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# Centre-State Resource Transfers, 1951-84: An Appraisal

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An Appraisal

As is well known our Constitution, right from the time of its origin, has been only semi-federal in character. Nowhere is the weakness of its federal character more evident than in the provisions of the Constitution relating to financial relations which, except for the provisions relating to the Finance Commission, were largely taken from the Government of India Act, 1935. The weakness derives from the imbalance between the Centre and the States in the resource raising powers built into the Constitution itself.

The Constitution, however, recognising the imbalance in access to resources of the Centre and the States, makes a number of enabling provisions in this regard. These provisions reflect the clear recognition on the part of our Constitution makers that the States would not be able to meet adequately the expenditure functions assigned to them unless they could have access to additional resources. These provisions can be said to go further and concede that going by the distribution of revenue raising powers between the Centre and the States as laid down in the Constitution, it is the Centre which would be in a position to raise resources in excess of its requirements for financing its own expenditure functions. Furthermore, the Constitution can also be said to recognise the need for an arrangement under which resource transfer from the Centre to the States takes place in a manner that is free from the Centre's discretion and as automatic as possible. This, we believe, must have been the spirit underlying the provisions in the Constitution envisaging

transfers by way of tax sharing as well as grants-in-aid of revenue, with the latter being altogether open-ended in that their devolution is linked to only "the need of assistance" of the States. These transfers were to be made in accordance with the award of the Finance Commission to be appointed every five years.

In the first thirty years, or so, since the Constitution came into effect, stresses and strains experienced in federal relations have been largely the result of the difficulties faced by the States in discharging the responsibilities assigned to them on account of the shortage of resources. No doubt, these difficulties have stemmed from the imbalance built into the Constitution. At the same time, however, the disproportion originally built in by the Constitution has further been accentuated by changes introduced subsequently. Various constitutional amendments and other enactments have clipped the States' revenue raising powers substantially. Thus, under the Constitution (Sixth Amendment) Act of 1956, taxes on sale or purchase of goods in the course of inter-State trade or commerce was added to the Union List as item 92A. Then the profit tax payable by companies was made non-divisible by a mere stroke of pen when it, really a part of it, ceased being called income tax. More recently, restrictions were imposed on States' powers to impose taxes on export sales and taxes on advertisements broadcast by radio and television were excluded from the States' purview. Since 1957, additional excise duties have been imposed by the Centre on textiles, tobacco and sugar in lieu of sales tax by the States.

Whatever the formal position as created by statutes, old or new, part at least of the imbalance, that has emerged in regard to the States'

responsibilities and their resources, is also an outcome of the manner in which the constitutional scheme of resource transfer has operated in practice whereby the States have become more and more dependent on resource transfers of non-statutory types, i.e., of the types that are outside of the scheme of resource transfer envisaged in the Constitution and are not automatic and free from discretionary interference.

In this paper, an attempt has been made principally to review the major changes in resource flows from the Centre to the States and in the magnitude and nature of financial dependence of the States in the course of the last thirty years or so.

Centre's commanding position

The distribution of receipts, as they accrue before transfers are effected to the States, given in Rows 1, 2 and 3 of Table I, shows the extreme concentration of both revenue and capital account receipts with the Centre right from the very outset. Of the total revenue account receipts mobilised by both the Centre and the States, the share of the latter now is only 37%. It is noteworthy that this share has come down from the level obtaining during the first decade of planning when it was over 40%. The share of the States in the mobilisation of capital account receipts raised by the Centre and the States together has been much smaller. This share has remained at about one-fifth of the total practically all through the period under review. Thus the States' share in the aggregate budgetary receipts - revenue and capital (excluding deficit financing)-is currently less than one-third. This proportion has also come down over

the period; from 38% in the First Plan period, it declined to 32% in the Sixth Plan period. Even these figures project a less tilted picture than it actually is. For in the calculation of the States' own capital account receipts are included receipts on account of 'internal debt' over which the States have in effect very little control since the amounts thus raised are subscribed by the financial institutions which are under the complete control of the Centre. The quota for market borrowing for each State is fixed by the Centre. All the States being in debt to the Centre they have, under Article 293, to get the Centre's permission for raising loans whatever their source and whatever be the purpose including that of covering the budget deficit. It is to be noted in this context that the States' share of market borrowing has been on the decline, a point to which we shall revert later on in this paper.

The picture in regard to the distribution of total budgetary resources between the Centre and the States looks much more balanced when resource transfers are taken into account. This can be seen from Rows 4, 5 and 6 of Table I. In fact, in regard to revenue account receipts the position today seems to be somewhat more favourable to the States compared to what it was in the First plan-period, though for more than half of the total period covered by this review the States' relative position in regard to the sharing of even revenue account receipt was not quite as good as in the terminal plan-periods.

When we come to capital account receipts, the States' relative share can clearly be seen to have suffered a significant deterioration, having come down from 55 per cent in the First plan-period to 37 per cent in the Sixth plan period. Here it ought to be added that in working out the States' share of capital receipts, Central transfers to the States on capital account have also been taken into account. In fact, the deterioration in the Centre-State sharing of the overall capital account receipts is the consequence of the decline in the capital account transfers from the Centre to the States. As can be seen from Row 6 of Table I the States' overall access to budgetary resources has, as a consequence, suffered a decline over the period under review.

<u>Centre-State share of development expenditure</u>

Access to budgetary resources has, of course, to have a relationship to the need for their use, i.e., for meeting budgetary expenditure. At the same time, one has to [illegible] on caution in relating resources to expenditure *ex post*, particularly because, given the severe constraints on their ability to resort to deficit financing, expenditure actually incurred by the States has, more or less, to match their receipts. In fact, as noted above, the freedom of the States is severely limited with respect not only to incurring what is narrowly referred to as deficit but also to raising funds through borrowing. All the same, it is worthwhile looking at the expenditure side.

