administered interest rates, high SLRs preempting a large proportion of the savings of the private sector for the government had helped to keep things under control. Once the key support systems of plan financing were withdrawn following liberalisation 'the internal logic of the system began to collapse', as one analyst puts it (McCarten, forthcoming). The practices of improvident plan budgeting and annual plan approval by PC, however, continued. Pay revision of employees precipitated the crisis which was already brewing, raising a question mark over the efficiency of the federal system in the matter of fiscal coordination.

What was the record of economic federalism in performing the third function of government listed in Musgrave's three-branch view of the public sector's responsibilities viz., redistribution? If the transfer system was deficient in providing the right incentives for good fiscal conduct on the part of the states, did it at least help to address the horizontal imbalances and bring about redistribution regionally? This is taken up next.

IV. Record of India's Federalism in Redistribution

Before proceeding to inquire whether or how far India's federalism has advanced the redistribution function of the government — which, in a federal context, translates into the task of ameliorating regional disparities across the country — it is pertinent to ask, does redistribution constitute a basic function of government? The question has assumed relevance in the context of increasing disillusionment with the limited success attained by redistributive measures to correct economic disparities and remove poverty and the focus shifting to efficiency in recent years. Transfers recommended by the Eleventh Finance Commission came under particularly sharp attack because of what was seen as an undue tilt towards equity to the neglect of efficiency; some critics have raised doubts even about the constitutionality of attaching weights to inequality indices in the formula for allocating the share of the central taxes among the states (Godbole, 2001).

Public expenditure theories designed to show how resources are optimally allocated between the public and the private sector by equalising the social costs and benefits at the margin, proceed on the assumption of a given state of distribution. However, Wicksell who first indicated how the public sector can be optimally organised, applying marginal analysis, also postulated that for the tax-expenditure

arrangements to be efficient as well as just, the underlying distribution of income must be fair. In order to close the model, a tax-transfer budget is required to establish a just state of distribution. What is 'just' in this context involves a value judgement raising issues in ethics. As Musgrave (1999), pointed out in the course of a recent debate on *Public Finance and Public Choice*, ultimately, the mandate for fairness or equity in the distribution of income and consumption in the community is derived from ethical precepts that are accepted by civil societies as a matter of categorical imperative.[7]

Starting from this premise, it is argued, in a federal system distribution has to be a concern of the centre mainly for the reason that redistributive policies are difficult to pursue at the state level. Redistributive tax – transfer policies in any one state tend to drive away the rich and bring in the poor. Thus while the states can have distributive concerns of their own, redistribution across the country has to be the concern of the centre.

'Grants' constitute the principal instrument available to the centre in performing this task. Funds are transferred to jurisdictions whose fiscal capacities are below the national average or a given standard, to equalise the fiscal capacities of subnational jurisdictions and thereby reducing interjurisdictional disparities. Equalisation grants are in vogue in many countries, e.g., Germany, Switzerland, Australia, and Canada and are used selectively in USA too. Such transfers are regarded as desirable as a matter of categorical equity when fiscal capacities of governments differ sharply because of disparities in average level of income or resource endowment. Grants are used also to support (or discourage) selected state level programmes that generate spillovers or benefits (or harmful outcomes) external to the state of origin (e.g., for reducing pollution) or for programmes of national interest.

According to one school, equalisation is conducive to efficiency as well because by helping to equalise net fiscal benefits across states, such transfers help to neutralise fiscally induced migration of labour. This view is contested by some on the ground that the migration that occurs from low productivity regions to those where productivity is higher, promotes efficiency and so, equalisation transfers, by discouraging such migration dampen the incentives for efficiency. The case for equalisation transfers is questioned also by pointing to the possibility that taxes and government expenditures get capitalised in the costs of goods and services and in the presence of full capitalisation, equalisation transfers of a general, non-matching variety cannot be justified either on equity or on efficiency grounds (Shah, 1996). However, full capitalisation is a rare phenomenon and so it is generally

agreed that there is some justification for equalisation on grounds of both equity and efficiency.

It is noteworthy that the case for equalisation is recognised explicitly in Article 36 of Canada's Constitution of 1982 in the following terms:

> 'Parliament and the Government of Canada are committed to the principle of making equalisation payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public service at reasonably comparable levels of taxation.'

Equalisation grants now form the dominant component of federal transfers to provinces in Canada, constituting 'a central pillar of fiscal federalism in Canada' (Boadway, 1998). These are unconditional transfers the rationale for which is derived from two 'overarching' principles, viz., a 'federal rationale' and a 'citizenship rationale'. The federal rationale proceeds on the reasoning that if the federal principle is to be meaningful, then each level of government in the federation should have the requisite financial means and financial security to carry out its constitutional responsibilities (Milne, 1998). This rationale was originally articulated by the *Canadian Royal Commission on Dominian Provincial Relations*, (*the Rowell –Sirois Commission of 1940*) while recommending 'National Adjustment Grant'. The arguments advanced in support of the recommendations are worth recalling. To quote:

> 'The Commission's plan (for National Adjustment Grants) seeks to ensure every province a real and not illusory autonomy by guaranteeing to it, free from conditions or control, the revenues necessary to perform those functions which relate closely to its social and cultural development'. (Report of the Royal Commission, quoted in Courchene, 1998).

The justification for equalisation derived from the citizenship rationale is based on the reasoning that the citizen of a federation, wherever he/she may live should have access to certain 'key economic and social rights – rights that ought to attend citizenship, as it were' (Courchene, 1998). Equalisation transfers also serve as a valuable aid to the stability of a federation - 'a glue' so to say, to keep a heterogeneous population together.

The scheme of transfers envisaged in the Indian constitution bears ample evidence of the awareness of the basic rationale for which intergovernmental transfers are required commonly in a federation. Sharing of tax revenues raised by the centre is explicitly mandated in the constitution in recognition of the vertical imbalance implicit in the assignment of the powers and functions to the two levels of government (the 'federal rationale'). The constitution also authorises the centre (and the states) to make grants for any public purpose which presumably embraces the case of spillovers. Although redistribution or equalisation does not figure in the way it is explicated in the Canadian constitution, the fact that the grants-in-aid to be provided by the FC are required to be determined on an assessment of the budgetary needs of individual states is taken to signify, quite rightly, a mandate for equalisaton at least to a reasonable extent (the 'citizenship' rationale).

That apart, balanced regional growth has been one of the professed aims of public policy in India right from the inception of planning. The focus of the literature on central transfers in India also has been to examine how well they have served equity by correcting economic disparities across regions. A brief review of the trends in regional disparities may be in order.

Regional disparities - Trends

Going by levels of income as reflected in per capita state domestic product (SDP), it would appear that the regional disparities in India have, if anything, accentuated in the last fifty years. While there has been significant improvement in income and consumption levels all over the country, the gap between the relatively rich and the poor states has widened.

Over the four decades 1960 to 1998 disparity in per capita NSDP of 25 states (excluding Goa) measured by the ratio of the highest to the lower income state has gone up from 1.9 to 3.5. The widening trend in the disparities has accentuated in the nineties (Table 10). The coefficient of variation (CV) has also increased from .197 to .309. Between 1970-71 and 1998-99, the proportion of NSDP accounted for by high income states has gone up from 28 to 34 percent while their population share has remained at 20 percent. The shares of middle and low income states in NSDP, on the other hand, have registered a decline (*see* Summary Table 2 below).

Summary Table 2
Share of States in Population and NSDP(%) – Groupwise

States	1970-71	1980-81	1990-91	1998-99*
High income				
Population	19.7	20	20.3	20
NSDP	27.6	30.8	33.0	33.8
Middle income				
Population	33.4	32.7	31.9	29
NSDP	34.6	32.5	31.0	32.9
Low income				
Population	43.8	44.1	45.1	45.0
NSDP	34.7	33.8	33.4	30.0

Source of NSDP data: CSO
* Population figures based on Census, 2001.

Latest estimates of the proportion of people living below the poverty line also show that although there has been a decline in the incidence of poverty in all states, there are marked variations across states; in Bihar and Orissa, the proportions are 42.6 and 47.2 percent respectively, in Madhya Pradesh and Uttar Pradesh, the proportion is over 30 percent and so is the case in the majority of the special category states, while in some states (Punjab & Haryana), BPL population has come down to less than 10 percent (Table 11).

Another indicator of living standards and level of economic activity viz. electricity consumption per capita also points to sharp and persistent regional inequalities (Table 12). As of 1998-99 the latest year for which figures are available electricity consumption per capita in Assam was 123 kwh against 724 in Gujarat and 861 kwh in Punjab. In 1985-86 the respective figures were 53 kwh, 229 kwh and 423 kwh. While the max/min. ratio in per capita electricity consumption has come down from 8 to 7 during this period, the gap between the advanced and the poorer states remains wide.

Disparities have remained sharp also in social development. Even now (2001) female literacy is only 34 percent in Bihar, 44 percent in Rajasthan and 51 percent in Orissa as compared to 88 percent in Kerala and over 60 percent in Maharashtra, West Bengal and Tamil Nadu. Infant mortality rate per 1000 live births is as high as 96 in Orissa, and 94 in MP as compared to 12 in Kerala, 47 in Maharashtra and 51 in Punjab (Table 13).

