Enforcing Fiscal Discipline : An Evaluation of the Second Report of the Ninth Finance Commission

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The prevailing economic and fiscal environment even more than its own terms of reference, has compelled the Ninth Finance Commission to formulate its recommendations with the aim of making every rupee count. No earlier Commission has been so constrained by the paucity of finances while framing its suggestions for distributing some component of Central revenues among the different States. Even administrators and academics, despite initial misgivings about the Commission's terms of reference, unhappily acknowledged that there were only deficits to share[1]. This realisation has had an effect on the Ninth Commission's recommendations in two ways:

i. It has led to a search for surpluses and revenue cushions available with the different governments which could be redistributed for optimum benefit.

ii. It has also focussed the Commission's attention on the unpleasant but unavoidable task of promoting prudent husbanding of financial resources.

Predictably, the Commission's Second Report, even more than the First, opens with a sombre presentation of the "steadily deteriorating fiscal scenario" of the '80s and draws pointed attention both to the dissavings on government account (as seen in the growing revenue deficits) as well as the costs of the rapidly increasing public debt. Like the Finance

Minister's budget speech for 1990-1, it minces no words while deploring the consequences of the unrestrained rise in public expenditure accompanied by stagnating revenues from State enterprises which have seriously undermined the country's long term economic and developmental interests. The three-fold objective of the Commission comprises two which are clearly meant to enforce fiscal discipline - the phasing out of revenue deficits by the end of the mandate period (1990-5) and the promotion of efficiency and fiscal restraint. Whether the recommendations will substantially contribute to these stated objectives is a different matter altogether. The Commission has itself indicated the manner in which it expects its approach to impose a degree of discipline on the budgetary operations of the State and Central governments[2]. These remarks will be taken into account while passing judgement on the Commission's recommendations.

The Search for Surpluses

The earlier perception that the Centre had access to a fiscal cornucopia which could be indefinitely tapped by the States has become outdated. The Ninth Commission's predecessors could have safely increased the States' share in taxes from 55 per cent to 85 per cent for income taxes and 20 per cent to 45 per cent for Central excises; the Ninth Commission has been left with very limited leeway in the matter. Both governmental levels were clamouring for more and both were running revenue deficits. In its search for available allocable resources, the Commission had before it just two difficult alternatives (both of which it has adopted to a limited extent).

- A close look at Central revenues to enforce economy and force out surpluses.
- A quest for funds, if available, with certain State governments that could be diverted to other more needy ones.

a. Disciplining the Centre

The Central government has never had to subject its fiscal decisions to Finance Commission scrutiny till the days of the Seventh Commission, although the terms of reference from the days of the Fifth Commission itself had provided for considering the Centre's resources and demands on account of expenditure on civil administration, defence, border security, debt servicing and other committed expenditure or liabilities before determining transfers to States. The argument that Finance Commissions do not subject Central finances to the same degree of scrutiny as State finances may not be totally valid; certainly, the Seventh and Eighth Commissions applied broadly similar considerations to both exercises. The approach of these Commissions did not also lack sophistication,[3] there were even occasional sorties into the normative methodology (especially with regard to dividend income and the major Central subsidies), even if the general tendency was to proceed on past trends. Nevertheless, the analyses were only of peripheral significance as determination of the quantum of transfers to States was an independent exercise not limited by the availability of sufficient Central surpluses after the reassessment of the Central forecast. The Eighth Finance Commission, for example, identified an overall surplus of Rs 96,319 crore by putting up the Finance Ministry's assumptions of Rs 65,912 crore. The fund requirements for State transfers were fixed at around Rs. 42,000 crore including both the revenue and capital accounts (net interest and committed liability grants were to be subsequently calculated by the government on the lines indicated by the Commission). But the Commission did not even point out anywhere that fortunately State transfers were well within the identified Central surpluses - the need for establishing such a link was not felt at that stage.

On the other hand, the Ninth Finance Commission in its First and Second Reports has clearly admitted that the level of transfers to States can be finalised only if adequate funds can be spared for the purpose by the Centre. In the First Report, the non-Plan revenue surplus implied in the Finance Ministry's es-

timates of Rs. 9,757 crore for 1989-90 had to be raised to Rs. 16,868 crore after reassessment by the Ninth Commission to accommodate the recommended devolution levels of Rs 13,660 crore of tax shares and grants.