Government expenditures are often classified under developmental and non-developmental heads.[1] As can be seen from Table II (Rows 5 and 6), at the beginning of the planning era, a quarter of the Centre's aggregate expenditures and two-thirds of the States' aggregate expenditures were

developmental in nature. This was quite understandable since the development heads came largely within the purview of the States under the constitutional scheme of division of responsibilities between the Centre and the States. Indeed, the relative share of development expenditures in the States' aggregate budgetary outlay has been rising and in the past ten years or so it has been close to 75 percent. Changes in classification notwithstanding, the increase in the relative share of development expenditure has been quite genuine. At the same time, the share of development expenditures in the Centre's aggregate outlay (excluding grants and loans to the States) has increased much more significantly. The share of development expenditure in the Centre's outlay has gone up from 25.3 per cent in the First plan-period to 49.2 per cent in the Sixth plan-period.

While the enhanced share of development expenditures in the budgetary outlays of the Central as well as State Governments can rightly be considered as indicative of a healthy trend, the relatively higher increase in the Centre's development expenditures can also be taken to reflect a greater involvement by the Centre in spheres of activity which, as pointed out above, the Constitution assigns to the States. It is proposed to examine this aspect of the Centre's development expenditures under various heads in a subsequent paper. It is sufficient for our present purposes to note that since the States' access to budgetary resources has, as noted above, suffered some decline over the years, given the share of development expenditures in their aggregate outlay, reduction of resource flows to the States could have acted as a major brake on the developmental activities.

States' increasing dependence

We referred above to the important role of Centre-State resource transfers in restoring a balance in the Centre-State distribution of aggregate budgetary resources. But the aggregate transfers (of all types) from the Centre to the States as a proportion of the Centre's total receipts (revenue and capital including deficits) declined somewhat over the period. As can be seen from Table III (Row 4), except during the First and the Fourth Plans, aggregate transfers from the Centre to the States never exceeded one-third of the aggregate Central receipts. Although revenue account transfers registered significant increases, the share of loan transfers to the States as a proportion of the Centre's capital account receipts declined sharply; in the First Plan period this share was 61.5 per cent and in the Sixth plan period it had come down to 27.1 per cent. This was despite the fact that the Centre itself continued to depend substantially, in fact, increasingly on capital account receipts as a source of finance. (See Row 5 of Table III).

Even though, as stated above, the Centre has been transferring to the States only around one-third of its total receipts, these transfers have been a source of important support to the States. As can be seen from Table IV, currently (i.e. during 1979-84) 41.6% of the States' aggregate expenditures (revenue and capital) are financed out of the Central transfers. The States would not have been able to incur the expenditures they did and provide corresponding services, but for the transfers from the Centre on this scale. At the same time, this can be taken as a measure of the States' dependence on the Centre. However, the dependence of the States on financial transfers from the Centre, as measured in aggregate terms, does not

tell the complete story.

Transfers effected under a clearly laid down framework, and without demanding any *quid proquo* in terms of adherence to certain conditions, can be said to impinge less on the States' autonomy within their spheres than transfers effected by the Centre on a discretionary basis and carrying conditions, explicit or implicit. Also, since these transfers are made in pursuance of the awards of a Finance Commission, they are, by and large, automatic and can be said to be free from discretionary interference from the Centre. But, as can be seen from Table V, during the period under review, transfers under the aegis of the Finance Commissions, referred to hereafter as statutory transfers, accounted for only two-fifths of the aggregate budgetary transfers. In fact, during the first two decades of planning, the share of statutory transfers hardly ever exceeded one-third of the aggregate Central transfers. Lately (i.e. in the past one decade) however, their weightage has improved somewhat and they have accounted for over 40 per cent of the total Central transfers to the States.

Three-fifths of the Central transfers to the States have been effected by the Planning Commission and the Union Ministries. These transfers have a high discretionary component. Till the Fourth Plan, the Central plan assistance was related to the schemes in the State plans, and each scheme was individually cleared by the Planning Commission. With the introduction of the Gadgil formula for plan assistance,[2] from the Fourth Plan onwards, plan assistance has certainly become considerably less discretionary and more automatic. But the importance of the Gadgil formula itself has been progressively whittled down and now almost 50% of the Central plan assistance to the States is given outside the formula.

Transfers made to the States other than in pursuance of the Finance Commission awards or by way of plan assistance (shown in col.3 of Table V) are referred to as discretionary because except for the sharing of small savings (these account for close to 30 per cent of total discretionary transfers during 1979-84) which is formula-based and therefore not subject to variations in shares, the rest is comprised largely of assistance for various Central and Centrally sponsored schemes.[3/] Though the States have been near-unanimous in opposing the proliferation of these schemes, the importance of these schemes as channels of resource transfers is on the increase. This can be judged from the fact that during the last five years, 1979-84, assistance for the Central and Centrally sponsored schmes together added upto about 35 per cent of the Central plan assistance for State plan schemes as compared to 31 per cent during the Fifth plan. It is also worthwhile noting that sheme-wise Central transfers are usually tied to matching contributions by the States themselves. This means that the more they try to avail themselves of such Central funds, the less the States are left with their internally generated resources to be used for their own schemes. This therefore could upset the States' own priorities.[4/]

Constitutional scheme sidestepped

The fact, that only two-fifths of the Central transfers are effected within the framework of the constitutional provisions governing the role of the Finance Commission, can be said to reflect on how the constitutional scheme has been sidestepped in actual practice. According to K.Santhanam, the financial relations between the Centre and the States, as conceived by our constitution makers, are based on two assumptions. The

first is that the main assistance required from the Centre would be in the nature of taxes and grants towards recurring revenue expenditure of the States. Though, under Article 293, the Centre is empowered to make loans to the States or to give guarantees in respect of loans raised by them, it was contemplated that normally the capital needs of a State would be met by its own borrowings. The second assumption is that the Finance Commission would be the chief instrument for determining the subventions and grants and the discretionary paragraph under Article 282 would be used only for special emergencies like famines, floods or other natural calamities.5/ But these assumptions, as spelled out by Santhanam, broke down in actual practice on account of the resort to Article 282 for extending assistance to the States by way of grants. As a result, Article 282 grants now (1979-84) account for around nine-tenths of the total Central grants to the States. This can be seen from Table VI. The excessive use of Article 282 for purposes other than what were originally envisaged in the Constitution has often been commented upon. According to the ARC Study Group on Centre-State relations, this practice was not "constitutionally neat".6/

Rationale behind Central Loans

While, as noted, the Constitution does not altogether preclude the use of loans as an instrument of Central transfers to the States (Article 293 clearly envisages a situation where the States may be indebted to the Centre), the substantive provisions on Centre-State financial relations only envisage transfer by way of tax sharing and grants under Article 275.7/ In actual fact, however, loans from the Centre have been a major means of

transfer, not only of non-statutory transfers but also of total Central transfers to the States. On the other hand, States' borrowings under Article 292 have at no time exceeded 15 per cent of their total capital receipts. Currently, i.e. during 1979-84, it has accounted for only eight per cent. (See Table VII). It ought to be added however that the position of Central loans to the States relative to tax transfers and grants (statutory and non-statutory) has been on the decline. Table VI brings this out.