Regional disparities – converging or diverging?

Literature on growth theory tells us that the level of development among nations tends to coverage as poorer nations catch up with higher growth. Studies undertaken by scholars throw some light on whether the hypothesis of convergence holds for states in India as well. While the results are not unanimous, some broad conclusions have emerged.

A study carried out by researchers at IMF based on data for 20 states spanning the period 1961-91 finds some evidence of absolute convergence whereby different entities move towards the same steady state (Cashin & Sahay, 1996) Others have questioned the findings pointing to methodological flaws. Most of the other studies find evidence either pointing to divergence or at best 'conditional convergence', that is, where the entities in question (states in this case) converge to possibly different steady states. A study by Rao, Shand and Kalirajan (RSK, 1999) covering 14 major states over the years 1965-95 finds no evidence of either absolute or conditional convergence; on the contrary the evidence, according to them, points to divergence. The study suggests that the speed of divergence had accelerated in the half decade, 1990-95.

A notable conclusion of the RSK study is that private investment (PI) plays an important role in explaining growth differences across states flowing disproportionately more to high-income states as well as to states with higher per capita public expenditure. They also argue that explicit centre-state transfers have had only moderate impact on inter-state disparities, and that their influence has been overshadowed by implicit transfers *via* subsidised lending (public and private) and interstate tax exportation.

A more recent study by M.S. Ahluwalia (2000), also concludes that interstate disparities have accentuated after the economic reforms of the 1990s as some of the richer states, recorded faster growth in the nineties than in the eighties and the dispersion in growth rates among states, increased significantly.

The widening trend in the disparities that was discernible even in the late eighties became more pronouned in the nineties. D.K. Srivastava, (2001), finds that the Gini-coefficient of inequality in real per capita GDP among 23 out of 25 states has increased over the period 1980-81 to 1996-97, with the rising trend setting in during the latter half of the eighties.

Like RSK, Ahluwalia concludes that the main factor underlying disparate growth performance of the states has been the larger flow of PI into the richer states offering better infrastructure and good governance. Finding no significant correlation between plan expenditure as a proportion of SDP and growth, Ahluwalia concludes that it is the variation in the scale of private investment that explains the inter-state divergence in capital build up. Since with liberalisation the centre's hold on location of investment has almost disappeared, it is for the states to attract private investment into their jurisdictions for which what matters is 'labour skills, work culture, good infrastructure and good governance'.

Statistical analysis however reveals a positive relationship between plan outlays and development (Sarkar, 1994). In any case it is generally agreed that poor infrastructure has been a major factor underlying the failure of poorer states to catch up. There is evidence suggesting that disparities in physical infrastructure development (PID) have sharpened over the years 1971-72 to 1994-95 (Ghosh and De, 1998). MSA's paper also brings out that PI which constitutes the mainspring of growth depends heavily on infrastructure. Thus the skewed flow of PI into the backward states can be traced to their poor ranking in terms of PID which again is attributable to their low levels of plan outlay. And for that the transfer system must bear larger responsibility.

A contributory factor may have been the distribution of investments of the central government. Unfortunately, no information is available on the statewise distribution of central investments, nor is it known whether regional spread figures in the investment decisions of the centre. In USA, even defence spending takes the regional spread into consideration. There can be little doubt that lack of basic infrastructure is a major handicap for their development – Manipur, Nagaland, Mizoram, Sikkim, and Tripura do not have any mentionable connections by rail with the rest of the country.

It is generally agreed, as MSA postulates, that in addition to infrastructure, other factors that influence PI flows are labour skills, work culture and good governance. While work culture, and governance depend on many factors which are not all economic, the role of public expenditure on education and training which ultimately determine the quality of social infrastructure like labour skills should not be overlooked. The level of public expenditure on social sector, however, varies sharply and this is where central transfers matter.

No doubt, transfers serve to moderate the variations in the revenue receipts of the states significantly. Thus in 1970-71, while the

CV in the per capita revenue receipts of the states from their own sources measured .45 with transfers, the CV in per capita revenue expenditures came down to .23. The disparities have however persisted, in fact, have widened. In 1998-99, the respective CVs of own source revenue and total revenue (with transfer) worked out to .54 and .33 respectively. CV in per capita revenue expenditures measured .32 in 1998-99 as against .23 in 1970-71(Table 14).

The following table compiled by D.K. Srivastava (2001), for the years 1996-97 to 1998-99 shows how the low and middle income states lag behind the higher income ones in per capita current expenditures by the respective state governments in sectors that hold the key to growth viz. social and economic services. On an average, the level of current expenditures of low income states on social services is less than half (46 percent) of what high income states spend. In economic services, per capita expenditure of low income states works out to no more than 67 percent. Even with the tilt towards poorer states in the devolution formula of the EFC, per capita revenue availability of the states does not come anywhere near equality. Available figures show that Bihar's revenue availability on non-plan account would be no more than 60 percent of the average for major states even after EFC's transfers.

Summary Table 3
Per Capita Revenue Expenditure on Services: Relativities Between Low, Middle and High Income Group States
(Average 1996-97 to 1998-99)

(Percent)

	General services excl. int. payment and pension	Interest payment	Pension	Social services	Economic services	Total
General category states						
LIS/HIS	61.63	52.24	50.71	45.89	67.32	53.46
MIS/HIS	68.42	60.74	102.58	73.72	106.04	78.97
Special category states						
LIS/HIS	50.40	51.64	79.48	50.51	41.89	49.59
GCS/SCS	32.78	72.90	82.41	51.63	35.35	48.72

Source: D.K. Srivastava (2001).
Notes: LIS= Low Income States, MIS = Middle Income Sates, HIS = High Income States

The fact is that the equalising effects of the transfer notwithstanding, the capacity of the states to undertake developmental expenditure by way of spending on social sector and investment projects, varies widely as is evident from the differences in their per capita plan outlay. During the Eighth Plan, Bihar had a per capita plan outlay of Rs. 1391 as compared to over Rs. 3000 in Haryana and

Punjab. In the Ninth Plan again Bihar had an outlay of only Rs. 701 per capita as against Rs. 4756 in Maharashtra and Rs. 4791 in Gujarat (Table 15). It may not be wrong to think that the accentuation of disparities in India in the last fifty years has resulted at least partly from the disparities in the capacities of the states to undertake growth promoting expenditures and the transfer system has not been able to alleviate them sufficiently.

Overall, the transfer system no doubt had a moderating influence on the disparities in the level of revenue expenditure across states but marked inequalities persist. One reason is that while transfers designed by FCs lay considerable stress on equity, funds flowing through other channels do not always move in the same direction. Transfers through the PC under the *Gadgil formula* are not as equalising as the statutory transfers. Assistance under CSSs and externally aided projects are believed to be even regressive. Substantial amounts are spent by central ministries on various programmes that benefit the states which are not routed through the state budgets. In the budget for 2000-01 for instance, a provision of Rs. 17,000 crore was made for various welfare schemes to be spent by central ministries directly or thorough district development agencies against Rs. 9700 crore under CSSs. The distribution of these amounts among the states is not known. While the basic weakness of the poorer states stems from their weak economies and accompanying revenue bases, the transfer system has not helped to reduce them to the extent required to bring about a measure of equality in their revenue capacity.

Economic federalism of the first three decades, was perhaps instrumental in containing the growth of disparities somewhat while liberalisation and change in the character of federalism thereafter took the lid off market forces and led to their accentuation. However, economic federalism did little to tackle the sources of the disparities, that is, factors that constricted the growth of poorer states and thereby of their revenue bases. Rather, by thwarting the growth impulses centrist federalism had acted against the forces of convergence to come into play and created a dependency syndrome among the poorer states.

There are some silver linings on the horizon, however. While demanding 'cooperative federalism' in their relations with the centre the states are nevertheless competing among themselves not only for a larger share of central funds but also in outshining each other in development. Despite all odds competitive federalism may provide the stimulus for convergence. But in order that the process does not take too long or exacerbate inter-regional disparities in the interim, the handicaps of backward states in terms of availability of resources need to be

neutralised so that they can compete on a reasonably equal footing, as the great exponent of competitive federalism, Breton (1995) points out.

It is disturbing to find that the changing character of India's fiscal federalism may be affecting its redistribution function in a negative way. But this is what is suggested by some new findings of Govinda Rao and Nirvikar Singh (Rao and Singh, 2001). Testing a model with simple specifications, they find some evidence of the importance of variables that may be taken to reflect the bargaining power of the constituents of the Indian federal system. This conclusion is derived from the 'positive effect' they find of 'economic and demographic size of the states on both statutory and discretionary transfers per capita and of the lagged effect of a match between the states and central ruling parties on grants for state plan schemes'. In one specification, they also find evidence of a positive though lagged effect of the 'proportion of ruling party/coalition MPs on per capita statutory transfers'. These findings are put forward with caveats regarding the 'potential fragility of econometric results' and so on. However, intuitively, it seems entirely plausible that the clout of a state in terms of its size (or strategic importance to the union government) can influence the dispensation of the centre's funds and other favours among the states.