The Second Report is even clearer regarding the connection between transfers and Central surpluses. If the Central government's forecasts for 1990-5 had been taken at face value its non-Plan revenue surplus before transfers would only have been around Rs 46,394 crore, which would in no way have covered the recommended devolution levels (Rs 1,06,602 crore). The Central government would have had to borrow even for paying out statutory Article 275 grants. As the Ninth Commission has noted, the total non-Plan revenue surplus available in 1984-5 would have been less than the States' share of the mandatorily divisible income tax receipts at current levels. Hence, a serious reassessment was clearly in order to release additional Central funds for State governments. The Ninth Commission has by its efforts identified revenue surpluses before transfers of Rs 1,49,271 crore to be placed at the service of State governments. It did this by listing a set of nine guidelines for reassessment of the Central forecast. Setting up the Centre as the role model for States, the Commission has proceeded more on practical rather than censorious lines. The trend approach is relegated to the sidelines, norms come to the forefront and what is feasible is given prominence. For example, realistic projections of growth rates have been assumed for divisible taxes, mainly in the interests of deficit States, so as not to inflate their likely revenues from these sources, leading to a reduction in their deficits and the grants available against the deficits.

While making Plan grants too, the requirements of States have been identified but not fully catered to, evidently because of the inadequacy of resources. The Ninth Finance Commission has taken pains to indicate that if the assumptions made by it materialise, Rs. 94,200 crore of budgetary support to the Central Plan at 1989-90 prices should be available during 1990-5. Thus the conflicting demands on available revenues are sought to be reconciled, leaving each party partially satisfied.

A comparison of the Commission's approach to the States and the Centre is in order. All the same we must not forget that such comparisons are relevant only up to a point. Central tax revenues are not totally comparable with apparently similar State tax heads. Nor can inter-country comparisons be made given the wide divergence in internal conditions, productive structures and developmental levels. With this caveat we may look at the Finance Commission's methodology in reassessing Central and State forecasts.

In the case of tax revenues, the modified representative tax system adopted to estimate the taxable capacities of individual States does not affect the overall quantum of transfers to States. The growth rates adopted for 1990-5 are slightly ahead of the sum of the assumed annual growth rates of SDP (6 per cent) and prices (5 per cent) at 11.5 per cent but this level is to be reached only by stages at the close of the mandate period. As against this, Central tax proceeds have been presumed to grow at 12.8 per cent annually. This is, no doubt, less than the long-term trend of 14.64 per cent between 1974 and 1990 (BEs) but it is certainly ahead of the Central forecast of 10 per cent. The justification is that Income tax and Central Excise proceeds are being projected with an eye to avoiding under-estimation of State deficits and reduction of their grants-in-aid. Since State shares are on a percentage basis, higher actual growth rates will in any case benefit them.

In the case of non-tax revenues, a uniform rate of 12 per cent has been applied to both Central and State interest receipts and this has also been adopted for calculating interest payments.

As for dividends, rates of return from Central public sector undertakings have been projected at 6 per cent and on other investments including industrial schemes at 5 per cent. This is more stringent than the 5 per cent maximum annual return assumed on State commercial enterprises and cooperatives, for a 3 per cent return alone has been applied to State financial institutions and none at all to promotional units, while milk supply schemes are only expected to break even by

1994-5. Other State non-tax revenues are not, however, strictly comparable to Central heads and different modulations of the normative approach have been applied to the different items, looking to the specific requirements of each.

On the non-Plan revenue expenditure side, the two exercises are even less comparable. Central forecasts have been watered down ignoring higher trend levels with a view to containing deficits. Only a 9.5 per cent growth rate has been allowed for the Centre's overall non-Plan revenue expenditure. A 10 per cent increase for defence and 8 per cent for the different subsidies argues a rather conservative approach. The States have received more meticulous treatment with a minute examination of their major expenditure heads. Provisions have been made on the basis of exogenous norms which are quite likely to be difficult to achieve, going by past experience. The Eighth Finance Commission's methodology has been generally accepted and occasional modifications introduced where required. Phasing has also been done gradually to enable States to eventually attain the desirable levels by the close of the forecast period. There does not seem to be much evidence however, that different standards have been applied to the Centre and the States.

It would be facile to conclude nevertheless, that the Ninth Finance Commission's recommendations by themselves will have a salutory effect on Central imprudence. Of course a higher level of transfers to State imposed on an already deficit budget could induce the Central government to be more careful about generating the required level of surplus funds but given the Centre's powers to print money and resort to deficit financing, the Finance Commission's interventions either by censure or by higher transfer recommendations for State can never be the major factor in compelling it to limit wasteful expenditure. The constraints must come, as they seem to have done at last, from the macro-economic realities of inflation and the debt burden. Eventually, the most effective check on Central extravagance can only be through the statutory audit of the C&AG and the intervention of elected representatives in Parliament.