The continuing importance of loans in Central transfers and the problem the States face today in regard to the servicing of their debts to the Centre are interconnected. The lower the proportion of loans in Central transfers, the smaller would have been the increase in the States' indebtedness. The issue which has not been faced squarely is whether it serves any major purpose to effect a substantial part of resource-transfer from the Centre to the States in the form of loans. One argument in defence of lending rather than making outright payments is that the Centre itself raises a substantial part of its total resources in borrowing. As much as one-third of the aggregate budgetary receipts of the Centre was in the nature of capital receipts excluding deficit financing, during the Sixth plan period (See Table VII Row 7). This argument could be met quite easily by requiring that in any assessment of the Centre's resources for the purposes of fixing the States' share therein, debt servicing (repayments plus interest charges) should first be provided for. By doing so, there could be no objection that in the sharing of resources between the Centre and the States, the former's access to resources was being overstated.

Another argument is that resource transfer through loans ensures productive use of resources thus transferred. It is doubtful that this argument is advanced with much seriousness, remembering that almost two-thirds of resource transfer are already taking place in the form of outright payments i.e. tax sharing and grants (See Table VI Rows 4&5). This, however, must not be construed to imply that the States are necessarily using efficiently the amounts they receive from the Centre by way of outright receipts. To ensure efficient use of resources by the States, regardless of the source from which they are raised, it is important to make sure that at least the scheme of Centre-State resource sharing does not put a premium on inefficiency. Can we say this with respect to the scheme currently in operation? We come to this question a little later in this paper.

Still another argument advanced in favour of resource transfer through loans is, as the Sixth Finance Commission puts it: "recoveries of old loans enable the Centre to relend the amounts so realised to States on the basis of criteria that can be revised from time to time to promote certain national priorities and to bring about a progressive reduction of regional disparities."[8/] On the face of it, this argument has some weight because debt servicing accounts for a little over half of the gross amount currently transferred to the States by way of Central loans. So it does add significantly to the resources at the disposal of the Centre. However, the question still remains that to the extent revision of past criteria is called for, or a need is felt for more progressive reduction of regional disparities, why this can be not achieved through a more equitable allocation of currently transferable funds without their being supplemented by recoveries of [illegible]

principal on past loans. The basic point is that departures made in this regard from the originally conceived constitutional scheme are not easy to defend on grounds of equity or efficiency.

We cannot, however, close the discussion of Central loans to the States as a vehicle of transfers without noting that there has been an actual decline in the ratio of Central loans in the aggregate Central transfers. This, though welcome in the sense that it entails relatively lower servicing burden for the States, cannot be endorsed if it means a reduced overall access of the States to the aggregate budgetary resources. As was noted, the States' access to aggregate budgetary resources has indeed come down over the years.

Role of Financial and semi-financial institutions

Another aspect which is often overlooked in the discussions on Centre-State financial relations is the role played by the financial and semi-financial institutions in influencing these relations. Banking and insurance are subjects which the Constitution places in the Central list. With the nationalisation of practically the whole of the organised banking and insurance, the Centre today exercises direct control over the deployment of all financial savings canalised through organised banking and insurance. For whatever "internal debt", including market borrowings, the States are able to raise annually, they depend practically altogether on these financial institutions. But, these institutions being in the control of the Centre, dispose of their funds, particularly in so far as it concerns subscription to State Government finances, directly

or indirectly, according to the guidelines, indeed detailed instructions set out by the Centre. For instance, when the States' overall share of market borrowings and its distribution between the shares are fixed each year by the Centre, they cover not only what each State Government raises for the financing of its budget but also what State bodies like Electricity Boards and Road Transport Corporations might raise from the market under State Government guarantees. The ceiling fixed by the Centre applies to all these State borrowings.

Besides banking and insurance companies which mobilise savings directly from the public, a large number of Central institutions have come up over the years under the various Central Ministries. These institutions depend for their funds largely on the Central budget, nationalised banks and insurance companies. Not only do the activities of these institutions have considerable overlap with the functions of the State Governments on subjects falling within the latter's purview under the Constitution but also these institutions, given both their access to large funds and the backing of the sponsoring and controlling Central ministries, can, and do, exercise, considerable influence on the States' own choice of priorities and schemes. The ARC study group had taken note of this aspect and observed as follows:

> "The role of the autonomous Central Organisations in State subjects created or largely financed by a ministry must not be allowed to exceed that of the ministry. The possibility of the use of such organisations for a massive encroachment on State subjects cannot be discounted. The National Cooperative Development Corporation and the Central Social Welfare Board provide ready examples. Unless restraints are placed on these, similar to those recommended for the ministries, the latter may tend to circumvent these by creating autonomous organisations and channelising funds through them".[2]

To the list of such organisations mentioned by the ARC, one could readily add the names of University Grants Commission, Housing and Urban Development Corporation, Khadi and Village Industries Commission and various commodity boards under the Ministry of Commerce.

