

FEDERAL FINANCE IN INDIA WITH SPECIAL REFERENCE TO FINANCE COMMISSION FISCAL TRANSFERS

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INTRODUCTION

The constitution of India adopted on 26th November, 1949, became operative on 26th January 1950 provides for two layers of government namely the central and the states. This kind of federal policy requires division of powers and responsibilities between the centre and the states. India is a vast, populous and most popular democratic country with 28 states and 7 union territories. There is no specific geographical region for the government of India such as state governments hence the union government has to concentrate all the states and union territories for their political, social and economical activities.

MOTIVATION OF THE STUDY

Fiscal federation in India refers to the inter governmental financial transfers between the centre and the states. The centre's revenue grows more quickly than the states and states responsibilities and expenditure grows more quickly than the centre, hence the centre is always the provider and states are always the receiver of fund in the federal system of India. The route of financial transfers from union government to the state governments are (i) planning commission transfers (ii) finance commission transfers and (iii) central sectors and centrally sponsored scheme. Most broad-based and progressive tax handles have been assigned to the centre. The centre also has residual tax powers. A number of tax handles have been assigned to the states as well, but the view point of productivity, only the sales tax is important. The states also collect revenues from excises on alcoholic products, stamps and registration and taxes on motor vehicles and road transportation. More than 50% of States total expenditures are financed from central transfers and loans.

NEED FOR THE STUDY

The present study attempts to analyse the Finance Commission Fiscal transfers to states in India. In this context the study aims to analyse the various issues of inter governmental financial transfers in India. The need for the study is important, especially in the context of present controversies regarding financial transfer between the states will also be examined in the present study.

OBJECTIVES OF THE STUDY

- To find out the role and responsibilities of the finance commission in India.
- To study the methods of allocating grants-in-aids to the states.

PERIOD OF THE STUDY

The study covers a period of 5 years from 2005- 10 that is twelfth finance commission. Since the present study attempt to analyse the functions of finance commissions in India, specially the twelfth finance for the years 2005-10 have been taken for complete analysis.

METHODOLOGY AND DATA BASE

The present study mainly depends on secondary data relating to the finance commission fiscal transfers such as, shares of sharable taxes and duties and grants-in-aids to the states from the centre etc. have all been collected from the reports of the various finance commissions and the budgetary documents of the Government of India. The collected data have been tabulated, classified and analysed have also been provided for data illustration. Statistical tools like percentage, time series analysis, simple growth rate and mean average are used in the study.

PLAN TRANSFERS

- The assistance given by the Planning Commission comprises both grants and loans.
- In earlier years both the volume and the loan-grant component was project based, but since 1969 the assistance has been allocated on formula basis as per the direction of National Development Council (NDC) which is constituted by the Union Cabinet Ministers, Chief Ministers of the various states, member of planning commissions and chaired by the Prime Minister of India.
- At present, 30 per cent of the funds is formulated by them.
- The plan transfers and their grant - loan components, are determined independently of the required plan investments, their sectoral composition, the resource available to the states or their fiscal performance and different Central Ministers give specific purpose transfers to states.
- The plan transfers is concerned, 30% is kept apart for special category states which consists of 90% as grants and 10% only as loan.
- For major states 70% fund is available which consists of 70% as loan and only 30% as grants. It is note-worthy to note that the loan should be repaid whereas the grants need not be so.

ASSISTANCE TO THE CENTRAL SECTOR AND CENTRALLY SPONSORED SCHEMES

- This is the third component of the transfer system and is given for specified purposes with or without matching provisions.
- Grants for the Central sector schemes are given to the States to execute central projects and are entirely funded by the Centre.
- Centrally sponsored schemes, on the other hand, are shared cost programs falling within the sales ambit with required matching ratios that are uniform across the states but which vary with the projects.
- There were 262 such schemes in 1985, and more have been added in subsequent years.
- These transfers have attracted the sharpest criticism due to their discretionary nature and conditionality attached to them.
- They accounted for about 60 per cent of the total plan assistance.