This intuition also accords with the view propounded by William Riker that 'federalism is the outcome of a constitutional bargain among politicians' (Riker, quoted in R-S, 2001). The challenge for constitution makers of federalist polities is to see that the process of bargaining yields outcomes that are both economically efficient and politically wholesome. Whether the practices in intergovernmental relations that are emerging in India now will be efficient for the economy and also the polity, only time will tell. Meanwhile, an exploration of ways to reform the system and arrest unhealthy trends may not be out of place.

V. Explorations for Reform

The preceding discussion shows that fiscal federalism in India had a positive impact on the performance of the public sector and the Indian economy in the initial period of planning covering the first two plan periods. Unfortunately, the growth momentum that the economy had acquired as a result did not last. The country moved on a slow growth path in the next twenty years. Growth picked up in the eighties but the chronic imbalances that had developed in the economy threatening stability culminated in the crisis forcing major reforms. Four basic weaknesses of the fiscal federalism as practised in India that seem to have dampened the growth performance of the economy are:

- Over-centralisation of economic policies and attempt by the centre to take on too much and micro-manage the economy by intruding into areas assigned to the states in the constitution, stifling local initiatives and weakening accountability of lower level governments.

- Failure to ensure the development and smooth functioning of a common market in the country and prevent its segmentation through fiscal and quasi-fiscal actions of governments at both levels.

- Faulty design of intergovernmental transfers creating perverse incentives for fiscal behaviour of recipient governments.

- Inadequate central oversight over states' borrowing resulting in the problem of subnational debt and deficit.

Reforms will be needed on a wide front if these weaknesses are to be removed. Working out an exhaustive agenda for reforms is beyond the scope of this paper. However, a few suggestions may be offered.

First, the scheme of assignment of functions and powers to different tiers of government as contemplated in the constitution should be respected in letter and spirit, with only such modifications as may appear needed to correct the deficiencies and the negative externalities that have surfaced over the years in their operation. The centre should disengage from functions that are better performed at the lower levels of government. The tendency on the part of the centre to micro-manage the economy should cease. The CSSs should be compressed to only a few that represent truly national interests that the states may not be in a position to look after.

With constitutional recognition of local governments, more powers and responsibilities should be assigned to *panchayats* and municipalities. The key to accountability in delivery of public services lies ultimately in this. Results achieved in some states with decentralisation are most encouraging.

Secondly, assignment of tax powers needs a fresh look. For SNGs to be accountable and fiscally prudent it is desirable that as far as possible they can meet their expenditures out of revenues they can raise on their own at least at the margin. This is particularly important in the

context of the constitutional recognition of the third tier of governments, as most of them lack any substantial revenue sources of their own.

Generally accepted principles of tax assignment in a federal polity suggest that in the interests of autonomy and efficiency, SNGs should have the power to levy taxes that provide little scope for tax exportation and do not interfere unduly with internal or international commerce. Residence-based taxes like proportional individual income tax and destination based value added tax on consumption come within this category. Taxes may be assigned concurrently to more than one jurisdiction: There is no particular virtue in assigning a tax exclusively to one jurisdiction. Compliance and administration are both helped if there is some uniformity in the tax bases but the power to fix the rates should rest with the states. That would enable the states to control the level of their revenue at the margin to finance expenditures desired by their people.

One way of enlarging the tax powers of subnational governments while avoiding the distortions, inequities, administration and compliance problems associated with independent taxation at lower levels is to allow them to levy surcharges on tax bases defined at higher levels. Subnational surcharges have been recommended as the most appropriate form of tax assignment for developing countries (McLure, 2000). The feasibility of assigning the power to levy surcharges to subnational governments particularly at the local levels (*panchayats* and municipalities) should be explored to a much greater extent than is the case now. Feasibility of assigning new taxes like the 'business value tax' proposed by Bird for local governments may also be explored to reduce their dependence on higher level governments for funds (Bird and Mintz, 2000).

Thirdly, in expenditure responsibilities, the concurrent list is much too wide providing scope for overlap. While there may be a case for central intervention in many matters, the scope for overlap needs to be reduced. Overlap leads to vertical competition among governments to capture voter power and dilution of accountability and thereby wasteful enlargement of government expenditure (William Niskanen in Buchanan and Musgrave, 1999). However, it should be the centre's task to control externalities and spillovers from the states' tax and expenditure policies firmly.

This is particularly important for the smooth functioning of the internal market in the economy. While with delicensing a major hurdle to the states' autonomy in industrial location policy and the working of free enterprise in the economy has now gone, some of the other barriers

remain, as evidenced by the reservation for small industries, continuing controls over the movement of several commodities like foodgrains, and cotton, origin based sales taxation of inter-state trade and the jungle of taxes and regulations at various levels of government. The reported exodus of intending foreign investors owes not a little to the mess created by regulations of various kinds, that are still in operation.[8] The centre would be well within its rights to see that the Part XIII of the constitution that assures free flow of trade and commerce within the country remains effective.

What is more, there is an urgent need to rethink the role of planning. With liberalisation and dismantling of the regime of controls that constituted its support system, planning has lost its rationale. The states should be encouraged to draw up their own schemes of development and implement them with resources available from their own budget and borrowing from the market.

As recommended by Chelliah in one of his recent papers, it is time the Planning Commission gave up its system of 'approving' the five-year and annual plans of the states. The states which are doing well should be allowed to draw up and implement their plans as they think best, the PC may help them with advice. The PC should focus its attention on the backward states by formulating special development programmes for them in consultation with them (Chelliah, 2000b). The programme should be implemented largely by the centre in association with the state governments. This is the only way in which the backward states and those coming within the special category can be helped to develop their revenue base and come out of their dependency syndrome. There should be no objection from the 'have' states to the centre concentrating on the backward states as the growth of the better off states is propelled largely by the flow of private investment. 'Industrial entrepreneur memoranda' drawn up in the last ten years (1991-2001) show that over 50 percent of the investments proposed are accounted for by only four states. That should compensate for the centre's attention being focused more on the poorer states.

The transfer system also needs some radical reform. To cure the weaknesses of the system, the multiplicity of transfer channels should go. All revenue transfers from the centre barring only those for meeting special situation, should come within the purview of the FC. However, the design of the FC's transfer needs to change. Revenue transfers should be based strictly on the basis of a normative assessment of the revenue capacity and cost disabilities of the states. That is the only way to neutralise the disincentive effects on fiscal discipline that is inherent from transfers.

One important reason for the inability of the FCs to assess the revenue needs of the states normatively, which is believed to be a prime source of fiscal indiscipline in the states is inadequate technical input in their deliberations. Determination of norms – or the application of techniques like the Representative Tax System as followed in Canada and Australia call for building up research expertise within the government. The need for establishing a permanent secretariat for the FCs to undertake research on a continuing basis has been emphasised by many. This requirement needs to be met.

Another problem with the FCs' transfers has been the segmentation of transfers recommended by them into tax devolution and grants-in-aid. With tax devolution accounting for nearly 90 percent of the revenue transfers ordained by the FC, the grants-in-aid have lost their teeth as an equalising and disciplining instrument. For transfers to be based on rational principles, the focus should be only on equalisation of revenue capacity to meet normatively assessed expenditure needs. That requires integration of all components of revenue transfer into one. Given the constitutional mandate for tax sharing it may not be easy to reduce the weight of tax devolution drastically in one stroke. A beginning can perhaps be made by gradually moving in that direction.

Equalisation transfers based on norms should provide the signals required for good fiscal conduct. General purpose grants such as for equalisation should carry no conditionalities except the requirement to maintain proper accounts and submission of accounts and supporting vouchers and audited accounts of PSEs within the prescribed time. Subjecting general purpose grants to any conditionality other than what is required for proper accounting violates the spirit of the constitution that mandates the flow of central revenues through an impartial body like the FC to assure impartiality in the dispensation of central funds.

This is not to negate the case for specific purpose transfers altogether. states with markedly lower levels of public services and wide gaps in areas like health and education will need specific purpose grants and their implementation must be regularly monitored. However, any such transfer should be integrated into the overall equalization transfers by setting them off against the entitlement of a given state to equalisation grants.

Transfers are needed also to neutralize spillovers and the potential for inefficient migration of labour and capital transfers, but all such transfers need to be carefully designed to see that a right balance is struck between equity, efficiency and autonomy. Transfers that are

meant to correct spillovers or externalities can result in 'backdoor centralisation' by shifting power over spending and public policy-making in favour of the centre that may not have been warranted by the constitutional arrangements. Hence the need for caution (Petchey, et.al. 1997).

Conditionalities can however be attached to loans. The system by which loans are advanced and mediated by the centre to states at present are marked by features that have a deleterious effect on fiscal discipline and need to be attended to urgently. Experience across the world shows that fiscal discipline among SNGs is promoted not so much by hierarchical controls as by the market – the capital markets, land markets and owners of mobile factors like workers and investors (Rodden *et.al,* forthcoming). States are forced to observe fiscal prudence as poorly performing states are punished by the market with higher cost of borrowing or limited access to credit. Societal norms and public awareness also matter (Shah, 1998). However, for markets to be efficacious in enforcing discipline, there should be a developed and well regulated capital market. That in turn presupposes that lending institutions are allowed to function autonomously guided purely by prudential norms.

Few among the developing countries can meet these requirements. In fact only in USA and Canada, SNGs have to rely only on the market for credit. But even in these countries market based discipline took time to be established and the countries had to go through a prolonged period of pain in the process – some states/provinces remained in default for long periods. Hence, some hierarchical, federal control exercised preferably through a loan council as in Australia will be needed before market based discipline can work. But such control should be rules-based.

