

Transfer Ticket

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In India, as in any federation, the assignment of expenditure responsibilities and the division of tax powers form the foundation of inter-governmental fiscal relations. There exist a number of channels for financial transfers from Centre to states in India. Thus the finance commission recommends transfers which are restricted to the states' non-plan requirements in the current (revenue) account. The planning commission recommends grants and loans to the states to meet their plan requirements. In addition, various Central ministries make specific purpose transfers.

Restructuring Centre-state fiscal relations is essential for sound fiscal consolidation.

Constitutionally, the Union list includes matters relating to currency, finance, defense, foreign affairs - including economic relations with foreign entities, matters affecting the country as a whole and those relating to inter-state relations. The state list has matters connected with the life and welfare of the population: local government, public health, infrastructure, land, agriculture and water management. The concurrent list has law, marriage, succession, personal law, transfer of most types of property, economic and social planning, trade unions, social security, education, electricity and Industries which the Parliament feels are best left to the centre.

The real picture is different. The Centre prevails in several important areas where its intervention is considered in the public interest by Parliament. For instance, although industry is on the state list, the Centre has been given power to legislate over industries. In the concurrent areas, if a state passes law which contradicts any Central law in the same area, the latter will prevail. In effect, the concurrent list is used by the Centre to abridge the states' freedom of action.

When it comes to assigning tax powers, the Constitution gave the Centre the power to levy income tax on non-agricultural income - individual and corporate, customs and excise duties, except on liquor. The states were assigned tax revenues related to land revenue, agricultural income tax, sales tax, except those on inter-state trade, liquor excise, taxation of inland transport - except railways, property tax and entry tax.

Since the most productive taxes were assigned to the Centre, the Constitution provided for Central taxes to be shared with the states. Provisions were made to give grants in aid to states needing assistance. In come tax and excise collected by the Centre were to be shared with the states on the recommendation of the finance commission.

Since 1952, 10 finance commissions have been appointed. Gross revenue transfers during 1990-95 from Centre to states, under the aegis of the finance commission, have constituted about 60 per cent of total transfers. In recent years, state finances have been helped by improved buoyancy in Central transfers. In 1997-98 gross transfer of Central resources financed 41.7 per cent of aggregate disbursements of states as compared with 41.2 per cent in 1996-97 and 39.1 per cent in 1995-96.

This trend will be strengthened with the recommendations of the 10th finance commission. This commission (1995-2000) has recommended an alternative scheme for pooling Central taxes for devolution to the states. These are some features of its proposed alternative scheme.

One, states should be allocated a share of an aggregate pool comprising the Centre's gross tax revenue instead of allocating, specified shares of Central revenue from only income tax and excise duties. Two, taxes listed in Articles 268 and 269 of the Constitution, other than Central sales tax and consignment tax, shall form part of the proposed Central pool. Three, the share of the states be fixed at 29 per cent. Four, the proposed ratio of 29 per cent on the basis of which states' allocations will be determined out of the Central pool shall be reviewed after 15 years.

How did the commission arrive at the figure of 29 per cent? One, shares income taxes, basic excise duties, and the grant in lieu of the railway passenger fare tax have together come to an average of 24.3 per cent during 1990-95. Two, including the potential from taxes envisaged in Articles 268 and 269, it will be reasonable to mark up this proportion to 26 per cent. Three, the share of additional excise duties together amounted to an average 2.9 per cent during 1990-95.

The recommendations of the 10th finance commission are a major departure from its predecessors. The idea of pooling Central taxes and allocating a share of the aggregated pool for devolution to the states seems sensible. It will allow states to share the aggregate buoyancy of Central taxes and also partly remove disincentives for the Centre in collecting those taxes it shares with the states - income tax and excise duties.

On debt relief to the states, the 10th finance commission has two interesting schemes. The, commission has linked debt relief to improvements in the ratio of revenue receipts to revenue expenditures in the states. It also links debt relief to debts retired through disinvesting equity in state public enterprises.

The commission suggests continuing the gap filling system. This approach discourages states from adhering to fiscal discipline. Grants are given to states under Article 275 to fill the residual gap of state budgets. With growing state expenditure levels on the one hand, and inadequate resource mobilization on the other, more states have regressed into the post-devolution deficit, category. This is a classic case of a soft budget constraint at the state level.

Gap filling should be eliminated. As long as states can fall back upon the Centre, there will be no compulsion on them to manage their finances efficiently. Deficit states should be made to cut inessential government spending and bridge the gap with their own resources.

After the planning commission was established, and development planning gained emphasis, the scope of the finance commission's recommendation narrowed. Over the years, the planning commission has become a major fund transferring body to the states. Plan grants rose from Rs 20.5 billion or 24.4 per cent of total transfers to states during the fourth plan (1969-74) to Rs 320.3 billion or 35.1 per cent of total transfers during the seventh plan (1985-90). Such transfers to states are grants and loans to finance plan schemes.

Since 1969 plan assistance is being made on the basis of the Gadgil formula by which 30 per cent of the funds available to the commission for distribution are earmarked for 10 special category states. Further, it is given on the basis of plan projects formulated by the states, with 90 per cent assistance given as grants. The remaining 70 per cent of funds available for the rest of the 15 states (of which, 70 per cent of assistance is given by way of loans, and the rest as grants) is distributed in accordance with the following: 60 per cent weight assigned to population, 25 per cent to per capita state domestic product, 7.5 per cent to fiscal management, 7.5 per cent to special state problems.

Plan transfers given to the states for plan purposes, and for their grant loan components, are determined independently of the required plan investments, their sectoral composition, the resources available to the states or their fiscal performance. Data relating to states' plan resources before statutory transfers, in per capita terms, under the seventh plan show that among the major states, except for Maharashtra and Gujarat, the resources available with the states for plan investments were negative. Such deficits were higher in low income Bihar, Orissa, Uttar Pradesh, Rajasthan and Madhya Pradesh. Richer states like Maharashtra, Gujarat, Punjab and Haryana accessed larger non plan loans and, as they could get Central plan assistance, per capita plan outlays in these states were almost twice those in the middle and low income states.

The third component of transfers from Centre to states is for specified purposes with or without matching provisions. Grants for so called Central sector schemes are given to states to undertake certain agency functions and, therefore, are entirely financed by the Centre. Centrally sponsored schemes, on the other hand, are initiated for services falling within state jurisdiction to ensure optimal levels of services are provided.

These are shared cost programs. The matching ratios vary from project to project, but are uniform across states. States see these schemes as intrusions into their domain by the Centre. They formed about 36 percent of total plan assistance and 17 per cent of total current transfers in 1992-93.

India's inter-governmental system of financial transfers suffers from a number of weaknesses. First, there are multiple bodies engaged via different routes to transfer funds from Centre to states. Naturally there arise jurisdictional problems and unclear objectives. After the 10th finance commission's proposals are implemented, such transfers will be meaningful. But those from the planning commission are not.

A tenuous relationship exists between required plan investments and plan transfers. Centrally sponsored schemes have helped the Centre to have a greater say in areas totally under state jurisdiction and thereby curtailed states' independent action.