States' Overdrafts

There can be no two opinion that the present system of Centre-State financial relations has no built-in checks against slackness in resource raising efforts and expenditure efficiency on the part of both the Centre and the States. While the Centre is obliged to share with the States the revenues it raises from certain specified taxes, the Centre is under no obligation to ensure that the revenue potential of such taxes is fully exploited. The consequence is that in regard to taxes whose revenue the Centre transfers largely to the States, as for example has been the case with regard to income tax, the Centre's effort in raising additional revenues has been, to say the least, rather, half-hearted. Likewise, since the Finance Commissions have continued with the pre-independence approach of trying to fill in the fiscal gaps of the States, not only there is no incentive for the States to economise on expenditure and make maximum revenue effort but also the manner of determining the States' gaps acts as an invitation to wastage in government spending and laxity in revenue effort. Still, the impression that the Centre is forced to resort to deficit financing in order to satisfy the insatiable demand for funds from the States is not borne out by facts. As has been noted above, only less than one-third of the Centre's aggregate resources get transferred to the States in various forms.

It is true that the States have been incurring increasing overdrafts. However before going into the reasons for the State's increasing overdrafts, it is necessary to place the magnitude of the overdraft problem in the correct p spective. As may be seen from Table VII though the problem of State deficits was persistent during all the plan periods, except the Fifth, and had become quite substantial during the Sixth, during all the plan-periods, including the Sixth, the proportion of the States' deficits to their total disbursements had been lower than the Centre's deficits as a proportion of its total disbursements.

One can point out three major possible factors behind the States' deficits. The first factor is the practice of the Finance Commissions to cover the non-plan revenue gaps by Article 275 grants without providing adequately against any inflation during the award period. As a result, the real value of grants gets usually reduced and a larger gap originates even before a Finance Commission's award starts getting implemented. The second factor behind the States' deficits is the existence of large non-plan capital gaps caused principally by the heavy debt burdens which the States have accumulated over the years. The consequences of denigrating the Centre-State relations into a debtor-creditor relationship are increasingly being reflected in these gaps. Not only was the rationale of the loan: grants composition of schematic plan assistance extended in the past rather questionable but even the composition of loans to grants ratio of the Gadgil Formula plan assistance was not quite explicable in terms of either the nature of State schemes financed out of plan assistance or the ability of individual States to repay debts as and when repayment fell due.

If the States find themselves caught into 'debt traps', the blame is not as much of the States as of the policy to continue using loans as an instrument of resource transfer on the present scale. During the Fifth plan period, the debt servicing payments on central loans accounted for more than two-thirds of the new Central loans. The ratio of debt servicing payments to fresh central loans would have been much higher (90%) but for the substantial debt rescheduling and relief recommended by the Sixth Finance Commission. The Seventh Finance Commission felt obliged to recommend (even though the relief recommended was not as liberal as that recommended by the previous commission) further relief and as a result, the ratio of debt servicing to new Central loans came down to 53% in 1979-80 and 1980-81.[10] Individually, the problem is more acute for some States than others. Thus even after debt relief, net resource transfer through loans (i.e. after allowing for debt servicing) for three States was nil or negative during the Fifth Plan. These States were Rajasthan, Himachal Pradesh and Tripura. But for the debt relief recommended by the Finance Commissions, 10 states would have had problems of reverse flow of funds during the Fifth Plan and one during the Sixth Plan (1979-80 and 1980-81).

The dimensions of the States' problem become much more glaring when one relates loan repayments by the States to their non-plan capital disbursements. Loan repayments were 97.5% of non-plan capital disbursements during the Fifth Plan and 86.8% during 1979-81.

The third important factor behind the States' deficits is their reduced share in the total market loans raised by the Centre and the States together. As can be seen from Table VII, the States' share which

was as high as 29% during the First Plan came down to 20% during the Fifth Plan. It dipped drastically during the Sixth Plan to 12.7%. The market loans which accounted for 15.1% of the States' aggregate capital account receipts during the Second Plan now account for only 8 per cent. As a result, the share of the States in the total outstanding Government securities as also in the security portfolios of financial institutions, has been coming down steadily.

Thus the problem of States' deficits cannot be discussed in isolation. It has to be viewed in the overall context of the Central transfers to the States and the composition of these transfers.

<u>Equity in Inter-State distribution</u>

One of the major arguments for the centralisation of resources in the hands of the Centre has been that then in the inter-State distribution of resources transferred to the States equity can be ensured. In practice, however, as can be seen from Table VIII the record of none of the three types of budgetary transfers has been very satisfactory in this regard. The low-income States, as a group have received relatively lower than average per capita transfers of all the three types.[11/] The three agencies, the Finance Commissions, the Planning Commission and the Union Ministries, do not seem to have had equity uppermost in their minds in effecting the inter-State distribution of the transfers within their respective ambit. The performance of the Union ministries, whose discretion is the least fettered, has been the worst, clearly indicating that discretion need not always be used for serving the cause of equity. This is also confirmed by the inter-State distribution of certain identifiable

Central plan outlays over the 30 years of planning, 1950 to 1980, as given in Table IX. That equity has not been the predominant objective of Central Paln expenditure is borne out by the very small per capita plan outlays received by low income States like Uttar Pradesh and Rajasthan. Indeed, Uttar Pradesh has fared the worst among the non-special category States.

In the inter-state distribution of investment funds by specialised financial institutions for industry and agriculture as also in the deployment of largely working capital funds by commercial banks, equity consideration has been given the complete go by. This can be seen from Table X. The discrimination against the low income States comes out sharply. They received only 52 per cent of the all-states per capita average of the institutional funds.[12/]

Thus, it cannot be said on the basis of the experience so far that the centralisation of resources has led to the equitable distribution of transfers therefrom among the States, whatever the mode of transfer tried over the past thirty years. Furthermore, the least satisfactory inter-state distribution came about in regard to transfers in which the Centre and its institutions had the maximum of discretion.

Suggestions for reform

Before one goes on to examine measures to improve upon the scheme of Centre-State financial relations, it is necessary to examine the factors that have led to the distortions in the scheme originally envisaged.

As noted, our Constitution was semi-federal in character from the very outset. Not only were practically all the centralist features of the Government of India Act retained in the Indian Constitution but also they werefurther reinforced through various subsequent amendments and other legislative measures. The advent of centralised planning added to the centralising trends generated by the political process. In this process, unlimited powers were given to the planning agencies - the Union Ministries and the Planning Commission - bending substantially the Constitutional provisions. Since decentralisation of financial powers does not go hand in hand with a centralised planning system, further centralisation of financial powers followed.