Recognising this truth, the Commission has suggested that as a check against unlimited drawal on RBI credit a convention should be established to limit deficit financing to a pre-determined figure laid down in consultation with the Governor, RBI. This would be in the interest of States too, as deficit financing and the consequential inflation can adversely affect State expenditure requirements. There are echoes here of the Gramm-Rudman clause in US budget-making, since both the methods are attempts to fix secular limits to the financial powers of the Government and Parliament. Like the Gramm-Rudman clause, however, this attempt is unlikely to succeed. Eventually, the Commission has been forced to dole out advice to both governmental levels regarding prudent fiscal policy. The inescapable conclusion is that the Commission's recommendations can only have a marginal effect on Central government fiscal behaviour and in any case this body is not the appropriate vehicle to undertake such a task.

One matter in which the Second Report of the Ninth Finance Commission has lagged behind the First is the case of Centrally sponsored schemes. Where the First Report rightly deplored the uncontrolled expansion of such schemes, the Second Report has been strangely silent. The issue is a ticklish one as can be seen from the dilemma already facing the reconstituted Planning Commission. No government at the Centre would like to cede its power to substantially influence policies and programmes in the State sector, especially when State responsibilities extend primarily to social sectors which have considerable electoral significance. By paring down Central requirements in this area, the Commission could have usefully identified additional funds for transfer to States.

b. Managing the States

The second avenue for squeezing out resources for reallocation to needy governments is the budgetary surpluses of some States before and after devolution. The fragmented approach to devolution in the Indian Constitution, following the Government of India Act of 1935, makes it difficult to pool

transferable funds and allocate them on a composite set of criteria. While Article 270 governs the transfer of income tax receipts, Article 272 determines what should happen to excise revenues. Income tax receipts must compulsorily be transferred to States while the Parliament can decide whether Excise proceeds should be so distributed or not - theoretically one could forsee a contingency in which they were wholly retained by the Central government, though in actual practice this has become almost impossible, since convention has sanctified the distribution of Central Excises also.

There are procedural complications too. State shares of Income tax proceeds are a compulsory charge on Central revenue; in the budget, they are netted out on the receipts side out of gross collections and do not accrue to the Consolidated Fund. Excise revenues, on the other hand, enter the Consolidated Fund and are then paid out to States according to the shares determined by Act of Parliament through a budgetary outflow on the expenditure side.

Above all, Article 270 - 2 enjoins that Income tax proceeds shall be assigned only to the States within which the tax is leviable. Sikkim, for example, could not claim a share of the tax revenues till Central income tax was actually introduced in the State very recently.

The need to take a holistic view of available resources to finance identified requirements has been put forward from time to time[4]. The Sarkaria Commission, which looked at one possible variant (Para 10.6.03 - Chapter X Financial Relations) did not favour the idea from the Constitutional point of view on the ground that all Central revenues should not form part of the divisible pool since Customs Duties, for example, are subject to violent fluctuations in response to external conditions and are not suitable for sharing. The Sarkaria Commission has also cited the views of the Sarkaria Committee in the matter and has not recommended giving States a fixed share in total Union tax revenues in order to avoid putting the Centre at a disadvantage and taking note of its "onerous responsibilities". Yet there

is a great deal to be said in favour of the idea as it would give States a predictable income and prevent the growing Central disinterest in and manipulation of Central Income Tax and excise revenues, attendant on the existing arrangements. Without ostensibly doing so, the Finance Commission will have no choice but to move towards treating all existing divisible heads and grants as one pool to be shared with States[5]. This has been the trend for some time despite the misgivings of surplus States who have been protesting, with some justification, their right to dispose of budget surpluses available after devolution, especially where, as in the case of Maharashtra, there are pockets of backwardness within the State. Nonetheless, this is one of the very few areas which can be tapped to cater to the additional requirements of the poorer States, given that the surpluses of the Central government have been shown to be finite and could even become nonexistent.

Without violently disturbing Constitutional equations, however, it may not be possible to substantially draw on these amounts. A frontal attack could even raise a storm of protest from the surplus States. Hence, the Finance Commissions have generally tackled the issue by a circuitous route, each improving on its predecessor.

The movement towards using tax shares also for equalisation purposes started with the Eighth Finance Commission. After setting aside the normal 10 per cent of Income tax proceeds for distribution on the basis of contribution, 25 per cent of the remaining amount alone was allotted for distribution on the basis of population, as against 80 to 90 per cent under previous Commissions. On the other hand, 25 per cent weightage was given to the inverse of per capita income and 50 per cent to the distance factor. The Ninth Commission in its First Report reduced the weightage of the inverse of per capita income to 12.5 per cent and introduced the proportion of persons below the poverty line as the indicator of backwardness to be applied for distributing the remaining 12.5 per cent. Faced with severe criticism on this account, the Second Report has replaced this criterion by a composite index of backwardness comprising

the population of Scheduled castes and Scheduled tribes and the number of agricultural labourers in the State.