Rules have the merit of transparency and even-handedness and may be framed to lay down limits to the absolute level of aggregate SNG borrowing (including those contracted outside their budget). Lending institutions should be guided by these norms. However, if market discipline is to come into full play, 'it is important not to backstop state and local debt and not to allow ownership of the banks by any level of government' (Shah, 1998).

Enforcement of fiscal discipline on the states is thus contingent on *inter alia* divestment of government ownership or control of the financial institutions. That raises the question, can the desirable reforms in the financial sector and other areas like removal of barriers to internal trade be brought about by the Parliament as it is constituted now?

While the philosophy guiding national economic policies has undergone a profound change in recent years, it is difficult to be optimistic. For one thing, even though the centre still wields considerable power over the states, the government at the centre is made up of a coalition of twenty odd parties with some of the regional parties wielding considerable power over the centre. This, together with the fact that legislation in many fields requires the approval of both houses of Parliament and it is the opposition that commands the majority in the Rajya Sabha, virtually ensures that the unanimity rule of decision-making which constitutes a key feature of cooperative federalism prevails.

The case for cooperative federalism is sometimes advanced by invoking the economic theory of bargaining propounded by Coase (1960) that suggests that market failures caused by economic spillovers or the inefficient provision of public goods can be resolved successfully by bargaining among the affected parties (like states in a federation). However, the conditions under which bargaining can succeed in resolving the spillovers or securing agreement in division of economic surpluses are rather restrictive and rarely hold in real life. In any case 'strategic interplay' becomes complicated when the number of bargaining jurisdictions is more than two or a given bargain is one of many. Those who argue that decisions on Finance Commission's recommendations should be subjected to approval by the inter-state council would do well to look at the experiences with bargaining in history. The failure of the confederate republic in America to secure agreement among the states for financing the defence of the newly independent country provides a classic example of such failure (I-R 1997). Interminable disputes among the states in India over sharing of river waters and the unimpressive record of the North-Eastern Council (NEC) also reveal the limitations of bargaining in producing efficient outcomes. It is not surprising that many bills considered vital for the implementation for the economic reforms and announced in the budget are currently stalled in standing committees of Parliament, the Minister for Disinvestment lamenting, 'everyone has enough power to block everything and no one has enough power to see anything through'.[9] Obviously cooperative federalism in its present form is not going to be of much help in moving the reforms forward although the process of consultation with the states initiated by the centre in the current phase of federalism is a welcome development. Which way then should we go?

If the impediments to the efficient functioning of the Indian economy are to be removed, fundamental reforms of its two basic institutions of federalism viz. representation ('R') in the central legislature and in rules of business, as also assignment ('A') will be needed. A consideration of the issues involved in such reforms is beyond the scope

of this lecture.[10] It is to be hoped that these will be taken due note of by the Constitution Review Commission. However, pending fundamental structural reforms, it may be fruitful to explore avenues of reform on the lines suggested above, whereby the inefficiencies can be minimised even under the existing constraints.

Concluding Remarks

Ultimately, in implementing economic reforms needed to push the economy forward there is no alternative but to reform the fiscal institutions of the federal system and the task needs to be faced upfront by the country. These reforms acquire further urgency with the tensions inherent in federal systems coming under increasing strain as modern technology demolishes frontiers and the world economy gets globalised, eroding the powers of nation-states on the one hand and of their sub-divisions on the other to pursue independent policies of their own. Smooth functioning of a fast globalising world economy presupposes a stable, secure and predictable environment for economic agents to operate. International organizations like the WTO are designed to ensure some discipline in the matter of international trade and commerce. The United Nations is now seeking a Global Tax Authority to curb tax competition and fiscal sovereignty of nations (Mitchell, 2001). Emergence of e-commerce is casting shadows on the ability of subnational governments to implement tax on sales in a non-distortionary manner.

Federalism in India as everywhere else, has to face the awesome challenges of the new millennium. That underlines the fact that no federal system can suit all countries for all times. Maintaining an appropriate balance in the relationship between the centre and the constituent units in a federation is as Buchanan said in the recent debate with Musgrave, akin to keeping a satellite in place, with centrifugal and centripetal forces keeping each other in check (Buchanan, 1999). To borrow another metaphor, federalism always remains a 'work-in-progress' or as Iqbal Narain put it 'constantly in the making' (Copland and Rickard, 1999). The federal structure needs perpetually to be altered and mended to cope with changing environment and emerging challenges.

However, the one cardinal reality that should never be lost sight of is that federalism is the only possible form of government for a polyglot country like India. For the federal structure to be stable and flexible, attention of both experts and the wider public is imperative all the time. I shall feel rewarded if this talk helps to stimulate a wider debate on the issues in federalism, and not merely fiscal federalism in India.

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Table – 1 : Receipts and Expenditures of States : Selected Parameters

(Percentages)

Year / Heads	1950-51	1960-61	1970-71	1980-81	1990-91	1995-96	1998-99	1999-2000
States' revenue expenditure as proportion of revenue expenditure of centre and states.	51.16	59.84	60.17	59.62	55.19	57.20	56.06	57.59
States' revenue expenditure (excluding expenditure on cs and css), as proportion of revenue expenditure of centre and states.	#	53.71	59.02	56.06	51.30	54.57	54.49	55.06
States' total expenditure (Rev.+ Cap.) as proportion of total expenditure of centre and states (rev. + cap.)	51.75	56.75	53.87	54.80	52.41	55.87	55.43	57.26
States' own revenue receipts as proportion of states' total revenue expenditure.	80.75	64.17	60.55	60.07	53.54	58.34	50.36	45.18
States' own revenue receipts + statutory transfers as proportion of states' total revenue expenditure.	97.59	87.70	87.15	88.64	70.88	81.84	69.27	62.65
States' revenue expenditure - (interest payments + pensions) as proportion of total revenue expenditure - (interest payments + pensions) of centre and states.	55.28	62.69	60.91	61.76	60.51	63.44	61.48	63.03
States' own tax revenue as proportion of total tax revenue.	35.41	33.70	32.53	33.59	34.36	36.54	38.29	38.38
States' total tax revenue as proportion of total tax revenue of centre & states	43.06	45.93	48.42	52.69	50.93	53.25	55.09	54.16

Year / Heads	1950-51	1960-61	1970-71	1980-81	1990-91	1995-96	1998-99	1999-2000
States' own revenue receipts as proportion of total government revenue	**41.73**	**39.54**	**38.34**	**37.52**	**38.11**	**41.25**	**41.05**	**37.36**
States' total revenue as proportion of total revenue of govt.	**47.84**	**58.71**	**58.37**	**63.08**	**63.21**	**63.60**	**62.75**	**63.05**

 # no cs/css in 1950-51.

Note : Revised estimates for 1999-2000.

Source : (1) Ministry of Finance - Indian Economic Statistics / Indian Public Finance Statistics (various issues)
(2) RBI - Study on State Finances (various issues).

Table – 2 : Composition of Revenue Transfers from Centre to States

(Percentages of total)

Plan/Period	Share in central taxes	Statutory grants	Total statutory transfers (col.2+3)	Plan grants	Discretionary grants	Total transfers
1	2	3	4	5	6	7
1st Five Year Plan 1951-56	54.43	4.27	58.70	29.27	12.03	100
2nd Five Year Plan 1956-61	45.85	13.45	59.30	36.99	3.71	100
3rd Five Year Plan 1961-66	47.84	14.20	62.04	36.40	1.56	100
Three Annual Plans 1966-69	48.00	17.63	65.63	33.28	1.09	100
4th Five Year Plan 1969-74	54.35	9.45	63.80	24.38	11.82	100
5th Five Year Plan 1974-79	50.24	16.77	67.01	29.35	3.62	100
Annual Plan 1979-80	59.80	4.81	64.62	31.68	3.71	100
6th Five Year Plan 1980-85	56.86	4.92	61.77	34.18	4.05	100
7th Five Year Plan 1985-90	54.17	6.87	61.04	35.05	3.91	100
Two Annual Plans 1990-92	52.33	11.28	63.61	33.46	2.93	100
8th Five Year Plan 1992-97	56.13	6.90	63.02	35.04	1.94	100
9th Five Year Plan 1997-2002	56.84	10.27	67.11	30.06	2.88	100

Source : RBI Study on State Finances (various issues).