In putting forth suggestions for reforms, one has to guard against the temptation to go in for formal decentralisation which does not ensure equitable sharing between the States. One of the many recommendations which has come up in recent discussions is to give back to the States some of the taxes surrendered to the Centre and to get new tax heads included in the State List. While this certainly could reduce the financial dependence of the States as a group and thereby increase their financial autonomy, the benefits to the States need not, in fact will not, be uniform. In the case of the economically backward States, it may turn out that the so-called increased financial autonomy fetches them very little additional resources. The real beneficiaries may well be only the relatively developed States. It may be remembered that even before tax devolution from the Centre, richer States like Punjab, Maharashtra, Haryana, Gujarat, Tamil Nadu and Karnataka had surpluses under non-Plan revenue accounts, while others had gaps even after tax sharing.[13/] Punjab and Maharashtra had surpluses in their non-Plan capital accounts too during the Fifth Plan.[14/]

A suggestion has often been made that some of the present non-sharable Central taxes as e.g. surcharge on income tax and corporation tax, proceeds in excess of cost from administered prices of goods produced or procured by Central Government undertakings like coal and petroleum and special capital receipts as e.g. yield from Special Bearer Bonds, should be brought into the divisible pool. While one appreciates the logic of these arguments - several of these Central receipts should have been shareable but for the subterfuges employed to make them non-sharable - one should not restrict one's demand for sharing to a few heads.

Firstly, item-wise sharing will perpetuate the present 'hide and seek' game played by the Centre and the States. Secondly, piecemeal approach has been the bane of the present system of resource transfers because it has led to the failure to perceive the resource flows in their totality and to devise an integrated basis for sharing. What seems to be called for is a more radical approach whereby in the Centre-State sharing, one takes note of the resource flows accruing to the Centre in their totality and sharing is done on objective and equitable basis both between the Centre and the States and between the States.

In our approach, it is not necessary that any fixed proportion for such sharing between the Centre and the States is laid down for all time to come. Instead, it can be decided upon by the Finance Commission or whichever new agency is entrusted with this task of resource transfers. Such an agency must however have the freedom to fix a reasonable proportion on the basis of an objective assessment of the needs of the Centre and the States. The danger of being overawed by the so-called more demanding requirements of the Centre will have to be appropriately guarded against.

The agency thus envisaged would have to be given a clear mandate for ensuring equitable distribution of the sharable resources among the States. The stipulation of Article 275 is not clear in this regard. Equity ought to be made in our opinion, the overriding criterion for the totality of resource transfers and not just a segment thereof.

The existence of numerous agencies in the field of resource transfers has in our view, presented an integrated look on the totality of resources and the needs of the States and the Centre. It is necessary to entrust this task to a single, permanent agency. This body should have the responsibility of allocating not only budgetary resources but also institutional financial resources. As the pace of development determines largely the resource raising capacity and the expenditure needs of the States, ideally it is the Planning Commission which should be entrusted with the task of resource transfers. Our disenchantment with the Planning Commission, as it is now constituted, should not lead us to throw this useful baby with the bath water. As an institutional safeguard against the Planning Commission operating as a department of the Central Government, it may be necessary to place the Commission under the Inter-State Council envisaged in Article 263 of the Constitution. Also, the appointment of the members of the Planning Commission should be approved by the Council. In fact, in all matters relating to Centre-State financial and other economic relations, the President should be guided by the Council and not by the Central Cabinet.

Concluding observations

It comes out clearly from the foregoing review of the flow of resources from the Centre to the States that not only has the fiscal dependence of the States on the Centre increased over the years but also the nature of this dependence has undergone a change that, in our view, cannot be considered in tune with the scheme which the constitutional provisions envisaged. Also, the Centre-State flows have not been equitable. This, unfortunately, has been truer, the greater was the discretion enjoyed by the Centre in regard to transfers. So, from the point of equity, the discretionary component of Centre-State financial flows must be curbed. But even with respect to non-discretionary transfers it will be necessary to require explicitly the observance of equity as the over-riding consideration in their inter-state allocation. However, the States will as a group, have first to be assured beyond doubt of an adequate share of the Central resources, access to which they can gain in a manner that is not susceptible to discretionary considerations and pressures from the Centre. Were the planning commission to be so constituted as to inspire the confidence of the States, the task of sharing of resources between the Centre and the States and as between States could safely be entrusted to such a body.

Notes and References

1/ The classification followed is the one used by the Reserve Bank of India in their analysis of the budgets of the Union and State Governments; for details of items included in the two categories of expenditure, see such analysis published annually in the Reserve Bank of India Bulletins. Their methods of classification have however undergone some changes from time to time.

2/ The Gadgil formula named after late Prof.D.R.Gadgil, then Vice Chairman of the Planning Commission was accepted by the National Development Council in 1968. The formula which has undergone some changes over time was used in determining Central Plan assistance during the Fourth Plan onwards. According to the formula, the North Eastern States, including Assam and Jammu and Kashmir were given special consideration in the allotment of Central funds for financing State plans. The balance in the divisible pool of Central plan resources meant for states was to be alloted among states according to five criteria with different weights. The criteria are Population, State income, tax efforts, special needs arising out of continuing power and irrigation projects, special problems of metropolitan areas, drought and flood affected areas and tribal areas.

3/ For details, see Report of the Sixth Finance Commission 1973.

4/ For details regarding the genesis, purposes and magnitude of these schemes, as also for a critique of these schemes, see Government of India, Administrative Reforms Commission, Study Team on Centre-State Relationships, Vol. I-III, Delhi , 1967.

5/ See Santhanam,K Transition in India, Asia Publishing House, Bombay, 1964, p.116.

6/ See Administrative Reforms Commission, op.cit. Vol.I, P.74

7/ These substantive provisions come under the heading ' Distribution of Revenue between the Union and the States'. Article 282 comes under the head 'Miscellaneous Financial Provisions'.

8/ See Finance Commission, Report of the (sixth) Finance Commission, Government of India, New Delhi, 1973.

9/ See Administrative Reforms Commission, op.cit. Vol.I p.163.

10/ See George K.K, Centre-State Financial Flows and Inter-State Disparities in India, University of Cochin ( mimeo ) 1982, for the data used in this and the subsequent paragraph.

