State Finances in India

Volume 1

Revenue Sharing

Christine Wallich

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ABSTRACT OF THE STUDY

This paper is the first volume of a three-volume set exploring a range of issues relating to the nature of intergovernmental fiscal relations in India. Under India's federal system, there is a strict division of fiscal powers between the Center and State level government so that each has specific expenditure and taxation responsibilities. Revenue sharing is the means by which the imbalance arising from these constitutional arrangements is righted. Revenue sharing is thus of crucial importance in determining the balance of relations between the Center and the States and the nature as well as the pace of development in India. India's revenue sharing system is unusual in that there are two institutions which, quite independently of one another, determine the intergovernmental fiscal flows. Broadly, the Planning Commission fixes the assistance the States receive to carry out their Plans while the Finance Commission determines the assistance required for current account budgetary support. The financial flows between the Center and the States are not without importance for Bank-financed projects. Because much Bank assistance in India is provided to the Central Government to be passed on to the States in accordance with the usual procedures for providing development assistance to the States, the timeliness and efficiency of project implementation as well as project selection hinge on the revenue sharing arrangements. The second volume in the series examines in detail the implications of revenue sharing for project finance, while the final volume contains a study of the States' own tax efforts.

Christine Wallich was an economist in the India Division of the South Asia Programs when this paper was prepared.

STATE FINANCES IN INDIA

VOLUME I: REVENUE SHARING IN INDIA

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INTRODUCTION

The subject of this paper is intergovernmental relations in India -- the allocation of fiscal and administrative responsibilities -- between the Center and States. Fiscal federalism is one of the thorniest subjects in public finance, and the problems in Center-State relations admit of no easy answers. Political considerations, constitutional requirements, administrative and regional realities are all crucial in weighing up the merits of the existing pattern of financial arrangements.

The most visible and also the most important aspect of the fiscal relations between Central and State Governments is the command over resources by the various levels of government and the direction and size of intergovernmental fiscal flows. This comprehends the division of tax powers and the means through which resources are adjusted to match expenditure responsibilities for State and Central levels of government. The measures by which this adjustment may be achieved are myriad; States may be given independent tax powers or there may be revenue sharing of various types: conditional and unconditional grants, matching grants, shared taxes, tax rental agreements, etc. Which of these means is chosen depends on what is desired to be achieved. Often transfer arrangements are politically motivated, but equally, they may be used to provide merit goods, promote greater resource efficiency, or solve regional problems.

A great deal of attention has focused on the financial arrangements between the Central Government and the States under India's federal system. This paper attempts to shed some light on these oft-times complex arrangements and to clarify some of the questions which have been raised. The two primary issues are the trends in centralization and central authority over the country's resources and expenditure programs, and the implications of the traditional transfer process for equity amongst the States and the balanced development of poor regions.

The paper is divided into five sections. The first provides some institutional background and describes the allocation of revenue powers and expenditure responsibilities between Central and State Governments. The channels through which transfers from one level of government to another are made and the trends in these transfers are also discussed.

In the second section, the issue of centralization is examined. The conclusion here is that while it is difficult to prove that substantial centralization has taken place, there is no question that the States are severely constrained in their revenue raising powers, have little control, at the margin, over programs of expenditure and are fairly dependent on the Center -- about 50% of their current and capital expenditures is financed through transfers of one sort or another from the Center.

Regional balance is discussed in the third section. The impact of different federal transfers on the ability of States to finance larger Plans is analyzed, and the question of whether these transfers have been responsive to the needs of the poorest States is examined. The evidence suggests that

there has been little overall consistency in the transfer process, and that this process cannot be characterized as either regressive or progressive. Nonetheless there have been certain inequities in respect of some poorer States. One difficulty appears to be the manner in which the States' current account surplus (determined by the Finance Commission's formula) determines the level of resources which the States have available for their Plans with the result that better-off States with a strong resource position are enabled to have larger Plans than those States for whom transfers provide only a means of covering the current account deficit.

Section IV completes the institutional background with a discussion of the award of the Seventh Finance Commission. The financial flows which come into play in the implementation of different types of World Bank-financed projects and the implications of the rules governing these flows for the efficiency and timeliness of project implementation are described in an appendix. The discussion concludes that the new "additionality" provisions may go a long way towards improving disbursement performance when the Bank finances projects in the State Plan.

I. INSTITUTIONAL BACKGROUND

India is a federation in which, according to the Constitution, certain responsibilities and powers are assigned to the Center and State Governments. The Constitution has a direct bearing on the pattern of intergovernmental fiscal relations since it sets down specific taxing powers and expenditure responsibilities for each level of government. For reasons of efficiency and uniformity, a number of important and broad-based tax sources were assigned to the Center and, since the States have been assigned far more expenditure functions than they can finance through their own revenue sources, a degree of vertical imbalance -- the failure of expenditures and own revenue at each level of government to balance -- is a built-in feature of the Indian Union. In general, the States depend quite heavily on transfers from the Center to supplement their own resources in order to meet their assigned expenditure responsibilities.

Revenue Powers

The Center was assigned many broad-based taxes such as taxes relating to industry and those having an interstate base. These include taxes on personal (non-agricultural) income, corporation tax, customs duties, excise duties (other than on narcotics and liquor), taxes on non-agricultural wealth, estate duties on non-agricultural land, and taxes on interstate trade. The residual power of levying those taxes not specifically assigned to the States or the States and Center concurrently, also rests with the Center.

To the States have been assigned almost all taxes on agriculture such as agricultural income tax, property taxes, land revenues, and estate duty. The States may also levy sales taxes, registration and stamp taxes, excise duties on narcotics and alcoholic beverages, income taxes on professions and motor vehicle taxes.

Borrowing powers of the States are set forth in Articles 292 and 293 of the Constitution. States may borrow within India only, and in practice, State borrowing is regulated by the Center, since the Constitution provides that no State may borrow without consent of the Center if there are any outstanding debts to the Center or guaranteed by the Center. 1/

Expenditure Responsibilities

The functions of State Government include fostering the development of irrigation, power, education, health, family planning, cooperatives, rural development, slum improvement, and forests. In addition, local functions such as public order, courts, and police are also the responsibility of State Government. The most important functions of the Center include defense, external affairs, foreign trade, railways, industries, currency, posts and

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1/ For a full list of taxing and legislative powers, see Appendix V for State, Center and Concurrent lists.

telegraphs, and heavy industry. There are a fair number of concurrent powers, including planning, monopolies, labor disputes, and social security. 1/ When interests conflict in the concurrent field, the Center prevails. The States have sovereign power regarding items on the State list.