In the case of Central Excises, the Eighth Commission had given weightages of 25 per cent, 25 per cent and 50 per cent respectively to population, the inverse of per capita income and the distance factor for distributing 40 per cent of the revenues. For a further 5 per cent, the ratio of the deficit of a deficit State to the total deficits of all States was taken as the criterion. The First Report of the Ninth Commission broke up the 25 per cent divisible on the inverse of per capita income equally between the income adjusted total population (IATP) and the poverty ratio. The Second Report, however, has made two changes. The weightage attached to the distance factor has come down to 33.5per cent of 45 per cent, while the deficit factor has been given 16.5 per cent weightage (16.5 per cent of 45 per cent - that is 7.5 per cent of the total Central excise proceeds against 5 per cent earlier). Besides, the poverty ratio has been replaced by the index of backwardness. There is a distinction between the criteria that reflect the backwardness of a State and those that reveal only budgetary inadequacy. (Even a developed State could have a deficit budget - a fact that is clear when we look at some special category States). The deficit factor is an indicator of the latter kind. It is noteworthy that the weightages of both these kinds of indicators have been steadily on the increase so that today only 32.5 per cent of divisible Income tax and 25 per cent of Central excise receipts are distributed on the basis of factors which are not aimed at equalising the spending capacities of the States.

On the revenue grants side, a considerable amount of manipulation has gone into reworking allocations. The Second Report has really attempted to break free of the gap-filling approach[6]. The non-Plan expenditures on social and economic services required to maintain standards achieved at the close of the Sixth Plan at a normative cost in 1994-5 have been placed against estimated per capita Plan revenue expenditures required to be made so that all States are enabled to improve their service levels, with the lower level States moving faster than

the others. The ratios of the difference of per capita expenditure from the highest level have been calculated and the total requirements of States worked out for the entire population on this basis. The relative shares of each State in the total Plan revenue resources available have been then worked out and applied to the likely available resource level. Likely Gadgil formula assistance for these States has been estimated and pro-rata alloted to the States on the basis of the previous allocation pattern. 40 per cent of the non-Plan revenue surpluses has also been adjusted to arrive at the ultimate deficits. Only 50 per cent of these deficits have eventually been provided as grants-in-aid.

Some queries/comments can be made at this point.

- The distinction between Plan and non-Plan expenditure has been removed as far as the revenue account is concerned. Despite the Finance Commission's expectations, however, the possibility always exists that the grants recommended by it could be taken into account while determining the likely Gadgil formula assistance for State governments. If the assistance grows faster than the 10 per cent assumed by the Finance Commission, this will provide additional funds for States. At any rate, the minimum assistance levels proposed by the Commission will have to be provided.

- Only 40 per cent of the surpluses of States have been adjusted to calculate grants-in-aid. This is a via media adopted in view of the fact that the grants-in-aid cover both the Plan and non-Plan accounts.

- The equalisation method adopted steers a path between the sometimes conflicting objectives of maintaining standards of economic and social services already achieved and providing funds

for bringing up the standards in the poorer States - at least States which had spent heavily on these sectors in earlier years have not been penalised for being pioneers.

- The overall manipulation gives the impression that the intention was somehow to stay within the existing levels of Central transfers to States, which is a professed objective of the Commission.

The cumulative effect of the working of Finance Commissions since the Eighth Commission has been the steady reduction in the shares of the richest States in Central transfers for the benefit of the low income States (Table I). The shares of high income States in tax devolution have fallen from 14.2 per cent (Eighth Commission) to 13.8 per cent (the Second Report of the Ninth Commission). Maharashtra has lost at least 4 percentage points in the process. In respect of all revenue transfers also, (excluding calamity grants) their shares have come down from 13.1 per cent to 11.8 per cent with Maharashtra again suffering the most (a decline of 1.3 percentage points). Middle income States have suffered the same fate - a fall from 30.8 per cent to 29.2 per cent in the case of tax shares and 30 per cent to 26.8 per cent for all transfers. West Bengal has lost heavily (0.8 per cent in tax shares and 1.6 per cent in all transfers) while Andhra Pradesh and Karnataka have suffered some damage. In fact, middle income States have lost more than high income States in terms of percentage points.

The beneficiaries have been not only low income States but also special category ones. The low income States have increased their shares of tax devolution from 35.3 per cent to 44.4 per cent - an improvement of 9.1 per cent - and in all transfers by a smaller extent (42.9 per cent to 45.8 per cent). Rajasthan has been the major beneficiary (1 percentage point in tax shares and 1.6 percentage points in all transfers). As for special category States, in all transfers their shares have gone up from 14 per cent to 16 per cent. This has happened even when the overall percentage of tax devolution to States has remained constant,

that is to say, the new special category States which were formerly Union Territories have cut into the States' shares after they have changed status.