11/ For a detailed discussion on this issue, see Gulati I.S. and George K.K. "Inter State Redistribution through Budgetary Transfers" Economic and Political Weekly, March 18, 1978.

12/ For a detailed discussion, see Gulati I.S. and George K.K, "Inter-State Redistribution through Institutional Finance", Economic and Political Weekly (Special Number, August 1978.

13/ See Report of the (Seventh) Finance Commission, 1978.

14/ See Report of the (Sixth) Finance Commission, 1973.

## Share of States in the Combined Resources of the Centre and States - 1951 - 84

Figures in Percentages.

| | Plan periods | | | | | | |
|---|---|---|---|---|---|---|---|
| | I | II | III | AP | IV | V | VI |
| 1. Own revenue account receipts of the states as percentage of the combined revenue account receipts of Centre and States. | 44 | 42 | 33 | 34 | 34 | 35 | 37 |
| 2. Own capital account receipts of the States as percentage of combined capital accounts receipts | 22 | 21 | 19 | 17 | 21 | 21 | 20 |
| 3. States' total receipts as percentage of the aggregate resources (1+2) | 38 | 34 | 28 | 30 | 30 | 31 | 32 |
| 4. States' total revenue account receipts (own plus transfers from the Centre) to the combined revenue account receipts of Centre and States. | 56 | 57 | 47 | 51 | 54 | 54 | 58 |
| 5. States' total capital account receipts as percentage of the combined capital account receipts of Centre and States | 55 | 42 | 45 | 38 | 42 | 36 | 37 |
| 6. States' total revenue and capital account receipts as percentage of combined revenue and capital account receipts of Centre and States | 56 | 51 | 47 | 46 | 50 | 47 | 52 |

Notes and References:

1. The figures in this and subsequent tables are given for plan periods starting from the First plan including the three years of Annual Plans (1966-69). The time span covered by the Vth and VIth plans are slightly different so as to conform to the periods covered by the Sixth and the Seventh Finance Commissions.

   Fifth Plan - 1974-75 to 1978-79
   Sixth Plan - 1979-80 - 1983-84

2. Figures in Rows 1 nd 3 are exclusive of deficits of the states to Centre whereas those in Rows 4 to 6 are inclusive of deficits.

3. States' total revenue/capital account receipts referred to in Rows 4, 5 and 6 are taken to include gross Central transfers.

Source: Reserve Bank of India, Report on Currency & Finance, various issues.

Table II : Development Expenditure of Centre and State 1951-1984

Figures in percentage

| | Plan periods | | | | | | |
|---|---|---|---|---|---|---|---|
| | I | II | III | A.P | IV | V | VI |
| 1. Share of Developmental Expenditure in the total Revenue expenditure of the Centre | 13.6 | 26.4 | 15.5 | 11.9 | 32.0 | 36.5 | 40.5 |
| 2. Share of Developmental Expenditure in the total Revenue expenditure of the States. | 52.7 | 56.2 | 57.7 | 55.8 | 60.1 | 68.6 | 70.4 |
| 3. Share of Developmental outlay in the total capital outlay of the Centre. | 75.6 | 75.8 | 76.9 | 95.8 | 78.6 | 83.0 | 84.2 |
| 4. -do- of the States | 104 | 94.0 | 93.3 | 97.4 | 100.0 | 98.1 | 97.6 |
| 5. Share of Total Developmental Expenditure in the total outlay (Revenue + Capital) of Centre | 25.3 | 44.1 | 34.2 | 26.4 | 41.0 | 45.8 | 49.2 |
| 6. -do- of States | 64.1 | 55.8 | 65.2 | 62.4 | 65.7 | 73.6 | 74.9 |
| 7. Share of states in the aggregate developmental expenditure (on Revenue Account) of Centre and States | 81.9 | 71.5 | 77.2 | 82.5 | 66.9 | 64.5 | 64.3 |
| 8. -do- (On Capital Accounts) of Centre & States | 66.1 | 47.2 | 40.0 | 48.0 | 48.4 | 48.6 | 49.9 |
| 9. Share of States in total Developmental expenditure (on Revenue + Capital Accounts) of Centre and states | 75.4 | 50.3 | 60.4 | 70.1 | 61.8 | 60.0 | 60.5 |

Notes: (1) Classification of expenditure (into developmental expenditure) followed is the same as followed by the Reserve Bank of India. The basis of classification has undergone some changes over periods of time.

(2) Capital outlay excludes Loans and Advances extended.

(3) See also footnote I to table I.

Source: The same as for Table I.

TABLE III

Share of Transfers to the States in the total Central Resources (1951 - 84)

Figures in percentages

| | Plan Periods | | | | | | |
|---|---|---|---|---|---|---|---|
| | I | II | III | AP | IV | V | VI |
| Tax sharing with the States as % of Centre's gross Tax Revenue | 17.0 | 19.6 | 15.2 | 17.6 | 23.3 | 19.8 | 26.9 |
| Total Revenue Account Transfers (Taxes+Grants) as % of Centre's Gross Revenue Account Receipts | 23.0 | 27.4 | 24.3 | 28.4 | 33.9 | 31.0 | 35.8 |
| Central loans to States as % of Centre's Capital Account Receipts (including Deficit Financing) | 61.5 | 35.2 | 40.2 | 34.9 | 40.2 | 30.1 | 27.1 |
| Total Transfers as % of Total Central Receipts | 36.4 | 31.3 | 31.3 | 31.4 | 36.4 | 30.7 | 32.6 |
| Memorandum item | | | | | | | |
| Centre's Capital Account Receipts (Capital Receipt + Deficit Financing) as % of Centre's Total Resources. | 35.0 | 49.6 | 43.4 | 45.3 | 40.5 | 36.1 | 38.4 |

est: See Note I to table I

rce: Same as for Table I

Table IV

Dependence of the States on Central Transfers (1951-84)