Vertical Balance

The Constitution recognizes that the assignment of legislative and taxing powers does not give the State Governments, under their own independent control, resources sufficient to perform the assigned expenditure functions. Accordingly, several forms of revenue sharing were provided for. The Constitution calls for the creation of a Finance Commission, a statutory body to award tax sharing and grants-in-aid to the States. The Center also has the power to provide additional grants-in-aid to the States (Article 282) for "any public purpose," and it is through this provision that the Planning Commission, created by a resolution of Parliament in 1950, channels assistance.

Thus, there are thus presently two main conduits of financial assistance from the Center to the States:

(a) The Finance Commission, a statutory body appointed by the Central Government, makes (quinquennial) recommendations on awards to the States for non-Plan revenue expenditure.

(b) The Planning Commission, which determines the block-assistance for State Plan expenditure, grants advance Plan assistance and fixes other miscellaneous kinds of assistance for State Plan expenditure.

In addition, there is also miscellaneous ad hoc assistance, which may be channeled through Central ministries (with Planning Commission approval) and the Reserve Bank, among others, often termed "discretionary assistance."

Classification of Expenditures: Budgets and Plans

Before discussing these two institutions and the assistance provided through them, some clarification of the distinction between non-Plan and Plan expenditure is useful. The Plan is essentially a list of projects to be implemented. While most schemes are capital in nature -- investment expenditure makes up the bulk of Plan expenditures--the Plan also includes some revenue (current) expenditures. For example, many Plan schemes, such as those in education, involve expenditure on wages and salaries which come under the revenue, not capital, account in the State budget. The same would be true of subsidies for purchases of medicines or fertilizers. These recurrent Plan

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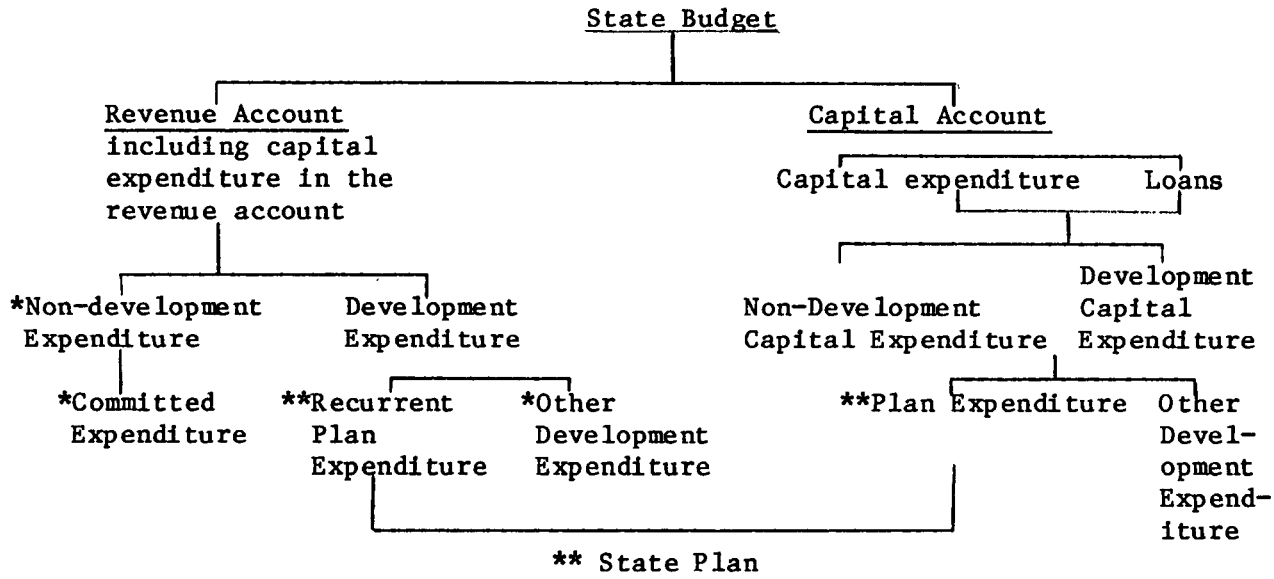
1/ By contrast, there is only one concurrent tax, the stamp duty on documents.

expenditures become committed expenditure--for which the States are responsible--when the schemes are completed at the end of the Plan. Other Plan schemes involve both capital and current expenditures as well as loans, such as Command Area Development.

As such, then, there is no one-to-one correspondence between Plan and Budget. The nature of the relationships is diagrammed in Chart 1. The table shows that Plan expenditures may be found under any of the head of the Budget, and from a first glance at the Budget, it is not always easy to identify expenditures on Plan schemes readily, since expenditures on any one scheme may be found in various parts of the Budget, according as the scheme is composed of revenue expenditures, capital expenditures or loans. 1/

Chart 1: CLASSIFICATION OF EXPENDITURES



* Expenditures which Finance Commission assists.

** Expenditures which Planning Commission assists.

Source: Adapted from Venkataraman; State Finances in India.

Plan expenditures comprise only a part of a still broader category, development expenditure. Development expenditures consist basically of expenditures on items in the Plan heads, such as education, health, irrigation,

1/ State budgets frequently include an appendix showing Plan outlays classified by budgetary heads; demands for grants also show Plan and non-Plan expenditure separately.

etc., but not necessarily in the Plan itself. Examples of non-development expenditures are civil administration, courts, tax collections, jail, debt service and the like. Both may be either capital or revenue expenditure.

These various expenditure categories are directly linked to the two kinds of assistance. The Finance Commission assists States with the non-Plan revenue account which includes both developmental and non-developmental expenditures. Committed expenditures, those recurrent expenditures which may have been financed by the Center under the Plan, but which become the States' responsibility at the end of the Plan, are also included in non-Plan revenue expenditure. Assistance from the Planning Commission is directed towards all Plan outlay, whether capital or recurrent in nature.

Finance and Planning Commission Coordination

The process by which the national resource "pie" (taxes, non-tax revenue, foreign aid, borrowing, etc.) is divided up by these bodies between Plan and non-Plan uses and between Center and the States is a complex one. Coordination between the Planning and Finance Commissions is quite explicit. Moreover, since the Sixth Finance Commission, in 1973, a member of the Planning Commission has also been appointed to the Finance Commission. It is this coordination which intimates to the Finance Commission the intended size of the Plan and the financial requirements of Center and States on Plan account.