Table – 3 : Developmental and Non-developmental Expenditures of Centre and States as Proportion of GDP

(Percentages)

	1950-51	1960-61	1970-71	1980-81	1990-91	1995-96	1998-99	1999-2000 RE
GDP at market prices (Rs. Crore)	**9934**	**17167**	**45677**	**143764**	**568674**	**1188012**	**1758276**	**1956997**
Centre								
Revenue expenditure	3.88	4.87	6.90	9.22	12.93	11.76	12.31	12.93
(I) Developmental expenditure	0.36	1.40	1.78	3.13	4.67	3.57	3.65	3.84
(ii) Non-developmental expenditure	3.51	3.47	5.12	6.09	8.26	8.19	8.66	9.09
Capital expenditure	1.26	4.53	3.44	5.64	4.81	2.90	1.96	2.03
(I) Developmental expenditure	0.51	1.61	1.30	2.13	1.41	0.45	0.45	0.58
(ii) Non-developmental expenditure	0.74	2.92	2.14	3.51	3.40	2.45	1.51	1.45
Total expenditure	5.13	9.40	10.34	14.87	17.74	14.66	14.27	14.96
(I) Developmental expenditure	0.88	3.01	3.08	5.26	6.08	4.02	4.10	4.43
(ii) Non-developmental expenditure	4.26	6.39	7.26	9.61	11.66	10.64	10.17	10.53
States								
Revenue expenditure	3.75	5.85	7.53	9.83	11.93	11.83	12.28	13.68
(I) Developmental expenditure	1.83	3.30	4.13	6.32	7.10	6.40	6.66	7.25
(ii) Non-developmental expenditure	1.92	2.56	3.40	2.51	4.83	5.43	5.62	6.43
Capital expenditure	1.00	2.63	1.98	3.65	2.37	1.96	1.78	1.94
(I) Developmental expenditure	0.68	1.77	1.29	2.26	1.62	1.55	1.31	1.45
(ii) Non-developmental expenditure	0.31	0.86	0.59	1.39	0.75	0.41	0.47	0.49
Total expenditure	4.75	8.49	9.51	13.49	14.30	13.78	14.06	15.62
(I) Developmental expenditure	2.52	5.07	5.42	8.58	8.71	7.95	7.96	8.70
(ii) Non-developmental expenditure	2.23	3.42	4.09	4.91	5.59	5.83	6.10	6.92
Combined								
Revenue expenditure	7.63	10.72	12.52	16.49	21.62	20.68	21.91	23.75
(I) Developmental expenditure	2.19	4.70	5.12	7.93	10.11	8.65	9.10	9.83

	1950-51	1960-61	1970-71	1980-81	1990-91	1995-96	1998-99	1999-2000 RE
(ii) Non-developmental expenditure	5.44	6.03	7.40	8.56	11.51	12.03	12.81	13.92
Capital expenditure	2.25	7.16	4.66	7.74	5.31	3.61	3.37	3.46
(I) Developmental expenditure	1.20	3.38	2.63	4.39	2.90	2.00	1.76	2.04
(ii) Non-developmental expenditure	1.06	3.78	2.03	3.35	2.41	1.61	1.61	1.42
Total expenditure	9.89	17.88	17.17	24.24	26.93	24.29	25.28	27.21
(I) Developmental expenditure	3.39	8.07	7.74	12.32	13.01	10.65	11.36	11.86
(ii) Non-developmental expenditure	6.49	9.81	9.43	11.92	13.92	13.64	13.92	15.35

Source : (1) Ministry of Finance - Indian Economic Statistics / Indian Public Finance Statistics (various issues).
(2) GDP - CSO - Macroeconomic Aggregates - National Account Statistics - 2001 - Part - I.

Table – 4 : Revenue and Fiscal Deficits of the Centre and States

(as percentage of GDP)

Year	Revenue deficit			Fiscal deficit		
	Centre	States	Combined	Centre	States	Combined
1970-71	-0.36	0.04	-0.32	2.83	2.01	4.34
1971-72	0.20	-0.02	0.19	3.51	2.17	5.03
1972-73	-0.03	0.13	0.10	4.66	2.58	4.89
1973-74	-0.36	0.18	-0.18	0.24	2.23	4.09
1974-75	-0.98	-0.52	-1.50	2.74	1.63	3.86
1975-76	-1.06	-1.14	-2.21	3.06	1.34	4.35
1976-77	-0.31	-1.22	-1.55	4.15	1.71	5.08
1977-78	-0.42	-1.00	-1.43	3.61	2.04	4.61
1978-79	-0.26	1.03	-1.30	4.93	2.44	5.42
1979-80	0.57	-1.28	-0.71	5.26	2.41	6.13
1980-81	1.18	-0.62	-0.09	5.85	3.01	7.66
1981-82	0.17	-0.77	-0.60	5.11	2.53	6.38
1982-83	0.66	-0.47	0.19	6.53	2.70	6.91
1983-84	1.09	-0.10	0.99	6.11	2.95	7.70
1984-85	1.42	0.36	1.79	7.05	3.37	9.11
1985-86	1.99	-0.19	1.81	8.38	2.79	8.79
1986-87	2.48	-0.01	2.49	8.40	2.99	10.24
1987-88	2.57	0.29	2.87	7.61	3.09	9.08
1988-89	2.48	0.43	2.93	7.30	2.68	8.43
1989-90	2.44	0.72	3.17	7.31	3.03	8.74
1990-91	3.26	0.90	4.16	7.85	3.19	9.30

Year	Revenue deficit			Fiscal deficit		
	Centre	States	Combined	Centre	States	Combined
1991-92	2.49	0.87	3.36	5.56	2.82	6.94
1992-93	2.49	0.68	3.16	5.38	2.68	6.78
1993-94	3.81	0.40	4.21	7.01	2.28	8.12
1994-95	3.07	0.55	3.61	5.71	2.64	6.92
1995-96	2.52	0.74	3.24	5.10	2.71	6.52
1996-97	2.40	1.18	3.56	4.90	2.67	6.26
1997-98	3.06	1.10	4.15	4.83	2.86	7.16
1998-99	3.81	2.48	6.29	5.14	4.13	8.86
1999-2000	3.76	2.90	6.66	5.56	4.71	9.76

Source : (I) Basic data - Ministry of Finance : Indian Economic Statistics - Indian Public Finance Statistics (various issues).
(ii) GDP data - National Accounts Statistics, 2001 (Part - I), Central Statistical Organisation.

Notes: Minus (-) sign denotes surplus. States include union territories (UTs) with legislatures.

Table – 5 : Outstanding Debt of Centre and States as Proportion of GDP

(Percentages)

	At the end of					
	1975-76	**1980-81**	**1985-86**	**1990-91**	**1995-96**	**1998-99**
GDP at market prices (Rs. Crore)	**83269**	**143764**	**277991**	**568674**	**1188012**	**1758276**
Centre						
1. Internal liabilities (a+b)	23.90	33.70	42.97	49.77	46.72	47.46
a) Internal debt (i)+(ii)	16.69	21.47	25.55	27.08	25.91	26.14
(i) Market loans & bonds	8.56	11.46	15.09	24.51	20.15	23.85
(ii) Ways & means from the RBI	8.13	10.01	10.47	2.57	5.76	2.30
(a) Treasury bills	6.98	8.94	9.36	1.41	3.84	1.07
(b) Special floating loan	1.15	1.07	1.11	1.15	1.92	1.22
b) Other liabilities	7.21	12.23	17.42	22.69	20.80	21.32
of which						
(i) Small savings	4.74	5.55	7.72	8.81	7.73	10.02
(ii) Provident funds	1.85	1.84	1.67	2.05	2.49	1.72
2. External debt	8.99	7.86	6.53	5.54	4.31	3.26
Total (1+2)	**32.90**	**41.56**	**49.50**	**55.31**	**51.03**	**50.72**
States						
1. Market loans & bonds	2.54	2.12	2.17	2.75	3.03	3.43
2. Ways & means from the RBI	0.18	0.34	0.12	0.12	-0.002	0.17
3. Provident funds etc.	1.37	1.71	2.29	2.98	3.16	3.47

	At the end of					
	1975-76	**1980-81**	**1985-86**	**1990-91**	**1995-96**	**1998-99**
GDP at market prices (Rs. Crore)	**83269**	**143764**	**277991**	**568674**	**1188012**	**1758276**
4. Loans from banks & other institutions	0.59	0.64	0.62	0.51	0.61	0.79
Total (1+2+3+4)	**4.68**	**4.80**	**5.19**	**6.36**	**6.79**	**7.86**
Loans from the centre	**11.63**	**11.87**	**13.61**	**13.03**	**11.07**	**11.59**
Combined						
1. Internal liabilities (a+b)	28.59	38.51	48.17	56.13	53.51	55.32
a) Internal debt (i)+(ii)	19.41	23.92	27.84	29.95	28.94	29.74
(i) Market loans & bonds	11.10	13.58	17.26	27.26	23.19	27.28
(ii) Ways & means from the RBI	8.31	10.34	10.59	2.69	5.76	2.46
of which (a) Treasury bills	6.98	8.94	9.36	1.41	3.84	1.07
(b) Special floating loan	1.15	1.07	1.11	1.15	1.92	1.22
b) Other liabilities	9.18	14.59	20.32	26.18	24.57	25.58
of which						
(i) Small savings	4.74	5.55	7.72	8.81	7.73	10.02
(ii) Provident funds	3.22	3.55	3.95	5.03	5.65	5.19
(iii) Loans from banks & other institutions	0.59	0.64	0.62	0.51	0.61	0.79
2. External debt	8.99	7.86	6.53	5.54	4.31	3.26
Total (1+2)	**37.58**	**46.36**	**54.70**	**61.68**	**57.82**	**58.58**

Source : Ministry of Finance - Indian Economic statistics / Indian Public Finance Statistics (various issues).