Figures in percentages

| | Plan periods | | | | | | |
|---|---|---|---|---|---|---|---|
| | I | II | III | AP | IV | V | VI |
| 1. Revenue Transfers as percentage of Revenue Expenditures of States | 22.4 | 28.2 | 33.4 | 35.1 | 39.5 | 40.4 | 41.1 |
| 2. Loan Transfers as percentage of Capital Expenditures of States | 71.9 | 58.7 | 64.5 | 63.2 | 63.2 | 83.1 | 74.6 |
| 3. Aggregate Transfers as percentage of Aggregate Expenditures of States | 37.8 | 39.8 | 45.7 | 45.2 | 47.4 | 42.1 | 41.6 |

Source: As for Table I

**TABLE V**

Aggregate Central Transfers (Gross) Through Various Agencies (1951-84)

Amount in Crores of Rupees

| Plan Periods | Statutory Transfers | Plan Transfers | Discretionary Transfers | Total |
|---|---|---|---|---|
| (1951-56) | 447 (31.2) | 350 (24.5) | 634 (44.3) | 1431 |
| (1956-61) | 918 (32.0) | 1058 (36.9) | 892 (31.1) | 2868 |
| (1961-66) | 1590 (28.4) | 2515 (44.9) | 1495 (26.7) | 5600 |
| (1966-69) | 1782 (33.[illegible]) | 1767 (33.1 | 1798 (33.6) | 5347 |
| (1969-74) | 5421 (35.9) | 3535 (23.4) | [illegible]145 (40.7) | 15101 |
| (1974-79) | 11168 (44.2) | 7757 (30.7) | 6357 (25.1) | 25282 |
| (1979-84) | 22757 (43.1) | 15808 (30.0) | 14203 (26.9) | 52768 |
| Total (1951-84) | 44083 (40.7) | 32790 (30.2) | 31524 (29.1) | 108397 |

Note: Figures in brackets indicate percentage to total transfers.

Source: 1) For the period 1951 to 1979 report of the Seventh Finance Commission (1978) page 172.)

2) For 1979-84, Finances of State Governments, R.B.I. Bulletin, various issues.

TABLE VI

Composition of Central Budgetary Transfers to the States (1951-84)

| | Plan Periods | | | | | | |
|---|---|---|---|---|---|---|---|
| | I | II | III | AP | IV | V | VI |
| 1. Percentage share of statutory grants in staturory transfers | 23.0 | 27.2 | 24.8 | 29.1 | 25.8 | 25.4 | 5.9 |
| 2. Percentage share of statutory grants in total grants | 35.3 | 31.7 | 30.2 | 36.0 | 22.4 | 32.1 | 9.4 |
| 3. Percentage share of loans in non-statutory transfers | 81.2 | 72.4 | 77.3 | 75.1 | 69.3 | 62.4 | 56.3 |
| 4. Percentage share of tax transfers in total transfers | 24.1 | 23.3 | 21.4 | 24.0 | 30.2 | 33.0 | 40.6 |
| 5. Percentage share of grants in total transfers | 20.1 | 27.5 | 23.2 | 26.0 | 25.4 | 32.2 | 27.4 |
| 6. Percentage share of loans in total transfers | 55.8 | 49.2 | 55.4 | 50.0 | 44.4 | 34.8 | 32.[illegible] |

Source: As in table I

## TABLE VII

### Capital Receipts,* Deficits & Market Loans of Centre and States

| | I | II | III | AP | IV | V | VI |
|---|---|---|---|---|---|---|---|
| 1. Centre's overall Deficit as % of Centre's Total Disbursements | 12.5 | 11.2 | 4.4 | 4.6 | 4.9 | 4.4 | 6.1 |
| 2. States' Deficit as % of States' total disbursements | 0.8 | 1.1 | 0.4 | 1.4 | 0.6 | +1.5(S) | 2.7 |
| 3. Percentage share of States in Gross market loans of Centre & States | 28.8 | 26.6 | 23.7 | 12.9 | 21.0 | 20.2 | 12.7 |
| 4. Percentage share of Market Loans in Centre's Capital Receipts - (Gross) | 33.0 | 30.0 | 20.9 | 35.1 | 23.1 | 21.6 | 32.0 |
| 5. Percentage share of Market Loans in States' Capital Receipts - (Gross) | 14.4 | 15.1 | 9.4 | 8.7 | 8.4 | 8.9 | 8.1 |
| 6. Percentage share of Capital Receipts States' Total Receipts | 31.7 | 35.2 | 38.9 | 35.0 | 33.7 | 26.6 | 23.6 |
| 7. Share of C ital Receipts in Centres' Total Receipts | 22.5 | 38.4 | 37.6 | 40.7 | 35.5 | 31.7 | 32.3 |

S - Surplus
* - Excluding deficits

TABLE VIII

Aggregate (Gross) Budgetary Transfers, 1956 - 1991

| States | Rupees per Capita | | | | Index Numbers | | | |
|---|---|---|---|---|---|---|---|---|
| | Statutory | Plan | Discretionary | Total | Statutory | Plan | Discretionary | Total |
| A High Income States | | | | | | | | |
| Punjab | 405 | 443 | 604 | 1452 | 78 | 101 | 159 | 109 |
| Haryana | 389 | 498 | 490 | 1377 | 75 | 113 | 129 | 103 |
| Maharashtra | 461 | 291 | 397 | 1149 | 89 | 66 | 104 | 86 |
| Gujarat | 466 | 355 | 398 | 1219 | 90 | 81 | 105 | 91 |
| West Bengal | 524 | 314 | 486 | 1324 | 102 | 71 | 128 | 99 |
| Group A | 471 | 338 | 449 | 1258 | 91 | 77 | 118 | 94 |
| B Middle Income States | | | | | | | | |
| Tamil Nadu | 446 | 356 | 274 | 1076 | 86 | 80 | 72 | 80 |
| Kerala | 611 | 445 | 335 | 1391 | 118 | 101 | 88 | 104 |
| Orissa | 708 | 536 | 476 | 1720 | 137 | 122 | 125 | 129 |
| Assam | 742 | 675 | 659 | 2076 | 144 | 153 | 173 | 155 |
| Karnataka | 465 | 374 | 384 | 1223 | 90 | 85 | 101 | 92 |
| Andhra Pradesh | 504 | 427 | 381 | 1312 | 98 | 97 | 100 | 98 |
| GROUP B | 542 | 436 | 386 | 1364 | 105 | 99 | 102 | 102 |