Finance Commission

In order to make its recommendations, 1/ the Finance Commission needs to know the total resources available to the two levels of government 2/ as well as the various claims on each of them. In the recent past, the period of the Finance Commission award and the Plan period have been co-terminous, so that, through the National Development Council, the size of the overall Plan and the expenditure breakdown between the Center and the States is known to the Finance Commission when it begins its work. The States also submit memoranda to the Commission, detailing their budgetary positions and the assistance they require. To determine the total resources available, the Commission then forecasts the Center's resource position and recasts the

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1/ The Finance Commission "award" is actually a recommendation; it may be accepted in whole, or in part by the Central Government (President).

2/ There is a third tier of government in India, the local level, for which there is no resource raising competence defined in the Constitution. Instead, local government derives its taxing and expenditure powers from the State Government. In many ways, the financial relations of municipal and panchayat government to the State Government are analogous to those of the States to the Center, in that local governments receive financial assistance, grants and loans, from the former. These obligations are acknowledged by the Finance Commission as a part of State expenditures.

States' likely resource availability, given rates of taxes and fees prevailing at the outset of the period. 1/ It is worth pointing out that the States may speak with different voices in different fora, especially regarding resource availability. When meeting with the Finance Commission, financial difficulties will be emphasized to demonstrate the need for additional resources: it has frequently been argued that the Commission is handicapped by the absence of a permanent cell to study States' resource capacity. The direction of the emphasis is reversed in the Plan discussions where States seek to demonstrate their financial well being: a larger surplus indicates a State's ability to finance a larger Plan. With these estimates in hand, along with estimates of the Center's revenue expenditure requirements and close scrutiny of State budget forecasts, 2/ the Finance Commission estimates how much is needed by the States in toto. This determines the "vertical" distribution of resources. The distribution of this award among the States--the horizontal distribution--is also fixed by the Finance Commission. Among the factors guiding the Commission in fixing the States' individual shares are State population and per capita income.

There has been a great deal of discussion over the relative roles of the Finance and Planning Commissions. The present dichotomy splits their responsibility along revenue and capital expenditure lines, but this has not always been the case. In the first years after Independence, the Finance Commission was not limited to considering States' needs on revenue account alone but examined their capital expenditure requirements as well in fixing the level of grants-in-aid, so that until the end of the Second Plan, there was an overlap between the Finance and Planning Commissions. 3/ It was not until this time that the terms of reference of the Finance Commission were confined to the non-Plan requirement of the States.

The Finance Commission award is determined for five years, and consists of tax devolutions and grants-in-aid. How the relative proportions of devolutions and grants in the total award are determined depends on a number of factors. The possible range of awards can go from a devolution through which even the most deficit States find their budgets balanced and the remainder in surplus, to one in which devolutions are low, and grants in aid are used to cover the budgetary gaps of all States. In general, it has been

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1/ Any additional resources mobilized after the Plan period begins ("additional resource mobilization") are traditionally reserved for the Plan, and do not concern the Finance Commission until the subsequent award, five years later.

2/ At the request of the States, the Seventh Finance Commission has also reported results of its re-examination of the Center's revenue position.

3/ The formal responsibilities of the Finance Commission are set forth in Article 275 of the Constitution, which states that States' "fiscal needs" shall be the criterion by which the level of grants are determined.

accepted that the gap between States' own revenue and their "normal" expenditure should be met by devolutions, and that grants-in-aid should be largely a residual form of assistance. The proportions of devolutions and grants-in-aid are of great importance to the States themselves: a higher level of devolutions will leave those States with the smallest (pre-devolution) gaps with a large surplus on revenue account. This in turn enables them to finance a larger Plan. 1/ Regional balance too, is a consideration for the Commission, and equalization grants have been given by past awards for achievement of minimum levels of basic services (education in the First Commission, communication in the Third Commission, and public administration in the Sixth and Seventh Commissions).

Planning Commission and Plan Assistance

Since 1969, the bulk of the assistance which States receive for their Plans comes in the form of unconditional bloc assistance from the Center, distributed to them on the basis of the "Gadgil formula." This replaced the earlier patterns of assistance under which conditional central assistance was granted on a project-by-project basis and which gave the Center considerable discretion over State Plans and control over their implementation. According to the Gadgil formula bloc assistance for State Plans is distributed:

(i) 60% on the basis of States' population in 1971.

(ii) 10% to States whose per capita income is less than the all-India average.

(iii) 10% for States' tax effort in relation to per capita income.

(iv) 10% in proportion to the outlay on major irrigation and power projects in the State.

(v) 10% in discretionary assistance for "special problems".

An exception is made for the poorest States (Assam, Himachal Pradesh, Jammu and Kashmir, Nagaland, Sikkim and the smaller Northeastern States) which receive a lump sum payment fixed by the Planning Commission. The assistance given to the States under the Gadgil formula is distributed on a 70% loan, 30% grant basis; assistance to the poorer States is given 90% as grant and 10% as loan. This bloc grant is the largest source of assistance for State Plans, although not the only source.

1/ For the same reason, under the present sharing formulas, higher automatic devolutions can imply a regional bias, since the surplus States have a good resource base and fiscal capacity. This explains the preference for greater automatic tax sharing by the better off States and preference for grants by the poorer.

There are five other sources of assistance for State Plans. They are:

(a) advance Plan assistance;

(b) assistance for hill area development;

(c) assistance for tribal area development;

(d) Northeast Council assistance; and

(e) matching assistance for foreign aided projects, known as "additionality."

Advance Plan assistance is intended to provide for year-to-year Plan "gaps," 1/ and is used to ensure that Plan targets are fulfilled by resource-poor States, and also to provide a means of accelerating Plan implementation, where close adherence to annual allocations as determined by the Gadgil formula would be constraining. It is most often used to accelerate the pace of investments in power and irrigation projects. Advance Plan assistance is, in principle, recoverable over the five-year Plan period and assistance granted in one year may be offset against the normal Plan assistance in the next so that the State's assistance at the end of the Plan period still corresponds to the relative shares determined under the Gadgil formula. In practice, not all of the advance Plan assistance is recovered, especially the assistance given for relief expenditure.

Over and above the assistance given to States under normal Plan channels through the Gadgil formula, the Planning Commission provides assistance to certain States for hill and tribal development. The purpose of this assistance is to finance the States' "sub-plans" for those areas (these sub-plans form part of the State Plan). Assistance is given on a 100% grant basis.

Assistance is also given to the Northeastern Council States 2/ by the Planning Commission. Its purpose is to assist with regional schemes such as interstate water supply, power, education, training facilities, etc., and it is provided on a 90% grant, 10% loan basis.

1/ These are gaps in an ex-ante sense: assistance is determined at the beginning of the fiscal year in the course of the Annual Plan meetings if it appears that States will have insufficient resources to carry out the prospective programs. An ex-post gap may also arise towards the end of the Plan, also financed by the Center, but through overdrafts or special accommodation loans.