HORIZONTAL FISCAL IMBALANCE

- An important feature of Indian fiscal federalism is the wide inter-state differences in revenue capacity and consequently, per capita expenditures.
- There are 17 relatively more homogenous general category states, but even these have wide differences in size, revenue raising capacities; efforts, expenditure level and fiscal dependence on the center.
- In addition, in terms of economic characteristics the 11 mountainous states of the north and the north-east differ markedly from the rest and therefore are considered 'Special category' states.
- Of the 29, four states have been recently bifurcated from four large states viz., Jharkhand from Bihar, Chattisgarh from Madhya Pradesh, Uttarakhand from Uttar Pradesh and Telangana from Andhra Pradesh. Of the four, the Uttarakhand is considered as a special category state.
- Inter-state disparities in India even among the general category states are high and increasing.
- In 1980-81, the per capita GSDP of the richest State Punjab (Rs.2674) was about 2.9 times that of the poorest State Bihar (Rs.894).
- In 1998-99, this difference increased to 4.8 times with per capita GSDPs of the two states respectively at Rs.23254 and Rs.4813.

Fiscal Transfers from the State to local governments

- The states are required to appoint State Finance Commission (SFC) to make recommendations on the transfers to be made available to urban and local bodies - sharing of tax revenue between the states and the local governments.
- The volume of spending at the village level is abysmal and very few people have interested in the affairs of Panchayats and naturally, the attendance at the 'Grama Sabha' or village assembly, which is considered to be a basic pillar of participatory decision making is extremely low.
- Only 11 states including TamilNadu have constituted SFC. Some states are yet to constitute SFC even after a decade of giving constitutional recognition to local bodies.

➤ In some states, SFCs are yet to submit reports and in many where it has been submitted, the state government have not accepted the recommendations for implementation.

Twelfth Finance Commission total Transfer to States

The following table no:1 presents the shares of taxes and duties and grants-in-aid to states as per the recommendations of the twelfth finance commission for the years 2005-2010.

Table No.1
Twelfth Finance Commission total Transfer to States

S. No	State	Amount Allocation	Percentage
General Category States			
1	Andhra Pradesh	50353.26	6.7
2	Bihar	75646.83	10.1
3	Chhattisgarh	18273.2.4	66.00
4	Goa	1724.53	0.2
5	Gujarat	25608.75	3.4
6	Haryana	80.42.44	1.1
7	Jharkhand	23656.84	3.1
8	Karnataka	31416.28	4.2
9	Kerala	19607.72	2.6
10	Madhya Pradesh	46321.96	6.2
11	Maharashtra	36194.25	4.8
12	Orissa	36942.77	4.9
13	Punjab	12884.59	1.7
14	Rajasthan	39062.47	5.2
15	Tamilnadu	36688.13	4.9
16	Uttar Pradesh	133471.45	17.8
17	West Bengal	50877.28	6.8
Special Category states			
1	Arunachal Pradesh	3525.56	0.5
2	Assam	24329.40	3.2
3	Himachal Pradesh	14450.36	1.8
4	Jammu and Kashmir	20880.28	2.7
5	Manipur	6870.20	0.9
6	Meghalaya	4367.77	0.6
7	Mizoram	4660.91	0.6
8	Nagaland	7453.41	0.9
9	Sikkim	1829.14	0.2
10	Tripura	8417.00	1.1
11	Uttaranchal	12194.34	1.6
Total		755751.62	100.00

The table no.1 shows that the total finance commission transfers to all the 28 states from the government of India in terms of absolute amount comes to Rs. 755751.62 crores. Out of which Rs. 64673.25 has been distributed to 17 general category states and the remaining Rs. 108978.37 has been distributed to 11 special

category states which covers 14.1 percentage of the total transfer to all the 28 states. The highest share of Rs. 133471.45 crores goes to the largest state Uttar Pradesh which covers 17.8 percent of the total transfers. The second largest share of total transfer Rs. 75646.83 crores goes to Bihar which covers 10.1 per cent of the total transfers. The lower share of Rs. 1829.14 crores goes to Sikkim which covers 0.2 per cent of the total transfers. It is noteworthy to note that 14.1 per cent of the total transfer goes to 11 special category states and 85.9 per cent goes to the 17 general category states. In case of total finance commission transfer the general category states receive the higher percentage of 84.9 from the government of India.