contnd.........next page

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| C **Low Income States** | | | | | | | | |
| Uttar Pradesh | 446 | 390 | 264 | 1100 | 86 | 89 | 69 | 82 |
| Rajasthan | 553 | 451 | 734 | 1738 | 107 | 103 | 193 | 130 |
| Madhya Pradesh | 428 | 434 | 248 | 1110 | 83 | 99 | 65 | 83 |
| Bihar | 456 | 363 | 318 | 1137 | 88 | 83 | 84 | 85 |
| GROUP C | 459 | 398 | 332 | 1189 | 89 | 9[illegible] | 87 | 89 |
| D **Special Category States** | | | | | | | | |
| Himachal Pradesh | 1102 | 1405 | 498 | 3005 | 214 | 319 | 131 | 225 |
| Jammu & Kashmir | 1304 | 2058 | 1466 | 4828 | 253 | 468 | 386 | 361 |
| Tripura | 1519 | 1125 | 381 | 3025 | 294 | 256 | 100 | 226 |
| Manipur | 2302 | 1331 | 925 | 4558 | 446 | 303 | 243 | 341 |
| Nagaland | 6080 | 3896 | 2758 | 12734 | 1178 | 885 | 726 | 953 |
| Meghalaya | 1702 | 1764 | 845 | 4311 | 330 | 401 | 222 | 323 |
| Sikkim | 722 | 3271 | 1071 | 5064 | 140 | 743 | 282 | 379 |
| GROUP D | 1701 | 1902 | 1086 | 4689 | 330 | 432 | 286 | 351 |
| ALL STATES | 516 | 440 | 38[illegible] | 1336 | 100 | 100 | 100 | 100 |

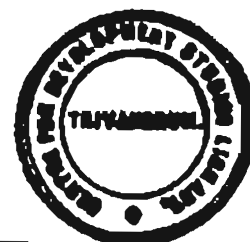
Source: George K.K., Centre-Stata Finrncial Flows and Inter - State Disparitiee in India, University of Cochin (Mimeo) 1982.

## TABLE IX

### Per Capita Central Plan Outlays -1950-80

Amount in Rupees

| itates | Amount |
|---|---|
| unjab | 321 |
| aryana | 297 |
| aharashtra | 307 |
| ujarat | 393 |
| est Bengal | 450 |
| Group A (High Income States) | 367 |
| Tamil Nadu | 307 |
| Kerala | 241 |
| Assam | 412 |
| Orissa | 510 |
| Karnataka | 322 |
| Andhra Pradesh | 245 |
| Group B (Middle Income States) | 321 |
| Uttar Pradesh | 141 |
| Rajasthan | 230 |
| Madhya Pradesh | 590 |
| Bihar | 589 |
| Group C (Low Income States) | 359 |
| Himachal Pradesh | 714 |
| Jammu & Kashmir | 355 |
| Tripura. | 39 |
| Manipur | 655 |
| Nagaland | 33 |
| Meghalaya | 48 |
| Sikkim | 586 |
| Group D (Special Category States) | 407 |
| All States | 350 |



Source: Planning Commission, "Report of the Working Group on Inter-regional Pattern of Investments by Centre, Banks and Public Finance Institutions" (Aug. 1982), quoted by Ram N.Lal, "Availability of Financial Resources and Inter-regional Disparities in Economic Development".

Note 1. Rearrangement of data and Calculation of group averages are done by us. The Group averages are worked out using 1971 Census figures of Population.

2. Data represent the total of identifiable Central Plan Outlays in respect of loans released for housing, industries and mining, railways, major ports, roads and power projects.

TABLE X

Per Capita Centre-State Institutional Financial Flows 1973-80

Rs.

| States | Commercial Banks | | | Develop ment Banks | ARDC | T t |
|---|---|---|---|---|---|---|
| | Credit | Invest- ments | Total (1+2) | | | |
| Punjab | 734 | 42 | 77[illegible] | 78 | 87 | |
| Haryana | 446 | 74 | 52[illegible] | 113 | 123 | |
| Maharashtra | 610 | 49 | 667 | 151 | 30 | |
| Gujarat | 323 | 69 | 392 | 219 | 27 | |
| West Bengal | 321 | 49 | 370 | 70 | 9 | |
| GROUP A | 472 | 54 | 526 | 129 | 35 | 6[illegible] |
| Tamil Nadu | 327 | 38 | 365 | 97 | 19 | 48[illegible] |
| Kerala | 316 | 69 | 385 | 67 | 14 | 46[illegible] |
| Orissa | 85 | 35 | 120 | 31 | 18 | 169 |
| Assam | 92 | 40 | 132 | 35 | 6 | 17[illegible] |
| Karnataka | 315 | 34 | 349 | 122 | 35 | 506 |
| Andhra Pradesh | 213 | 30 | 243 | 59 | 45 | 347 |
| GROUP B | 244 | 38 | 282 | 74 | 26 | 382 |
| Uttar Pradesh | 121 | 28 | 149 | 37 | 28 | 214 |
| Rajasthan | 168 | 51 | 219 | 60 | 26 | 305 |
| Madhya Pradesh | 111 | 27 | 138 | 26 | 32 | 196 |
| Bihar | 83 | 26 | 109 | 23 | 20 | [illegible]52 |
| GROUP C | 115 | 30 | 145 | 34 | 26 | 205 |
| Himachal Pradesh | 144 | 61 | 20[illegible] | 58 | 8 | 271 |
| Jammu & Kashmir | 163 | 74 | 237 | 77 | 1 | 315 |
| Tripura | 100 | 49 | 149 | 17 | 2 | 168 |
| Manipur | 50 | 91 | 141 | 5 | 8 | 154 |
| Nagaland | 84 | 280 | 364 | 35 | 4 | 403 |
| Meghalaya | 55 | 127 | 182 | 86 | - | 268 |
| GROUP D | 125 | 80 | 205 | 56 | 4 | 265 |
| ALL STATES | 252 | 40 | 292 | 73 | 28 | 393 |

Source: George K.K. op.cit

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