2/ Manipur, Meghalaya, Nagaland, Tripura, Assam, Mizoram.

Matching assistance for foreign-aided projects was introduced in 1975-76, as an inducement for States to identify projects amenable for financing by World Bank or other assistance agencies, and to enhance the States' willingness to cooperate in project preparation and timely implementation. The need for this assistance arises out of the fact that when foreign assistance finances projects in the State Plan, the loan agreement--by contrast--may be with the Center, with the proviso that the funds will be made available to the States in accordance with the "standard arrangements for Central assistance to the States for development." This is because constitutionally, only the Center is permitted to receive foreign aid. For State Plan projects, these standard arrangements are the Gadgil formula. The result is that the disbursements of foreign aid do not go exclusively to the project State, but are distributed to all States in proportion to their shares under the Gadgil formula. Foreign-aided projects are thus treated exactly as other projects in the State Plans. Thus, all States benefit in the absense of additionality, when any one State participates in a foreign-aided project, since aid enlarges the pool of resources transferable to the States. "Additionality" was introduced in order to provide an incentive to States for the preparation of foreign-assisted projects in sectors reserved to the States, and in which the Center could not act. Under the present arrangement for additionality, the States receive as a supplement to all other forms of Central assistance, 70% of the foreign aid disbursed for their projects (approximately 35% of total project cost in the case of World Bank projects where assistance is usually 50% of project cost). 1/ Since the full amount of the foreign assistance is taken into account in the Center's resource position, an amount equal to the State's share in the Gadgil formula will be made available to the States so that the ultimate benefit to any State from participation in foreign assisted projects is slightly greater than this.

Plan Coordination Between the Center and States

State Five-Year and Annual Plans are coordinated through a series of lengthy negotiations. Each year for the Annual Plan discussions, the officials from the State Government meet with the Planning Commission, Finance Ministry and working groups from Central ministries to fix the size and scope of their Plans. The nature of the dialogue depends very much on the State Plan, which may be a string of projects bearing no relation to the State's resource capacity, or a well laid out program geared to the State's needs and resources. In the course of these consultations and negotiations the State Plans are approved, project-by-project, and expenditures whittled down to ensure that the State priorities as expressed in the Plans are consistent with those of the Center and the size of the State Plans consistent with the resources available for them.

The National Development Council is the forum in which the more general aspects of the overall Plan--national priorities and broad questions

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1/ Strictly speaking, it is "up to 70%", but in practice 70% is the effective proportion.

of economic policy--are discussed by the Center and the States. Since planning is a subject of joint concern to both Center and States (it is on the concurrent list), the National Development Council (NDC) is usually consulted at various stages during Plan formulation so that an intergovernmental consensus can be obtained. NDC members include the Prime Minister and the Chief Ministers of all the States and members of the Planning Commission. Other ministers of the Center or State also attend if the agenda is of interest to them. Although the NDC is purely an advisory body as far as the Plan is concerned, in the recent past the States have used it as forum to discuss issues with the Center. In 1969, this occurred over the allocation of bloc Plan assistance (resulting in the introduction of the Gadgil formula) and in 1978, the level of Centrally sponsored schemes was discussed.

The size of State Plans are determined in light of the resources available to the States from:

(a) States' surplus on current account; 1/

(b) additional taxation/resource mobilization which may take place in the course of the Plan period;

(c) domestic borrowing by the States;

(d) Central assistance for State Plans; 2/

(e) advance Plan assistance;

(f) additional assistance for foreign-aided projects (70% of the amount of foreign aid disbursements);

(g) "small savings" receipts; 3/ and

(h) contributions of State public enterprises.

In the past, the States' own resources, including additional resource mobilization, have contributed about 30% to overall Plan finance, domestic borrowing

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1/ This surplus is to some extent determined by the Finance Commission award.

2/ The Central contribution to Centrally sponsored schemes often appears in State Plans. The Center, when compiling the Annual Plan for the whole country, includes this contribution in the Central Plan only.

3/ The government has a number of schemes, most of them run by the post office, to mobilize the savings of lower and middle income groups. In the past, the resources thus mobilized have been shared between the Center and the States, with each State getting two-thirds of the net resources mobilized in that State as a loan.

and miscellaneous capital receipts another 30%, and Central assistance, including advance Plan assistance, and foreign aid disbursements, 25-30%. Central sector and Centrally sponsored schemes have made up, on average, about 10-15% of the States' Plan expenditure.

The States do not have much control, at the margin, over the size of their Plans and do not generally have the resources to finance projects not included in the Plan because their revenue sources tend not to be very elastic (in the short run), once certain levels have been reached. The States' revenue account surplus and additional resource mobilization are both earmarked for Plan finance by the Planning Commission, but targets tend to be ambitious and few States exceed them, so that the potential for increasing Plan size through additional taxation or a larger-than-expected budget surplus is limited. Domestic borrowing is subject to a ceiling fixed by the Center, 1/ and normal Plan assistance is fixed through the Gadgil formula. The sources through which the States might obtain additional assistance from the Center are thus limited to the ad hoc transfers: Central sector and Centrally sponsored schemes, Advance Plan assistance, other non-Gadgil assistance for State Plans, additionality and overdrafts. Not all of these are wholly additional resources, for if the Center commits this assistance at the outset of the Plan period, the corresponding amount must be taken out of the divisible pool, since the Center's resources are fixed, and the transfer of normal bloc Plan assistance to the States will be correspondingly reduced. Most States will gain from obtaining additional assistance, although their net gain is less than the gross gain, and it is a gain which comes at the expense of other States who now share in a smaller poor of divisible resources.

From the foregoing, it is fairly clear that while the States are in many ways autonomous agents and have substantial resources of their own, they are also closely tied to the Center in carrying out both Plan and non-Plan expenditure programs. 2/

Miscellaneous Discretionary Assistance is the final category of Central assistance. Discretionary assistance comprises those funds which come to the States through channels other than the Planning and Finance

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1/ Domestic borrowing includes market as well as negotiated loans from the Life Insurance Corporation, the Reserve Bank and State enterprises, among others. The ceiling on borrowing is usually increased each year in equal proportion for all States.

2/ Some States were or are expected to be in surplus on current account, even before receiving revenue-sharing through the Finance Commission, and are thus not dependent on the non-Plan side. There were three of them during the period of the Sixth Commission's award, and five, during the Seventh Commission However, they are the exceptions, and do, of course, receive assistance on Plan account from the Central Government.