Table – 6: Debt and Interest Burden of States

Percentages)

State	Total debt/GSDP	Total liabilities/ Revenue receipts		Interest payments/ Revenue receipts	
	1997-98	1990-91	1998-99	1990-91	1998-99
Punjab	35.24	347.12	362.70	17.90	37.75
Orissa	37.96	208.71	330.63	16.80	32.60
West Bengal	22.97	191.53	304.86	15.46	31.82
Uttar Pradesh	26.59	170.85	279.79	16.40	32.44
Bihar	33.13	213.58	250.14	16.29	25.95
Himachal Pradesh	48.51	160.72	247.15	13.74	21.82
Rajasthan	27.78	157.24	246.04	14.36	27.44
Kerala	23.99	184.85	218.12	14.49	20.41
Haryana	20.12	147.46	173.3	15.36	22.35
Madhya Pradesh	19.79	143.56	169.82	11.28	16.17
Andhra Pradesh	20.82	126.11	167.64	11.78	19.90
Assam*	26.95	238.32	151.68	14.78	11.56
Goa	32.88	298.94	146.56	12.71	24.76
Gujarat	16.27	184.37	145.66	14.12	19.46
Maharashtra	12.08	113.23	143.42	11.18	18.59
Jammu & Kashmir*	NA	308.72	140.50	12.21	15.39
Karnataka	16.88	119.04	137.52	11.64	15.19
Tamil Nadu	15.55	108.12	137.31	9.08	15.03

State	Total debt/GSDP	Total liabilities/ Revenue receipts		Interest payments/ Revenue receipts	
	1997-98	1990-91	1998-99	1990-91	1998-99
Nagaland*	NA	105.04	133.01	7.72	13.93
Manipur*	35.60	89.39	128.21	8.34	10.33
Tripura*	36.01	96.16	109.54	7.81	11.26
Mizoram*	52.84	26.41	99.32	8.84	9.74
Arunachal Pradesh*	57.55	94.97	93.72	4.77	7.87
Meghalaya*	21.37	58.64	85.35	5.07	8.35
Sikkim*	NA	93.75	35.05	7.10	11.69

* Special Category States
NA Comparable GSDP data (1993-94 series) not available
Source : Anand et.al. (2001).

Table – 7 : Salary + Interest + Pensions of Selected States as a Percentage of Revenue Receipts

States	1990-91	1995-96	1998-99	1999-2000	2000-01
Kerala	96.40	71.38	81.34	104.05	92.57
Rajasthan	48.42	56.35	91.96	94.77	82.95
West Bengal	93.90	84.24	117.82	152.71	107.61
Orissa	60.89	74.31	117.67	97.43	96.13
Andhra Pradesh	60.20	64.20	67.25	69.16	69.38
Tamil Nadu	62.51	59.54	80.82	85.39	78.36

Source : Kurian (2001), Paper presented at ADB - NIPFP workshop, Sept. 5 - 6, 2001.

Table - 8: Own Revenue Receipts as Proportion of Revenue Expenditure

(Percentages)

States	1970-71	1980-81	1990-91	1998-99
High Income				
Goa			55.80	78.26
Gujarat	71.36	81.85	74.03	66.53
Haryana	79.49	88.03	81.79	66.07
Maharashtra	74.36	84.39	78.99	69.26
Punjab	101.69	80.18	61.35	56.89
Av. (HI)	**77.96**	**83.55**	**75.23**	**66.55**
Middle Income				
Andhra Pradesh	62.07	69.16	62.20	57.89
Karnataka	69.48	75.87	71.75	67.60
Kerala	57.23	65.42	54.83	56.43
Tamil Nadu	68.51	75.96	62.17	60.93
West Bengal	49.83	60.00	45.89	36.22
Av. (MI)	**61.30**	**69.37**	**59.31**	**55.80**
Low Income				
Bihar	41.88	39.54	32.01	33.10
Madhya Pradesh	69.70	64.04	54.74	48.46
Orissa	40.32	38.28	39.73	30.00
Rajasthan	39.13	61.64	58.53	45.72
Uttar Pradesh	68.14	52.17	41.31	34.17
Av. (LI)	**54.26**	**51.98**	**44.29**	**38.30**
Special Category				
Arunachal Pradesh				

States	1970-71	1980-81	1990-91	1998-99
Assam	28.57	26.05	36.45	32.48
Himachal Pradesh	25.00	32.09	24.42	19.86
Jammu & Kashmir	29.82	43.82	20.19	12.87
Manipur		7.14	9.52	7.87
Meghalaya	2.22	15.00	17.68	17.16
Mizoram			8.22	5.89
Nagaland	2.50	9.78	10.00	7.38
Sikkim		26.67	25.78	4.41
Tripura		10.34	8.85	10.97
Av. (SC)	**24.80**	**26.96**	**22.78**	**17.10**

Source : RBI - Study on State Finances (various issues).

Table – 9 : Borrowings of States: Sourcewise Distribution

(Percentage)

Year	From the centre *	From the market	State P.F.	Other loans
1950-51	82.81	12.50	4.69	0.00
1960-61	71.60	20.68	4.94	2.78
1970-71	65.57	20.00	12.87	1.57
1975-76	52.03	26.01	12.63	9.33
1980-81	75.60	7.57	9.73	7.09
1985-86	76.29	12.90	9.86	0.94
1990-91	68.50	16.71	12.94	1.85
1995-96	57.24	22.95	15.99	3.82
1997-98	62.38	19.11	10.72	7.79
1998-99	56.05	19.25	17.70	7.00
99-2000	54.23	16.36	19.89	9.53

* Includes small savings.

Table – 10 : Per capita NSDP@ - Statewise (Triennial averages for selected years)

(Rupees)

States	Average of 1960-61 1961-62 and 1962-63	Average of 1970-71 1971-72 and 1972-73	Average of 1987-88 1988-89 and 1989-90	Average of 1996-97 1997-98 and 1998-99
High Income				
Goa	...	...	7364	23853
Gujarat	402	821	4602	17393
Haryana	371	1010	5284	17804
Maharashtra	418	849	5369	19248
Punjab	401	1127	6996	18924
Average (HI)	**398**	**952**	**5923**	**19444**
Middle Income				
Andhra Pradesh	331	626	3455	12257
Karnataka	312	705	3810	13085
Kerala	292	659	3532	14448
Tamil Nadu	357	674	4093	15424
West Bengal	399	760	3750	11769
Average (MI)	**338**	**685**	**3728**	**13397**
Low Income				
Bihar	223	452	2135	5465
Madhya Pradesh	279	538	3299	9371
Orissa	240	551	2945	7556
Rajasthan	285	601	3092	11245
Uttar Pradesh	252	540	2867	8298

States	Average of 1960-61 1961-62 and 1962-63	Average of 1970-71 1971-72 and 1972-73	Average of 1987-88 1988-89 and 1989-90	Average of 1996-97 1997-98 and 1998-99
Average (LI)	**256**	**536**	**2868**	**8387**
Special Category				
Arunachal Pradesh	...	...	4670	11643
Assam	350	587	3195	7918
Himachal Pradesh	...	740	3618	11997
Jammu & Kashmir	266	575	3534	9916
Manipur	...	463	3449	9096
Meghalaya	...	620	3328	9678
Mizoram	...	...	4094	11950
Nagaland	...	540	3929	12422
Sikkim	...	...	4846	10990
Tripura	...	558	3163	8567
Average (SC)	**308**	**583**	**3783**	**10418**
Average of twenty five states	**324**	**666**	**3877**	**11936**
Max./Min. ratio	**1.87**	**2.50**	**3.45**	**4.36**
Coeff. of variation	**0.197**	**0.257**	**0.263**	**0.309**

Source: Basic data - Reports of the Finance Commissions and CSO.

* excluding Goa, @ At current prices

Table – 11 : Percentage of Population Below Poverty Line

(State wise) (30-day Recall Period)

States	1973-74			1983-84			1999-2000		
	Rural	Urban	Combined	Rural	Urban	Combined	Rural	Urban	Combined
High Income									
Goa							1.35	7.52	4.40
Gujrat	46.35	52.57	48.15	29.80	39.14	35.78	13.17	15.59	14.07
Haryana	34.23	40.18	35.38	20.56	24.15	21.37	8.27	9.99	8.74
Maharashtra	57.71	43.87	53.24	45.23	40.26	43.44	23.72	26.81	25.02
Punjab	28.21	27.96	28.15	13.20	23.79	16.18	6.35	5.75	6.16
Middle Income									
Andhra Pradesh	48.41	50.61	48.88	26.53	36.30	28.91	11.05	26.63	15.77
Karnataka	55.14	52.53	54.47	36.33	42.82	38.24	17.38	25.25	20.04
Kerala	59.19	62.74	59.79	39.03	45.68	40.42	9.38	20.27	12.72
Tamil Nadu	57.43	49.40	54.94	53.99	46.96	51.66	20.55	22.11	21.12
West Bengal	73.16	34.67	63.43	63.05	32.32	54.85	31.85	14.86	27.02
Low Income									
Bihar	62.99	52.96	61.91	64.37	47.33	62.22	44.30	32.91	42.60
Madhya Pradesh	62.66	57.66	61.70	46.90	53.06	49.78	37.06	38.44	37.43
Orissa	67.28	55.62	66.18	67.53	49.15	65.29	48.01	42.83	47.15