Instilling Fiscal Discipline

The Second Report of the Ninth Commission has been generously peppered with ominous allusions to prudence, tax effort, discipline, etc. The "confines of available resources" have been reluctantly recognised to be an inflexible constraint on the Finance Commission generosity. Without saying so directly, the Commission appears to have accepted the undeniable fact that its predecessors had not paid sufficient attention to encouraging fiscal restraint, despite professions to the contrary. This is in line with the growing evidence that the methodology adopted by the Commissions is likely to have encouraged the States to be positively imprudent - to rush into hasty decision making, committing to undertake infructuous and unproductive expenditure on the eve of expected Commission cut-off dates (for example, for salary fixation) and project requirements that were palpably false and unrealistic[7] (which they were subsequently compelled to implement). The atmosphere engendered was naturally one of fiscal licence coupled with the confidence that the Centre would eventually pick up the tab. The most pernicious consequence was however the positive disincentive to economising States who cut their coats according to the cloth. With the normative approach, however, State forecasts are becoming redundant, to be called for only to satisfy the convention that the States have been heard before the award is finalised. It is, therefore, useful to examine the Second Report from this specific viewpoint and determine to what extent the Commission has lived up to its own objectives of promoting fiscal discipline and discouraging excesses.

We have already looked at the role of the Finance Commission in curbing Central extravagance. Here we shall only study the effects on the behaviour of State governments. Fortunately, the Commission has itself asked and answered

this question in its concluding observations. It feels that the normative approach for determination of Central transfers would make it difficult for States to increase expenditure without mobilising additional resources. Besides, non-Plan capital gaps have not been fully closed, compelling States to be cautious in incurring additional debt especially to finance revenue expenditure. For the rest, there are homilies which apply equally to the Centre and the States - linking performance with accessibility to funds, zero-based budgeting and shedding peripheral activities, limiting employment in the government sector, streamlining and reducing budgetary support to public sector undertakings by adopting the interest subsidy route for market financing of core projects instead of budgetary outflows and restructuring public enterprises.

We readily concede that the shift to the normative approach is a positive incentive to efficient performance despite the drawbacks associated with the "average" approach on the tax revenue side[8]. The Finance Commission's observations regarding the non-Plan capital gap are relevant but difficult to achieve in the present context where the borrowing scenario is largely influenced by external factors and decisions rarely made as part of conscious self-directed policy. Market borrowing levels are fixed by the Planning Commission on a formula basis after the overall States' share is laid down after negotiations with the Finance Ministry. 70 per cent of Plan assistance which is distributed under the Gadgil formula after the shares of special category States and the overall States' share are determined through consultation, consists of loans to States. A few Central loans outside the Central assistance are linked to specific projects, with the really major component, in recent years, being the large gap filling amounts transferred to Punjab. As for Centrally sponsored schemes, the loan component of each (where there is such a component) is on a schemewise basis, determined Ministry by Ministry, through the Planning mechanism. All this is to say that the borrowing figures can be influenced to a very limited extent only by the

unilateral action of a single State; the only area of conscious management relates to State performance on the recovery of loans extended to favoured sectors and public sector undertakings but this is a relatively small component of the whole.

This apart, on the non-Plan revenue account alone, there does not appear to have been any positive encouragement to better fiscal management on the part of States. We had earlier concluded that the Finance Commission's role in inducing such behaviour is limited in the case of the Central government; for State governments, however, deprived of access to deficit financing, the 5 yearly exercises could have a much larger budgetary impact for good as well as for evil. But the Commission has not examined various available indicators of State willingness to effectively manage its own finances.

One of these could be the own revenues of States as a percentage of their domestic products (Table 2). More than even high income States, the middle income States seem to have made considerable efforts to improve their resource mobilisation and some have reached percentages above 14 per cent (Tamil Nadu, Kerala, Karnataka and Andhra Pradesh). Only 2 of the 4 high income States (Haryana and Maharashtra) have attained these levels. Certain low income States also have made efforts to tap a greater share of internal resources relative to SDP over time (Bihar and Orissa, for example), but others like UP and Rajasthan have stagnated along with one middle income State - West Bengal. Non-recognition of these efforts in any way goes against the Commission's objective of encouraging States which had made valiant efforts to increase internal revenues.

We could look at the growth of own revenues - tax and non-tax as well as the major State taxes in the recent past. Since earlier Commissions had laid down targets in these areas, comparisons of actual achievements against these targets would have been valid. As this issue has been fully treated in an earlier paper I will not spend much time on it here[9]. (Table 3 and 4 provide the data). There are sharp variations especially with regard to non-tax revenues which are worth examining.

The comparatively low levels of overall growth in own revenues in States like Punjab (both tax and non-tax revenue), West Bengal and U.P. (especially non-tax revenue) and Tamil Nadu (during the Seventh Plan alone) call for analysis and corrective action. On the major taxes, comments have already been made in the earlier paper and figures alone are being presented here. (Motor vehicles tax has not been considered as results are likely to be distorted due to the shift to one-time tax in several States). On the receipts side, even more specific indicators could have been taken up - the cost of collection of major tax revenues, for example. As for non-tax revenues, only the rates of return and the performance of the State electricity and transport undertakings have been looked at thoroughly by the Ninth Finance Commission, as is the normal practice.