Commissions. Its purpose is to assist States in financing non-Plan expenditures, but not necessarily non-development expenditures. Most discretionary assistance is in the form of specific-purpose grants and loans. The most important types of discretionary assistance are: Centrally sponsored and Central sector schemes and "special accommodation" loans and overdraft assistance. In addition, there is also assistance for police housing, educational schemes, agricultural schemes, roads, and natural calamities.

Centrally sponsored and Central sector schemes make up the bulk of discretionary assistance, as Table 1 on page 19 shows. These are schemes for which, because of their national importance, the Center takes the initiative. Proposed and formulated by the Ministry involved, approved by the Planning Commission and financed largely by the Center, the schemes are implemented by the States because they are in the sectors of State competency. There is little substantive difference between the two types of scheme other than that Centrally sponsored schemes are generally financed 100% by the Center, whereas Central sector schemes have matching requirements. In response to requests of the States, it was agreed in the National Development Council in 1969 to suggest a ceiling on assistance for Centrally sponsored schemes of 1/6-1/7 of total block assistance. Central sector schemes were subsequently introduced and enabled the Center to maintain its expenditures in State subjects. Examples of these schemes are Command Area Development, the Drought Prone Area Program, communicable disease control, primary education, family planning, minor ports and the pulses and oilseeds program, among others.

Overdrafts have in some cases become a mechanism for ad hoc assistance. These occur when the States fail to maintain the minimum balance each State is required to keep on deposit with the Reserve Bank and to some degree represent a ready reserve for them, although this is not their purpose. In response to an overdraft, the Reserve Bank extends a "ways and means" advance which is payable within 90 days. In practice, these advances have sometimes became permanent borrowing, and not temporary coverage for ways and means. The Center has in the past given loans to liquidate these overdrafts on an ad hoc basis. The use of overdrafts can thus distort the pattern of assistance from what is intended by the Center, enabling the States to some extent to override the principles for assistance set forth by the Planning and Finance Commissions.

In an attempt to control such overdraft use, "special accommodation" loans were first made during the Fourth Plan period, when it became clear that many States were likely to run budgetary deficits on non-Plan account greater than those estimated by the Fifth Finance Commission. The alternatives facing the States were to incur "unauthorized" overdrafts from the Reserve Bank, or to divert resources from Plan or other uses, with a consequent dislocation of Plan outlays. It was to avert any such dislocation that the Planning Commission requested the Finance Ministry to provide assistance to States with anticipated non-Plan gaps similar to the assistance given for ex-ante Plan gaps. These replace the ways and means advances referred to previously which were previously given, at end June each year, to clear any overdrafts with the Reserve Bank. The problem of unauthorized overdrafts has not been entirely

solved by these gap-filling loans, as overdrafts continue to be incurred. Since October 1, 1978, further controls have been instituted to prevent States from using overdrafts as a budgetary resource, so that if an amount is overdrawn for more than seven working days, payments may be suspended by the Reserve Bank until the overdraft is cleared.

Since 1955, the Center has provided special assistance for police housing, a non-Plan expenditure. The Center has also provided assistance for education, (since 1966) through grants for improving university teachers' salaries, and merit scholarships for poor children in primary and secondary schools. In agriculture too, there are a number of non-Plan developmental activities which the Center would like to foster. Loans have been given for cash prizes to districts in which output has risen and for procurement in food surplus States. Road development which opens up new districts or which connects two States, receives funds out of the Central Road Fund maintained through certain excise and customs duties. All of these types of discretionary assistance are determined by the relevant Ministries.

Table 1, which follows, shows the types of transfers which have been effected from the first Plan period. Transfers from the Finance Commission made up 41% of total transfers during the last Plan, non-statutory Plan assistance made up 33%, and discretionary assistance provided 26%. This last proportion has been increasing over time.

Table 1: CENTRAL TRANSFERS TO THE STATES
(Rs crores)

	Plan Period					
	I	II	III	ANNUAL	IV	V 1/
Finance Commission Transfers	429	918	1,590	1,782	5,423	8,734
I. Share of divisible taxes and duties in lieu of taxes:	326	711	1,259	1,330	4,645	6,366
(a) income tax	278	375	555	507	2,138	2,586
(b) excise tax	46	281	615	757	2,385	3,678
(c) estate duty	2	12	26	18	39	38
(d) grant in lieu of railway fares	0	43	63	48	80	64
(e) grant on account of agriculture wealth tax	0	0	0	0	3	-
II. Statutory grants in aid	103	207	331	452	775	2,368
Transfers for the Plan	350	1,056	2,515	1,800	5,182	5,903
1. Normal Plan Assistance (Gadgil)	350	1,056	2,515	1,800	3,483	4,797
2. Advance Plan Assistance:	-	-	-	-	85	-
(Nat. calamities, grants and loans)	-	-	-	-	833	6
3. Small Savings Loans	-	-	-	-	781	1,100
Non-Plan Assistance: (Miscellaneous Discretionary)	634	891	1,495	1,765	4,709	3,221
1. Central Sector and Sponsored Schemes	530	286	223	117	1,332	1,639
2. Ways and Means Advances	-	-	-	-	472	700
3. Overdraft Clearance	-	-	-	-	421	-
4. Other Non-Plan Assistance /a	104	606	1,272	1,648	2,484	882
TOTAL TRANSFER	1,413	2,865	5,600	5,347	15,313	17,857
as % of GDP	2.6	4.3	6.1	6.3	7.5	6.4
as % of total public expenditure	38.4	37.8	34.3	32.0	45.2	24.0

/a Includes special accommodation loans, non-Plan central assistance for certain projects, other non-Plan grants and loans and loans for purchase of fertilizers.

1/ The figures refer to the 4-year Fifth Plan period 1974/75 to 1977/78; with respect to figures in Fifth Plan, the years 1976/77 are revised estimates; figures are for 1977/78 budget estimates.

Source: National Institute of Public Finance and Policy; Seventh Finance Commission Report; Statistical Abstract of India, 1975; Economic Survey, various issues.

II. TRENDS IN CENTRALIZATION

One purpose of a federation, as opposed to a unitary state, is to accomodate some diversity within a unified political system. Federalism allows States which differ in many respects to retain their autonomy over matters of regional or local concern, but recognizes the need for national policy in key areas. In the "ideal" federation, States are able to act independently within their own spheres of competence and have the financial resources to carry out their assigned tasks. Their resources are sufficiently elastic to meet the need for addtitional public services in a growing economy. This "ideal type," with its perfect coincidence of revenues and expenditures, hardly ever happens, largely because of the superior revenue-raising capacity of the Center, and because, as "normative" public finance theory has it, over time, expenditures of local government have a higher income elasticity of demand than those of national level governments. The resulting gap between States' revenues and expenditures implies some dependence on debt finance or on Central Government, usually via revenue-sharing.