States	1973-74			1983-84			1999-2000		
	Rural	Urban	Combined	Rural	Urban	Combined	Rural	Urban	Combined
Rajasthan	44.76	52.13	46.14	33.50	37.94	34.46	13.74	19.85	15.28
Uttar Pradesh	56.53	60.09	57.07	46.45	49.82	47.07	31.22	30.89	31.15
Special Category									
Arunachal Pradesh	52.67	36.92	51.93	42.60	21.73	40.88	40.04	7.47	33.47
Assam	52.67	36.92	51.21	42.60	21.73	40.47	40.04	7.47	36.09
Himachal Pradesh	27.42	13.17	26.39	17.00	9.43	16.40	7.94	4.63	7.63
Jammu & Kashmir	45.51	21.32	40.83	26.04	17.76	24.24	3.97	1.98	3.48
Manipur	52.67	36.92	49.96	42.60	21.73	37.02	40.04	7.47	28.54
Meghalaya	52.67	36.92	50.20	42.60	21.73	36.81	40.04	7.47	33.87
Mizoram	52.67	36.92	50.32	42.60	21.73	36.00	40.04	7.47	19.47
Nagaland	52.67	36.92	50.81	42.60	21.73	39.25	40.04	7.47	32.67
Sikkim	52.67	36.92	50.86	42.60	21.73	39.71	40.04	7.47	36.55
Tripura	52.67	36.92	51.00	42.60	21.73	40.03	40.04	7.47	34.44
All India (States & UTs)	**56.44**	**49.01**	**54.88**	**45.65**	**40.79**	**44.48**	**27.09**	**23.62**	**26.10**

Source : Planning Commission.

Table – 12 : Consumption of Electricity Per Capita – Statewise

(Kwh)

States	1985-86	1990-91	1995-96	1998-99
Gujarat	299.00	469.00	655.00	724.00
Haryana	247.00	400.00	498.00	503.00
Maharashtra	313.00	411.00	545.00	594.00
Punjab	423.00	606.00	757.00	861.00
Andhra Pradesh	183.00	245.00	369.00	404.00
Karnataka	187.00	296.00	360.00	349.00
Kerala	140.00	188.00	245.00	305.00
Tamil Nadu	213.00	323.00	455.00	498.00
West Bengal	135.00	148.00	187.00	211.00
Bihar	95.00	110.00	139.00	152.00
Madhya Pradesh	168.00	247.00	359.00	398.00
Orissa	130.00	271.00	354.00	313.00
Rajasthan	140.00	201.00	292.00	361.00
Uttar Pradesh	118.00	166.00	209.00	329.00
Assam	53.00	94.00	100.00	123.00
Himachal Pradesh	123.00	209.00	305.00	334.00
All India	**178.00**	**253.00**	**335.00**	**360.00**
Average	**185.44**	**274.00**	**364.31**	**434.94**
Standard deviation	**94.65**	**139.32**	**181.99**	**213.68**
Coefficient of variation	**0.51**	**0.51**	**0.50**	**0.49**
Maximum	**423.00**	**606.00**	**757.00**	**861.00**

States	1985-86	1990-91	1995-96	1998-99
Minimum	**53.00**	**94.00**	**100.00**	**123.00**
Max/Min (Ratio)	**8.00**	**6.40**	**7.60**	**7.00**

Index All India = 100

States	1985-86	1990-91	1995-96	1998-99
Gujarat	168.00	185.40	195.50	201.11
Haryana	138.80	158.10	148.70	139.72
Maharashtra	175.80	162.50	162.70	165.00
Punjab	237.60	239.50	226.00	239.17
Andhra Pradesh	102.80	96.80	110.10	112.22
Karnataka	105.10	117.00	107.50	96.94
Kerala	78.70	74.30	73.10	84.72
Tamil Nadu	119.70	127.70	135.80	138.33
West Bengal	75.80	58.50	55.80	58.61
Bihar	53.40	43.50	41.50	42.22
Madhya Pradesh	94.40	97.60	107.20	110.56
Orissa	73.00	107.10	105.70	86.94
Rajasthan	78.70	79.40	87.20	100.28
Uttar Pradesh	66.30	65.60	62.40	91.39
Assam	29.80	37.20	29.90	34.17
Himachal Pradesh	69.10	82.60	91.00	92.78
All India	100.00	100.00	100.00	100.00

Source : Planning Commission - Report on the working of the State Electricity Boards and State Electricity Departments (various issues).

Table – 13 : Literacy and Infant Mortality Rates

States	1981	Literacy 1991	Rate * 2001	Female 1981	Literacy 1991	Rate 2001	Infant 1981	Mortality 1991	Rate ** 1997
Andhra Pradesh	34.10	44.10	61.11	23.30	32.70	51.17	86	71	63
Bihar	30.30	38.50	47.53	15.80	22.90	33.57	118	73	71
Gujarat	49.90	61.30	69.97	36.90	48.60	58.60	116	67	62
Haryana	41.70	55.90	68.59	25.80	40.70	56.31	101	75	68
Karnataka	43.90	56.00	67.04	31.70	44.30	57.45	69	73	53
Kerala	78.90	89.80	90.92	73.40	86.20	87.86	37	17	12
Madhya Pradesh	32.20	44.20	64.11	18.00	28.90	50.28	142	104	94
Maharashtra	53.50	64.90	77.27	39.60	52.30	67.51	79	59	47
Orissa	38.80	49.10	63.61	24.00	34.70	50.97	135	115	96
Punjab	46.40	58.50	69.95	38.40	50.40	63.55	81	56	51
Rajasthan	28.40	38.60	61.03	13.40	20.40	44.34	108	90	85
Tamil Nadu	52.60	62.30	73.47	39.40	51.30	64.55	91	58	53
Uttar Pradesh	31.40	41.60	57.36	16.30	25.30	42.98	150	98	85

States	Literacy 1981	Rate * 1991	2001	Female 1981	Literacy 1991	Rate 2001	Infant 1981	Mortality 1991	Rate ** 1997
West Bengal	46.30	57.70	69.22	34.40	46.60	60.22	91	65	55
Max. / Min.	**2.78**	**2.33**	**1.91**	**5.48**	**4.23**	**2.62**	**4.05**	**6.76**	**8.00**
All - state average	**43.46**	**54.46**	**67.23**	**30.74**	**41.81**	**56.38**	**100**	**73**	**64**
Standard deviation	**13.25**	**13.62**	**10.02**	**15.45**	**16.89**	**12.99**	**30.66**	**24.17**	**22.12**

* percent of population of seven years and older.
** per thousand live births.

Source : 1. *World Bank – NIPFP India - Policies to Reduce Poverty and Accelerate Sustainable Development* - Jan 31,2000.
2. Census of India - Provisional Population Tables - 2001.

Table – 14 : Profile of 15 Major States * - A Summary
Inter-State Disparities in Per Capita & Expenditure of Major States*

(Per Capita) (in Rupees)

	1970 - 71		1980 - 81		1990 - 91		1995 - 96		1998 - 99	
	Max/Min	**C.o.V.**	**Max/Min**	**C.o.V.**	**Max/Min**	**C.o.V.**	**Max/Min**	**C.o.V.**	**Max/Min**	**C.o.V.**
GSDP/NSDP	**2.6**	**.267**	**2.9**	**.311**	**3.1**	**.334**	**4.9**	**.352**	**3.5**	**.352**
Plan revenue expenditure	**3.3**	**.368**	**2.5**	**.233**	**3.0**	**.262**	**4.6**	**.318**	**3.7**	**.346**
Non-plan revenue expenditure	**2.4**	**.232**	**2.7**	**.28**	**2.3**	**.261**	**3.2**	**.353**	**3.3**	**.359**
Total revenue expenditure	**2.3**	**.232**	**2.4**	**.242**	**2.2**	**.218**	**3.3**	**.318**	**3.0**	**.321**
Loans and advances	**13.4**	**.718**	**5.1**	**.516**	**10.3**	**.725**	**17.3**	**.498**	**9.2**	**.668**
Capital outlay	**6.9**	**.5**	**4.5**	**.342**	**4.4**	**.375**	**8.6**	**.531**	**6.3**	**.555**
Total capital expenditure	**3.7**	**.469**	**2.7**	**.29**	**3.9**	**.392**	**8.7**	**.454**	**4.5**	**.433**
Own revenue receipts	**5.1**	**.454**	**5.9**	**.476**	**5.2**	**.435**	**7.6**	**.564**	**6.1**	**.538**
Transfers	**2.2**	**.259**	**1.8**	**.168**	**2.4**	**.274**	**2.9**	**.324**	**2.8**	**.326**
Total revenue receipts	**2.9**	**.27**	**2.5**	**.274**	**2.4**	**.226**	**3.4**	**.34**	**3.0**	**.332**

* Including Assam and excluding Goa.
Source : RBI - Study on State Finances (various issues).