TAXES AND DUTIES

- **Income Tax sharing** between the centre and the states underwent a fundamental transformation with the Constitutional in 2000.
- The net proceeds of income tax are shared with States on a mandatory basis.
- The commission made recommendations regarding the combined share of States out of the “divisible pool” of the net income tax proceeds and the proportionate share of each indivisible state within the combined share of all States.

Twelfth Finance Commission Transfer - Taxes and Duties

The following table no. 2 presents the share of sharable taxes and duties to the 28 states during the period of twelfth finance commission transfer from the Government of India for the years 2005-2010.

Table No.2

Twelfth Finance Commission Transfer - Taxes and Duties

S. No	State	Amount Allocation	Percentage
General Category States			
1	Andhra Pradesh	45138.68	7.36
2	Bihar	67671.04	11.03
3	Chhattisgarh	16285.76	2.65
4	Goa	1589.14	0.26
5	Gujarat	21900.47	3.57
6	Haryana	6596.46	1.08
7	Jharkhand	29624.02	3.36

8	Karnataka	27361.88	4.46
9	Kerala	16353.21	2.67
10	Madhya Pradesh	41180.59	6.71
11	Maharashtra	30663.21	2.67
12	Orissa	31669.47	5.16
13	Punjab	7971.00	1.30
14	Rajasthan	34418.56	5.61
15	Tamilnadu	32552.74	5.31
16	Uttar Pradesh	118209.45	19.29
17	West Bengal	43303.91	7.06
Special Category states			
1	Arunachal Pradesh	1767.34	0.29
2	Assam	19850.69	3.24
3	Himachal Pradesh	3203.22	0.52
4	Jammu and Kashmir	7441.71	1.30
5	Manipur	2221.44	0.36
6	Meghalaya	2276.61	0.37
7	Mizoram	1466.52	0.24
8	Nagaland	1613.67	0.26
9	Sikkim	1392.94	0.23
10	Tripura	2626.09	0.43
11	Uttaranchal	5762.22	0.94
Total		613112.02	100.00

Source: Finance Commission Report

The following are the deductions from the above table no. 2

1. The higher share of central taxes and duties of Rs. 118209.45 crores goes to the largest state Uttar Pradesh which covers 19.28 per cent of the total.
2. The second highest share of central taxes and duties of Rs. 67671.04 crores goes to Bihar which covers 11.03 per cent of the total share in central taxes and duties.
3. The lowest share of central taxes and duties of Rs. 1392.94 crores goes to Sikkim which covers only 0.23 per cent of the total.
4. The total transfer of share in central taxes and duties of XII finance commission comes to as Rs. 613112.02 crore for the years 2005 to 2010. Out of which Rs. 563489.57 crore goes to 17 general category states and the remaining Rs. 49622.45 crore goes to 11 special category states.

GRANTS-IN-AID

- The Finance Commission, is asked by the President, estimates the revenue needs of States and recommends grants-in-aid of their revenues.
- It also lays down the principles which should govern three grants from the Centre to the States.
- Therefore, all the States need not receive their grants and different States may receive different level of amounts.
- The Finance Commission can also recommend special purpose grants to any State which may be included in its terms of reference.

- This type of grants may include grants for helping the local bodies, grants for relief in the case of natural calamities, grants for up-gradation of State activities and so on.

Twelfth Finance Commission Transfer - Grants-in-Aid

The following table no.3 presents the twelfth finance commission transfer to 28 states in the form of grants-in-aid for the years 2005-2010. It is important to note that the amount received by the states from the centre in grants-in-aid need not be repaid to centre. Whereas the amount received by the states from the centre in loan component should be repaid with interest.