The problem with such vertical imbalance is twofold. Firstly, there is the bearing which fiscal autonomy has on State autonomy. Secondly, there is the expenditure "responsibility" question: allegedly the incentives for States to economize on expenditures and to match costs and benefits of public expenditures at the margin are reduced when revenues are from an external source.

In the Indian case, this normative picture must be modified a bit. Firstly, planning alters the picture with respect to State autonomy considerably. National priorities govern a large sphere of activity and indicate intervention in many areas, although these priorities are fixed in consultation with State Governments in the National Development Council. Secondly, since much of Central assistance to the States does not come cost-free, the tendency to ignore costs and benefits of expenditure at the margin is somewhat offset. Nonetheless, States have become increasingly concerned about the gap between their expenditures and revenues, as evidenced by the discussions preceeding the Seventh Finance Commission's revenue-sharing arrangements.

In the following paragraphs, the actual trends in State expenditures and revenues and measures of vertical imbalance will be examined.

Table 2: SHARE OF STATES IN TOTAL PLAN EXPENDITURE (%)

Plan Period	State Share
Second Plan	41.7%
Third Plan	45.4%
Fourth Plan	42.6%
Fifth Plan	49.2%

Source: Plan Documents.

Taking the expenditure side first and looking at the share of the Central expenditure in the total Plan, it is clear that while the Center's share has always been greater than 50% of the total, it is very difficult to discern a trend. The proportion of the States rose from 42% of total Plan expenditure in the Second Plan period to 45% in the Third Plan and rose again to 49% during the Fifth Plan period. The Fifth Plan figure somewhat overstates the States' share of expenditure, because the practice of stating investment on a gross, rather than net basis, introduced at the outset of the Fifth Plan period, exaggerates investments in Central subjects (industry and railways, for example) more than it does in State expenditure subjects such as agriculture and social services, where depreciation is negligible. The growth which may have taken place in the States' share is thus obscured. In sum, on Plan account there is little evidence that expenditure functions have become centralized. 1/

A similar absence of trend is evident in States' expenditure on revenue account. The share of the States in total current expenditures has always been higher than that of the Center, but has fluctuated from year to year. Over the period, no consistent increase in the Center's share is discernible.

Table 3: SHARE OF STATES IN TOTAL REVENUE EXPENDITURE
(percent)

	%
1950/51	50.9%
1955/56	59.1%
1960/61	57.1%
1965/66	52.2%
1970/71	55.0%
1971/72	53.9%
1972/73	54.4%
1973/74	55.9%
1974/75	52.9%
1975/76	51.9%

Source: "Trends and Issues in Indian Federal Finance," p. 47, op. cit.

1/ At this point it is also very difficult to discern whether sectorwise centralization of expenditures has occurred. At the usual level of disaggregation of Plan heads, State and Center expenditure subjects cannot be easily differentiated. Thus, while it is true that Central expenditures in "agriculture"--a State subject--have risen rapidly since the First Plan, not all of this represents encroachment of the Center on a State subject, since many agricultural expenditure functions are in fact Central subjects (storage and procurement, for example). Nonetheless, it is clear that many of the newer Centrally sponsored schemes in agriculture are in the State sphere, such as CAD, DPAP, SFDA, land reform, etc. See Appendix V for Center and State lists.

Similarly, on the revenue side, the States' share in the total tax collections in the Union fell over the 29-year period from 35.4% in 1950/51 to 29.5% in 1965 but have hovered at approximately 30-32% ever since. During this period, the share of the States in total revenue collection showed a similar pattern, falling from 38.1% of the total at the outset of the 1950s to approximately 30% in 1965, with little change thereafter.

Table 4: SHARE OF STATES' TAX AND NON-TAX REVENUE COLLECTIONS AS % OF TOTAL REVENUE COLLECTIONS OF CENTER AND STATES

	States' Share of Total Tax Collections	States' Share of Total Tax and Non-Tax Collections
1950/51	35.4%	38.1
1955/56	36.8%	40.5
1960/61	33.7%	34.1
1965/66	29.5%	29.4
1970/71	32.3%	30.6
1971/72	30.5%	28.4
1972/73	29.9%	28.1
1973/74	31.2%	29.4
1974/75	31.3%	30.2
1975/76	31.8%	30.2
1976/77	32.8%	n.a.
1977/78	32.6%	n.a.
1978/79	31.4%	n.a.

Source: "Trends and Issues in Indian Federal Finance," op. cit.

In the past decade, as the table shows, there has been no appreciable shift, indicating that, in the recent term, the States' resource mobilization effort has been as good as that of the Center.

While no shift in tax shares has been discernable, the absolute divergence between States' own revenues and their expenditures, and the concomittant dependence of the States on transfers from the Center continues to be a central issue in Center-State fiscal relations. The following table shows the extent to which States' expenditures are financed by revenues of the States themselves.

Table 5: SHARE OF STATE EXPENDITURES FINANCED BY OWN REVENUES

Plan Period	Share financed by States 1/
I	.63
II	.52
III	.48
Annual	.52
IV	.43
V	.53

Source: National Institute of Public Finance and Policy.

1/ This measure is sometimes called the coefficient of vertical imbalance and measures the degree to which States are able to finance their expenditures from their own revenue collections, independently of assistance from the Center. In any period, State income is the sum of tax and other revenues, grants, and borrowing, so that:

$$R = E = T_o + T_s + NTR + G_u + G_c + B$$

where
- R = revenue
- E = expenditures
- T_o = own tax revenue
- T_s = shared taxes
- NTR = own non-tax revenue
- G_u = unconditional grants from Center
- G_c = conditional grants
- B = borrowing

The extent to which States' own resources cover their expenditure needs is measured by:

$$V = (a_1T_o + a_2T_s + a_3NTR + a_4Gu + a_5Gc + a_6B)/E$$

where "V" is the coefficient of vertical balance, and the alphas are 0 or 1, depending on whether the revenue source is controlled by the State or Central Government. In general:

- $a_1 = 1$ (own taxes)
- $a_2 = 0$ (shared taxes)
- $a_3 = 1$ (non-tax revenues)
- $a_4 = 1$ (unconditional grants)
- $a_5 = 0$ (conditional grants)
- $a_6 = 1$ (States' borrowing)

Alphas can also vary between 0 and 1, if Center and States share control over a revenue source. This would be the case, for example, if States can influence the choice of the Center's revenue sharing formula, or if the Center controls the tax rates of certain State taxes.