The expenditure side is also liable to a closer study with a view to focusing on slack administrative practices. The costs of delivery of the major services are a relevant variable and the overall picture would emerged when the non Plan budgetary balances become clear. We could then ask whether a State has a non-Plan revenue deficit or surplus in the final analysis (Table 5). Haryana and Madhya Pradesh are the only States that have generated revenue surpluses throughout the '80s. Bihar, Tamil Nadu and Karnataka have run deficits in only 2 of the 10 years whereas West Bengal has been in deficit in 9 out of 10 years, Kerala in 7 and U.P., Maharashtra and Rajasthan in 5 years.

None of these possible indices of prudent fiscal behaviour have been mentioned, so that one is disposed to enquire whether the Commission itself has linked "performance with accessibility to funds", as it has so sagely counselled the States and Central governments.

An area that has been practically left untouched by the normative approach relates to assistance given to special category States. While the same criteria have been applied to them in determining the tax shares as are applicable to other States, more or less actual levels of receipts and expenditure have been adopted in fixing grants-in-aid. The overall share of these States

in Finance Commission recommended transfers has gone up as we have indicated earlier. The most anomalous thing however is the special attention paid to these States, even where their per capita SDP is far above the all - States average - Goa in fact has the highest SDP of all States, while Sikkim and Nagaland are also fairly well off. The justification that these States require special treatment because of their size and strategic location will not hold water for all time, without some accompanying attempt to enforce financial discipline. On all fronts, these States are today in a position to indiscriminately put up expenditure, without a thought to the resource availability so much so that their share of all Central transfers has spiralled steadily upwards from 12.5 per cent in 1979-80 to 22 per cent in the 1986-7 budget estimates. This has been seriously hampering efforts to prod the States into gradually becoming more self reliant and provoking other States too into demanding special status for one reason or another[10] (Punjab had already defacto achieved this objective, despite its higher per capita SDP).

In the light of the developments in fiscal federalism reflected in the Ninth Commission's reports, it might be useful to speculate on the likely directions of State policy in future.

The growing shortages in Central funds available for disbursement to States as a whole may compel high and middle income States to shift their strategy from merely supporting demands for an increase in the level of transfers to one of the defence of their existing shares. They may pay greater attention to influencing Commission deliberations with a view to reducing (or at least preventing the extension of) the scope of equalising criteria in the distribution of tax shares. Opposing both greater allocations to special category States as well as expansion of the applicability of the budget deficit criterion are likely to yield dividends for these States. Various permutations and combinations of different criteria of backwardness are also likely to be suggested by them depending on the mix that would favour each. The curtailment of Central statutory funding might finally force middle income States to give up hopes of ever becoming eligible for statutory grants.

As for Plan transfers, much will depend on the outcome of the present controversy relating to Centrally sponsored schemes. If the ultimate fallout is a reduction in the quantum and importance of such schemes the middle and high income States will attain greater flexibility in making expenditure and resource- raising decisions. They will then indeed move towards greater autonomy in decision-making and explore inter-State and multi-State mechanisms to evolve useful common policy initiatives. This would be generally beneficial, as experience has shown that workable innovative programmes like those relating to nutrition or employment, have invariably had their genesis in the State sector and were only subsequently picked up and developed as nationwide schemes. Financial autarchy could make States more inclined to assert themselves politically and federalise party and governmental structures.

The behaviour of low income States will continue to be governed by their dependence on Central largesse. As the Ninth Commission has not fully met even their identified requirements, they would have to set their houses in order, to indent upon available resources and manage domestic finances. The stiffer resistance they are likely to face from the other two groups of non- special category States to general expansion of equalisation criteria in distributing tax shares will lead them also to discover permutations and combinations that will specifically benefit each State. Hopefully, they will set about improving internal resource generation and claim credit for this in future Finance Commission deliberations.

It is thus hoped that all States will be thrown more on their own resources and concentrate on developing methodologies to effectively manage domestic finances, without looking to the Centre alone for succour. If this happens, however, it will hardly be due to Finance Commission methodology - it will only be the natural outcome of the resource constraints of the Central government.

One likely fallout of the reduced fund availability

for distribution to States will be a diminution in the dependence of all States on Finance Commission transfers. As these transfers are in any case governed by certain general principles, States will tend to concentrate more on the complex political processes behind the sharing of non-statutory funds like general purpose Plan assistance or amounts earmarked for Centrally sponsored schemes. This is also not a bad thing, as federalism implies active political interaction, over and above the supposedly objective award of an independent group of experts.