Table no.3

Twelfth Finance Commission Transfer - Grants-in-Aid

S. No	State	Amount Allocation	Percentage
General Category States			
1	Andhra Pradesh	5214.58	3.7
2	Bihar	7975.5.6	11.03
3	Chhattisgarh	1987.94	1.4
4	Goa	135.39	0.1
5	Gujarat	3708.28	2.6
6	Haryana	1445.98	1.0
7	Jharkhand	3032.82	2.1
8	Karnataka	4054.40	2.8
9	Kerala	3254.51	2.3
10	Madhya Pradesh	5141.37	3.6
11	Maharashtra	5531.06	3.9
12	Orissa	5273.30	3.7
13	Punjab	4913.59	3.4
14	Rajasthan	4643.91	3.3
15	Tamilnadu	4135.39	2.9
16	Uttar Pradesh	15262.00	10.7
17	West Bengal	7573.37	5.3
Special Category states			
1	Arunachal Pradesh	1758.22	1.2
2	Assam	4478.71	3.1
3	Himachal Pradesh	11247.14	7.9
4	Jammu and Kashmir	13438.76	9.4
5	Manipur	4648.76	3.3
6	Meghalaya	2091.39	1.5
7	Mizoram	3194.39	2.2
8	Nagaland	5839.74	4.1
9	Sikkim	436.20	0.3
10	Tripura	5790.91	4.1
11	Uttaranchal	6432.12	4.5
Total		142639.60	100.00

Source: Finance Commission Report

The following notable points can be inferred from the above table 4.8.

1. The 17 general category states i.e. developed states which contribute higher revenue to the centre in the form of taxes and duties receive the less grants-in-aid revenue from the centre viz. 58.4 per cent.
2. The 11 special category states which contribute comparatively less revenue to the centre in the form of taxes and duties receive the higher grants-in-aid revenue from the centre namely 41.6 per cent.
3. The highest grants-in-aid revenue of Rs. 15262.00 crores received by Uttar Pradesh. In terms of percentage it comes to 10.7.
4. The lowest grants-in-aid revenue of Rs. 135.39 crore received by Goa. In terms of percentage it comes to 0.1.
5. The 17 general category states received the grants-in-aid revenue of `83283.68 crore, whereas the 11 special category states received `59355.92 crore.
6. The Jammu and Kashmir, the most disturbed state of India received the second larger amount of 13438.57 crore, which covers 9.4 per cent of the total grants-in-aid.
7. The small states like Goa and Sikkim received the lowest grants-in-aid revenue of 135.39 crore and 436.20 crore respectively.
8. It can be concluded from the above inferences that the finance commission of India follows the equitarian criteria than the efficient criteria for distribution of grants from the centre to the states, hence backward special category states received more grants than the developed general category states.
9. It is very interesting to compare the grants-in-aid revenue of the state with the shares of sharable taxes and duties which presents in the previous table no.3. The share in taxes and duties of Uttar Pradesh, Bihar and Jammu is Rs. 118209.45 crore, Rs. 67671.04 crore and Rs. 7441.31 crore respectively, whereas the grants-in-aid revenue of Uttar Pradesh, Bihar and Jammu and Kashmir is Rs. 1526.00 crore, Rs. 7975.79 crore and Rs. 13438.57 crore respectively.
10. It is noteworthy to note that the highest tax collection capacity states i.e., developed states received higher the absolute amount in the form of taxes and duties from which the highest revenue goes to the centre whereas the lowest tax collection capacity states ie the backward states termed as special category states received higher the absolute amount in the form of grants-in-aid, which contribute the lowest revenue to the centre in the form taxes and duties.

SUGGESTIONS

- Due to time limitation all the routes of fiscal transfer from the Centre to the States such as (i) Planning Commission transfer, (ii) Finance Commission transfer, (iii) transfer of central sector and centrally

sponsored scheme and the transfer of Parliamentary constitutional development fund could not be analysed.

- Due to time limitation, the present study analysis only the Finance Commission Fiscal Transfer from the centre to the states in India.
- In further research all the routes of fiscal transfer can be analysed with complete data.

CONCLUSION

Indian Federal Financial system has played a vital role in economic development. Federal Finance refers to the intergovernmental financial transaction between the centre and the states. India is a populous country with 28 states and 7 union territories. The centre's revenue grows more quickly than the states and the states responsibilities and expenditure grows more quickly than the centre, hence the centre is always the giver and the states are always the receiver of fund in the federal system of India. Most of the states expenditure more than 50 per cent is covered by central transfer of fund. There is no specific geographical region for the centre, hence the duty of the government of India is to concentrate the development of all the states in India. The Finance Commission transfer is based on equestrian criteria to equalize the socio-economic conditions of the states in India, hence the states can be classified as general category states and special category states. The backward states are considered as special category states and provide more funds through Finance Commission transfer for the betterment of the states.

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