(This discussion draws from J. Hunter's Federalism and Fiscal Balance.)

The State shares in Table 5 were derived on the assumption that States control their own tax and non-tax revenues, but that grants-in-aid, shared taxes, and Plan assistance are set independently by the Center. Under these assumptions the proportion of State expenditure financed by the Center has averaged over 50%; but there still does not appear to be any trend in the degree of vertical balance.

If it is assumed that the States have some influence over the level and allocation of shared taxes from Finance Commission devolutions e.g. $a_2 = .5$, then the State share would be as follows:

Table 6: SHARE OF STATE EXPENDITURES FINANCED BY OWN REVENUES, ADJUSTED

Plan Period	State share */
I	.61
II	.60
III	.56
Annual	.60
IV	.51
V	.62

*/ assuming States can influence the level of shared taxes.

Source: National Institute of Public Finance and Policy.

Under this measure, the proportion of State expenditure controlled by the States is higher but there is still no discernable trend.

The coefficient of vertical balance can be used to characterise Plan and non-Plan finance as well. On Plan account, some dependence of the States on Central resource transfers for the financing of their Plan is evident from the First Plan onwards. The Center has, since the Fourth Plan, financed about 35% of States' Plan expenditure, as Table 7 shows. The remaining 65% has, however, been financed by the States themselves--through the current account surplus, 1/ through additional taxation during the plan period and via their own capital receipts (market and other (non-Government) loans, recovery of loans and advances, deposits and advances, etc.) The proportion of State Plans financed by "normal" Plan transfers (this excludes advance Plan assistance and Centrally sponsored schemes, etc.) has decreased since the Third Plan period, from 62% of State Plan expenditures to 50% in the Fourth Plan period and 36% in the Fifth Plan, with an increase in the share financed by States' revenue account surplus and their own capital revenues.

1/ Since States' revenue account surplus is in part derived from Finance Commission transfers, a case can be made for saying that States' dependence on the Center is greater than what is indicated by the 35% of State Plans covered by Central Plan transfers.

Table 7: SHARE OF STATES' PLAN EXPENDITURE FINANCED BY CENTRAL TRANSFERS

	States' Plan Expenditure Rs. Crores	Normal Plan Assistance /a Rs. Crores	% Financed by Transfers	% Financed By Own Surplus, Additional taxation and Miscellaneous Capital Revenues %
I	1,427	350	24.5%	75.5
II	2,083	1,058	50.8%	49.2
III	4,058	2,515	62.0%	38.0
Annual	3,020	1,800	59.6%	40.4
IV	6,927	3,483	50.2%	49.8
V	13,408	4,797	35.7%	64.2

/a Does not include advance Plan assistance and relief assistance.

/b Fifth Plan figures refer to the four-year Plan period 1974/75-1977/78.

Source: Plan documents, National Institute of Public Finance and Policy, Reserve Bank Bulletin.

With respect to the revenue account, the States have financed the bulk of their expenditures out of their own revenue sources. The proportions covered by the Center as shown in Table 8, have remained more or less constant at 30% over the period. On balance, since the early 1950's, 70% of States' current expenditure has come out of their own revenue coffers.

Table 8: STATES' DEPENDENCE ON THE CENTER, NON-PLAN EXPENDITURE (Rs. Crores)

	States Non-Plan Expenditure	Finance Commission Transfers	Proportion financed by States
I	2,476	729	70.6
II	3,802	918	75.9
III	6,775	1,590	76.5
Annual	8,116	1,782	78.0
IV	19,721	5,420	72.5
V	31,207	8,751	71.9

Source: National Institute of Public Finance and Policy, Reserve Bank Bulletin.

Given that on Plan and non-Plan account, States finance the bulk of their expenditures on their own--coefficients of vertical balance have averaged .50 and .75, respectively--dependence on the Center does not appear excessively high. However, it could be argued that it is not so much the absolute proportion of expenditures financed by the Center which is important, but their 'elbow room at the margin' which counts. One factor which could make much of the above tax shares and vertical balance analysis somewhat misleading is the fact that the States are not, on the expenditure side, entirely free agents. Planning means that States are limited as far as the size and composition of the State Plans as well as the level of their revenue expenditure.

While States' own revenues may finance 45-50% of Plan expenditure, State Plans are drawn up in conjunction with the Center, so the composition of the Plan is not entirely up to the States. Nor do they have complete latitude to choose between the Plan expenditure/current expenditure mix. the "Tiebout" world of State and local finance, in which jurisdictions provide services to suit local preferences and thus a variety of public expenditure mixes, can be found, does not describe the Indian federal system. 1/ Measures of "dependence", based exclusively on revenue sources, which assume that expenditures are independent, are therefore somewhat misleading.

States are also constrained with respect to expenditures outside the Plan, because most of their incremental revenues are earmarked for the Plan. "Additional resource mobilization" -- defined as any revenues derived from tax base or tax rate increases introduced after the beginning of a Plan period for which targets are set by the Planning Commission in consultation with the States -- is required for the fulfillment of the State Plan. The States' revenue account surplus is also earmarked for Plan finance, as is most of its borrowing. The net result is that with the budgetary surplus and additional resource mobilization earmarked for Plan needs, the States have little scope of undertaking new schemes of expenditure, other than by running a larger deficit than they expected, or by cutting back their non-Plan or Plan expenditure. To the extent, then, that the States do face constraints at the margin in undertaking expenditure outside of what is planned, the share of State Plan or non-Plan expenditure financed by the States themselves can be somewhat misleading. This situation, of course, is part and parcel of the nature of planning itself, and should be viewed in light of the fact that most States are keen to have the largest possible development Plan: for this purpose non-essential and non-Plan expenditures must be kept to a minimum.

The high level of devolutions introduced by the recommendations of the Seventh Commission represent a substantial move away from past practice. On revenue account, the Seventh Finance Commission provided almost all

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1/ Tiebout, C. M. "A Pure Theory of Local Expenditures", Journal of Political Economy, Vol. 64, 1956.

States with surpluses, whereas in the past, the majority of States were left with zero budget surpluses. This gives them some cushion for independent action.

As far as transfers for State Plans are concerned, there has been a definite trend towards greater automaticity in the transfer process, giving the Center less discretion. Since the Fourth Plan, transfers have been effected through the Gadgil formula, which replaced the "schematic patterns of assistance" through which assistance was fixed until 1969. While the restrictions of the earlier pattern, under which all Plan transfers were earmarked for specific Plan projects on a conditional basis are absent, some discretion does remain with the Center with respect to the non-Gadgil Plan transfers. But it is probably fair to conclude that the procedures for Plan assistance gives the States more autonomy, and the Center less discretion, than in pre-Gadgil days, while still retaining for the Center sufficient flexibility for the Planning Commission to "pace" Plan implementation across the various States.