Notes

1. See, for example, "Issues Before the Ninth Finance Commission: On Closing Pandora's Box", by S. Guhan, paper presented at the Seminar on "Issues Before the Ninth Finance Commission" organised by the NIPFP, New Delhi, 1988.

2. Paras 10.8 to 10.14 - Chapter X "Concluding Observations" of the 2nd Report of the Ninth Finance Commission.

3. The Eighth Commission, for example, looked at trends in the growth of the major Central Taxes, assumptions made by the Seventh Finance Commission and the Sixth Plan as well as price and income elasticities worked out by an NIPFP study in addition to CBDT forecasts.

4. One of the earliest to suggest this was K.V.S. Sastri in "Federal - State Fiscal Relations in India" O.U.P. 1966.

5. There is a clear indication of such an approach in the Ninth Finance Commission's Second Report, where it has admitted its intention of staying within the existing overall limits of Central transfers.

6. Even the First Report, despite normative

calculations of receipts and expenditure, only recommended grants to close the newly-established revenue gaps.

7. An interesting sidelight of the Second Report of the Ninth Commission is the manner in which the Centre, threatened by the prospect of a closer scrutiny of its resources, has resorted to the same techniques as States and projected growth levels of receipts and expenditure which represent perhaps the worst scenario before it - an eventuality that it was likely to avoid any advance corrective measures.

8. See "Financial Management in States: Role of Finance Commission" J.L. Bajaj and Renuka Viswanathan, Economic and Political Weekly, 7th October, 1989.

9. J.L. Bajaj and Renuka Viswanathan - op.cit.

10. The tirade of a Kerala politician some time back on the issue, which attracted considerably adverse publicity may be remembered.

Table 1

(Per cent)

	Shares in Tax Shares			Shares in Grants		
	Eighth Commi-sion Report	Ninth Commi-ssion Report I	Ninth Commi-ssion Report II	Eighth Commi-ssion Report	Ninth Commi-ssion Report I	Ninth Commis Report II
High Income						
Gujarat	4	3.6	3.9	3.7	3.1	3.3
Haryana	1.2	1.2	1.3	1.1	1.2	1.1
Maharashtra	7.3	7.3	6.9	6.7	6.8	5.9
Punjab	1.7	1.6	1.7	1.6	2	1.5
TOTAL	14.2	13 .7	13.8	13.1	13.1	11.8
Middle Income						
Andhra Pradesh	7.7	7.2	7.5	7.3	6.5	6.7
Karnataka	4.8	4.8	4.5	4.4	4.2	3.9
Kerala	3.5	3.4	3.3	3.3	3	3.2
Tamil Nadu	6.9	7.1	6.8	6.3	6.4	5.9
West Bengal	7.9	7.2	7.1	8.7	7	7.1
TOTAL	30.8	29.7	29.2	30	27.1	26.8
Low Income						
Bihar	11.2	11.6	11	10.7	10.7	10.7
Madhya Pradesh	7.8	7.7	7.4	7.6	7.1	7.4
Orissa	4.4	4.3	4.9	4.8	4.4	5.2
Rajasthan	4.3	4.9	5.3	4.3	4.8	5.9
Uttar Pradesh	16.6	17.4	15.8	15.5	15.8	16.6
TOTAL	35.3	45.9	44.4	42.9	42.8	45.8
Grand Total	**80.3**	**88.3**	**87.40**	**86.0**	**83.0**	**84.4**

Table 2

Own Revenue/SDP

(Percentage)

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87
High Income								
Gujarat	10.4	10.8	10.3	11.4	10.8	11.5	12.6	13.6
Haryana	12.76	11.74	12.7	12.76	12.95	13.4	13.8	14.6
Maharashtra	11.31	11.22	12.06	13.1	12.82	13	13.7	14.7
Punjab	9.8	10.13	10.55	10.9	10.73	9.9	10.3	10.7
Middle Income								
Andhra Pradesh	11.22	11.17	10.74	11.15	11.36	13	14.2	14.2
Karnataka	11.96	12.7	13.08	14.18	13.81	14.3	15.5	14.7
Kerala	13.38	12.55	16.49	13.12	12.15	13.2	14.7	14.6
Tamil Nadu	9.98	13.66	12.35	14.37	14.24	13.6	14.1	14.3
West Bengal	7.45	7.53	7.94	7.66	7.21	7.4	8.1	7.9
Low Income								
Bihar	6.27	5.76	6.31	6.37	6.62	7	8.5	8.4
Madhya Pradesh	12.86	10.61	12.2	12.33	11.58	11.5	11.5	12.5
Orissa	7.71	8.6	7.25	7.72	6.8	7.4	7.4	8.4
Rajasthan	10.67	10.37	9.76	10.75	9.58	10.5	11.2	10.9
Uttar Pradesh	7.97	6.36	7.66	7.57	7.18	7.2	7.4	7.6