Table – 15 : Per Capita Plan Outlay - Statewise (First to Ninth Plan)

(in Rupees)

	First Plan (1951-56)	Second Plan (1956-61)	Third Plan (1961-66)	Fourth Plan (1969-74)	Fifth Plan (1974-79)	Sixth Plan (1980-85)	Seventh Plan (1985-90)	Eighth Plan (1992-97)	Ninth Plan (1997-02)
Non-Special Category States									
High Income States									
Goa			349	459	855	1687	2871	6064	9165
Gujarat	18	29	106	170	392	1034	1563	2611	4791
Haryana				224	527	1318	1911	3202	3364
Maharashtra	48	72	94	178	415	942	1480	2187	4756
Punjab	47	157	200	217	675	1117	1746	3074	3765
Middle Income States									
Andhra Pradesh	36	64	82	97	277	557	868	1482	3399
Karnataka	25	38	102	119	364	583	830	2587	4850
Kerala	22	45	96	121	242	588	741	1785	3120
Tamil Nadu	29	53	83	126	248	630	1077	1762	3360
West Bengal	28	48	68	73	253	616	672	1348	2301
Low Income States									
Bihar	17	44	70	94	207	442	642	1391	701
Madhya Pradesh	31	76	88	92	294	697	1178	1561	2451
Orissa	14	61	87	101	241	549	919	2957	2679
Rajasthan	16	66	112	117	241	559	746	2422	2657
Uttar Pradesh	20	36	65	109	249	505	832	1417	1459
Special Category States									
Arunachal Pradesh	139	293	199	383	1161	3169	5355	12235	20174

	First Plan (1951-56)	Second Plan (1956-61)	Third Plan (1961-66)	Fourth Plan (1969-74)	Fifth Plan (1974-79)	Sixth Plan (1980-85)	Seventh Plan (1985-90)	Eighth Plan (1992-97)	Ninth Plan (1997-02)
Assam	26	61	104	153	279	533	919	1924	1875
Himachal Pradesh	23	55	96	293	621	1258	2194	4523	10884
Jammu & Kashmir	39	99	202	343	685	1440	2045	4783	4412
Manipur	25	89	155	283	747	1604	2608	4905	5989
Meghalaya				376	770	1662	2794	5340	6212
Mizoram					1195	2421	4180	9896	15593
Nagaland			180	769	1360	2488	4065	6233	6372
Sikkim					1573	3567	5838	12061	16848
Tripura	32	88	132	222	395	1131	1850	3775	6423
***Max/Min(Non-Spcl category states)**	**3.43**	**5.41**	**3.08**	**3.07**	**3.26**	**2.98**	**2.98**	**2.38**	**6.92**
***Coefficient of variation (Non-Spcl category states)**	**.398**	**.512**	**.341**	**.346**	**.396**	**.368**	**.380**	**.308**	**.40**

*The computation has been done including Assam and excluding Goa in the non-special category states.

Source : Planning Commission

Appendix I

The Distribution of Powers and Functions in Federal Systems (Selected Criteria)

	Canada (1867)	**United states (1789)**	**Switzerland (1848/ 1999)**	**Australia (1901)**	**Germany (1949)**	**India (1950)**	**Malaysia (1963)**
Basic Features							
Residual power	F	S	S	S	S	F	S
Enumeration of state powers	Yes	No	Some	No	No	Yes	Yes
Scope of Powers							
Finance and Fiscal Relations							
Taxation							
Custom/ Excise	F	F/C	F	F	F	F/FS	F
Corporate	FS	C	F	C	C	F	F
Personal income	FS	C	FS	C	C	FS	F
Sales	FS	C	F	C	C	FS	F
Debt & Borrowing							
Foreign	FS	Fs	Fs	C	Fs	F	F
Domestic	FS	FS	FS	C	FS	FS	FS
Functioning of Economic Union							
External trade	F	F	F	C	F	F	F
Inter-state trade	F	F	F	C	C	F	F
Intra- state trade	S	S		S	C	F	F
Social Affairs							
Education & Research							

	Canada (1867)	**United states (1789)**	**Switzerland (1848/ 1999)**	**Australia (1901)**	**Germany (1949)**	**India (1950)**	**Malaysia (1963)**
Primary & sec. edu.	S	S	CS	S	S	CS	F
Post-secondary edu.	S	FS	FCS	FS	C	FCS	F
Health services							
Hospitals	SF	SF	S	FS	C	S	F
Public health & sanitation	S	S	C	S	C	S	FC
Law and Security							
Org. of courts	FS	FS	S	FS	C	FS	F
Internal security (police)	FS	FS	C	SF	CS	FS	F

Source: Adapted from Appendix A, Comparing Federal Systems by Ronald L. Watts (Queen's University, Ontario, Canada,1999)

Legend:
F= federal power
S= state (provincial/ canton/land/autonomous community)
C= concurrent power (federal paramountcy, except where denoted otherwise).

Appendix II

Weight in the Formula for Inter-se allocation by the Respective Finance Commissions

Factors/Elements of the Formula	XI	X	IX			VIII
		IT Plus 40 percent of UED	First Report	Second Report		90 percent of Shareable ITs plus 40 percent of UED
			90% of Shareable IT$$ and 40% of UED	IT	UED$	
Population	10.0	20.0	25.0	22.5	25.0	25.0
Distance	62.5	60.0	50.0	45.0	33.5	50.0
Inverse of income			12.5	11.25	12.5	25.0
Poverty ratio			12.5			
Index of backwardness				11.25	12.5	
Area	7.5	5.0				
Index of infra-structure	7.5	5.0				
Tax effort	5.0	10.0				
Fiscal discipline	7.5					
Contribution*				10.0		
Tax revenue devolution	29.5% of Net Proceeds of all shareable Union Taxes and Duties	77.5% of IT and 47.5% of UED#	85% of IT and 45% of UED##	85% of IT and 45% of UED		85% of IT and 45% of UED##

Source: The respective reports of the Finance Commissions.

Notes: UED: Union Excise Duties, IT: Income Tax

*: This is used with minor modification to compute the income Adjusted Total Population (IATP) by the Ninth Finance Commission
**: Contribution is measured by assessment/collection/derivation
#: 7.5% of UED was to be distributed over the deficit states only
##: 5 percent of the UED was to be distributed over the deficit states only
$: The remaining 16.5% was to be distributed over the deficit states only.
$$: 10% of the shareable IT was to be distributed on the basis of contribution.

Appendix III

Criteria and Weightage under Modified *Gadgil Formula*

And Formulae as revised in October, 1990 and in December, 1991
For allocation of Central Assistance for States' Plan.

(Weightage %)

VI. Criteria	Modified Gadgil Formula (1980)	NDC Revised Formula (1990)	NDC Revised Formula (1991)
A. Special category states (10)	30% share of 10 states excluding North Eastern Council	30% share of 10 states including North Eastern Council	30% share 10 states excluding North Eastern Council
B. Non-special category states (15)			
(i) Population (1971)	60.0	55.0	60.0
(ii) Per capital income of which	20.0	25.0	25.0
(a) According to the 'deviation' method covering only the states with per capita income below the national average.	20.0	20.00	20.0
(b) According to the 'distance' method covering all the fifteen states.	-	5.0	5.0
(iii) Performance of which	10.0	5.0	7.5
(a) Tax effort	10.0	-	2.5
(b) Fiscal manage-ment	-	5.0	2.5
(c) National objectives	-	-	2.5

VI. Criteria	Modified Gadgil Formula (1980)	NDC Revised Formula (1990)	NDC Revised Formula (1991)
(d) Special problems	10.0	15.0	7.5
Total	100.0	100.0	100.0

Notes : 1. Fiscal Management is assessed as the difference between states' own total Plan resources estimated at the time of finalising Annual Plans and their actual performance, considering latest five years.

2. Under the criterion of the performance in respect o certain programmes of national priorities the approved formula covers four objectives viz., (I) population control, (ii) elimination of illiteracy, (iii) on-time completion of externally aided projects, and (iv)success in land reforms.

End Notes

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1 The Approach Paper to the Tenth Plan (TPAP) reiterates the resolve to transfer most of the CSS to the states (GoI 2001).

2 'States Fiscal Reforms Facility Fund' has been created at the centre to this end. The TPAP also envisages conditionalities to be attached to Plan grants (paras 2.23 & 2.24).

3 See for example, Bhagwati and Desai (1970).

4 Since 1998-99 accretion to small savings go to a National Small Savings Fund and do not figure in centre's loans to states, though the liability for repayment rests ultimately with the central government.

5 A recent instance is the decision to work out a 'one-time settlement' for Rs. 26,000 crore owed by SEBs to central utilities (*Times of India*, 4 March, 2001).

6 'The compulsions of coalition, politics make fiscal discipline a pipe-dream. Year after year, the minimum support price is raised only because the government does not have the courage to say a firm 'no' to Punjab where the ruling party is a member of the coalition at the centre. It is the same story when it comes to procuring inferior quality foodgrains from Andhra Pradesh or asking the STC to buy tobacco from that state', ('Imprudent Suggestion' editorial in the *Economic Times*, 27 November, 2001).

7 The logic of 'categorical imperative', however, cannot be invoked in support of redistributive central transfers as the only means of achieving inter-regional equity. This is because 'equity' is advanced not by redistribution alone. Efficient allocation of resources within the country can also be a potent instrument of furthering the development of all regions. But the case for redistribution as a legitimate task of government on ethical grounds stands.

8 *The Economic Times*, 20 November, 2001.

9 'The Trouble with Coalition', *The Economist* (London), 24 November, 2001.

10 For an illuminating discussion of the alternatives and trade-offs, see Inman and Rubinfeld (1995). For a review of the literature *see* Bagchi (2000).