Table 3

Compound Growth Rates

(Per cent)

	Tax		Non-tax		Own Revenues	
	6th Plan	7th Plan	6th Plan	7th Plan	6th Plan	7th Plan
High Income						
Gujarat	16.9	14	16.82	12.8	16.88	12.3
Haryana	15.49	17.9	13.92	15	14.93	16.8
Maharashtra	14.92	17	16.57	9.7	15.4	14
Punjab	12.88	13.2	9.62	6.5	12.1	11.8
Middle Income						
Andhra Pradesh	18.95	16.7	13.76	13.2	17.57	15.2
Karnataka	17.57	16.5	14.31	8.6	16.61	14
Kerala	16.41	15.7	1.8	4.9	12.84	12.7
Tamil Nadu	21.68	9.9	12.22	3.5	20.02	8
West Bengal	14.9	14.8	4.47	3.5	12.84	13.3
Low Income						
Bihar	14.72	17	29.99	25.2	19.83	20.7
Madhya Pradesh	17.37	17.6	9.42	14.5	14.1	16.3
Orissa	15.23	20.9	14.59	14.5	15.01	18.8
Rajasthan	17.59	15.2	13.87	7.6	16.15	12.3
Uttar Pradesh	15.19	14.5	8.14	10.7	13.15	12.7

Table 4

Compound Growth Rates (Per cent)

	Stamps		Excise		Sales Tax	
	6th Plan	7th Plan	6th Plan	7th Plan	6th Plan	7th Plan
High Income						
Gujarat	11.2	8.43	7.56	10.74	16.06	14.43
Haryana	16.11	15.38	21.26	18.84	15.35	16.75
Maharashtra	15.89	17.34	19.2	14.53	14.86	14.1
Punjab	5.4	9.92	15.49	8.76	15.22	12.63
Middle Income						
Andhra Pradesh	13.4	13.5	20.01	9.82	22.64	14.64
Karnataka	16.14	16.91	19.59	13.54	19.39	15.63
Kerala	13.36	12.12	10.46	16.61	18.2	13.55
Tamil Nadu	15.77	15.15	107.76	-	20.45	11.55
West Bengal	14.29	10.54	12.01	12.87	13.82	14.85
Low Income						
Bihar	15.07	6.42	63.03	15.06	15.54	13.06
Madhya Pradesh	16.49	13.45	17.67	13.86	18.15	16.73
Orissa	14.69	10.81	19.09	10.88	13.86	19.31
Rajasthan	14.67	18.06	30.05	17.66	15.6	14.78
Uttar Pradesh	13.07	10.07	20.75	25.77	15.84	11.71

Table V

Non—Plan Revenue Surplus/Deficit

(Rs. Crore)

	1979-80	1980-81	1981-82	1982-83	1983-84 RE	1984-85 BE	1985-86	1986-87	1987-88	1988-89
High Income										
Gujarat	92.3	121.73	120.31	66.26	139.03	68.26	-69.91	-309.52	-411.8	-353.68
Haryana	84.32	59.22	50.53	44.76	85.85	29.58	106.12	162.82	43.6	97.6
Maharashtra	195.41	121.02	147.37	210.12	70.77	-212.0	-316.65	-0.55	-84.1	-243.41
Punjab	77.49	18.13	62.63	102.48	59.27	-9.35	7.34	90.41	-333.03	-239.22
Middle Income										
Andhra Pradesh	121.29	103.41	97.91	132.57	-88.58	-169.03	-7.31	38.63	51.45	120.31
Karnataka	80.65	58.65	164.29	141.89	72.91	143.62	-84.74	79.39	25.1	-184.55
Kerala	57.93	-27.22	95.98	26.78	-58.2	-13.67	-74.17	-152.24	-153.15	-139.14
Tamil Nadu	95.3	127.7	81.61	01.94	51.71	17.18	188.57	103.61	-304.5	-217.56
West Bengal	-13.71	-23.51	-87.81	-242.44	-206.17	-371.94	82.89	-187.31	-133.8	-104.99
Low Income										
Bihar	230.51	59.55	-94.65	-37.7	72.14	106.712	97.67	354.4	190	424.63
Madhya Pradesh	167.08	117.78	229. 26	187.77	176.28	79.13	70.42	35.77	66.79	48.91
Orissa	18.68	80.81	27.98	-22.98	0.36	-74.03	-60.09	-19.74	-21.23	60.77
Rajasthan	18.01	65.3	34.23	54.54	44.64	-75.86	-2.16	-60.17	-291.66	-191.81
Uttar Pradesh	245.06	182.64	353.43	192.37	-105.74	-147.31	74.61	-177.51	-206.3	-559.97