There is one final factor which has a bearing on the centralization issue, and this is the existence of a substantial flow of non-Plan, non-statutory assistance to the States. The largest chunk of such assistance comes through Centrally sponsored and Central sector schemes. Under the Fifth Plan, there were 103 centrally sponsored schemes on the books, with assistance to the States totalling Rs 1,440 crores for the Fifth Plan period or 30% of total normal Plan assistance from the Center. 1/ During the Fourth Plan period, there were 47 such schemes giving rise to Rs 781 crores of transfers (22% of normal Plan assistance). In 1969, as a part of the changes in principles of Central assistance, it was agreed that such schemes could be justified only if the project were (i) for research or demonstration; (ii) of national importance; (iii) having regional character; or (iv) involving outlays whose benefits could not be broken down territorially. In the first instances, it is the large externalities characteristic of research and development or projects of national importance which make intervention by the Center necessary to achieve a desirable level of investment in such projects. In the latter cases, Central intervention is again called for because of the "free-rider" problem. If the project carried out in one State has spillover benefits which accrue to neighboring States, getting these States to cooperate in sharing the cost is very difficult, since they will benefit regardless of whether they participate or not. The overall assistance for Centrally sponsored schemes was also limited at this time to 1/6-1/7 of normal Plan assistance given under the Gadgil formula, a limit which has not been strictly adhered to. Several States have argued that the schemes should be integrated into State

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1/ A list of centrally sponsored schemes in the Fifth Plan is provided in Appendix IV.

into State Plans 1/ and the assistance provided through the Gadgil channel, especially as these schemes are largely in sectors constitutionally reserved for the States, (51 of the 102 projects are in the agricultural sector), and represent 20% of total assistance for Central schemes during the Fifth Plan. This affects State Plans since the "kitty" for normal Plan assistance is correspondingly reduced. Other difficulties such as the staffing patterns frequently required by the Centrally sponsored schemes and the problem of committed expenditure for completed Centrally sponsored projects also conspire to make Central schemes administratively difficult for the States. The Center, understandably, is concerned about national norms, and the possibility that these schemes, if in the State Plans, might be under-implemented, should the States perceive more pressing commitments in other sectors.

To summarize briefly:

(a) There is no evidence for growing centralization as far as State and Central expenditure trends are concerned.

(b) Similarly, the little centralization has occurred on the revenue side, as State revenues have risen in tandem with the Center's.

(c) Regarding States' "dependence" on the Center as measured by the proportion of their total expenditures financed through resource transfers from the Center, the evidence is that the States are dependent on Central assistance. The Center finances about 50% of State expenditures; close to 50% are financed by States' own revenue sources.

(d) The Center maintains some control over State expenditures through its role in the planning process and because at the margin, States have few resources to implement their own schemes. Some discretion by way of ad hoc types of assistance and Central schemes also rests with the Center.

1/ While the Plans are being finalized, the States tend to prefer that such schemes be kept to a minimum, and that the corresponding financial allocations be used to increase the pool for State Plan finance. Once the Plans are finalized, however, these schemes are more attractive, since they then represent additional resources to the States. Within State Government, those ministries which are benefitting from the Center's attention are not enthusiastic about devolving funds through block assistance channels if the sector is not one of State priority; the reverse is true in sectors on which the States place greater priority than the Center.

III. REGIONAL BALANCE

India comprises States and regions of extreme diversity with respect to size, natural resource endowment, population density, economic organization, infrastructural facilities, and industrial and commercial structure. These disparities are easily captured, though perhaps not adequately measured, by per capita income differentials. In 1971, the per capita income of the poorest State, Bihar, was 45% of that of Punjab, the richest State in the country.

Balanced regional development has always been one of the major objectives of policy in India. To this end, any number of incentives have been used: location of industries, licensing restrictions, fiscal incentives, special programs for backward, hill and tribal areas, etc. Backward area bias, in fact, is present in most spheres of Central intervention in the economy.

Balanced regional development has also been a part of the credo of the Planning Commission: special assistance to hill and tribal areas, the criteria for advance Plan assistance and the weighting for poorer States in the Gadgil formula attest to this. Similarly for the Finance Commissions: equalization in the sense that poorer States should get higher per capita transfers than richer States has been part and parcel of the principles underlying transfers on revenue account. The question of equalization is much more complex than simply having progressive transfers. The goal of regional balance, of course, is that all regions should develop equally -- the ultimate aim is per capita income equalization; equalization of transfers or grants for the standardization of services is only seen as a means to this end. The extent to which the income equalization can be or has been achieved by the revenue sharing, has not yet been systematically examined in India.

There is a strong theoretical basis for horizontal equalization of public expenditures through revenue sharing. Public expenditure theory since Pigou indicates that public expenditures on a good should be carried to the point where the marginal cost of each unit of expenditure is equal to its marginal social benefit. Translating this into a geographical rule, the equilibrium relationship is that the ratio of marginal social benefits to marginal costs of public expenditures must be equal for all States. This, of course, does not imply equal investment or expenditure across States. If these ratios are not equal, then a reallocation of expenditures or costs from one State to another can increase total national welfare.

In a federation this national welfare-maximizing position is unlikely to be achieved by States acting independently. The reason is that their income differences (and thus tax capacity) will affect choices pertaining to the level of public expenditures. Poor States are likely to have underprovision of public services because, with a small tax base, the per capita tax cost of these services will be disproportionately high, while in rich States, the same revenue collection will be less burdensome, expenditure levels high, and the marginal benefit of additional expenditure may

be declining. An interventionist government can transfer resources from rich to poor and increase national welfare, since the marginal cost of raising revenue in rich States is lower, and the benefit of public expenditure in poor States, higher and still rising.

The crucial assumption is that by intervening, the Government is not diverting resources from an area of high development potential to one of low development potential, but that rather, through equalization transfers, the Government ensures a more efficient resource allocation pattern in the long run by increasing labor productivity and mobility through public expenditures in health, education and similar sectors and by providing infrastructure which enhances capital productivity in the poor area. The alternative scenario for the poor area in the absence of such equalization transfers is one in which the region becomes increasingly impoverished as labor and capital move to richer regions where their productivity and returns are higher. The assumption, in short, is that poor areas do have development potential.

To achieve the purpose of equalization grants, enhanced resource allocation, these grants must be of certain types: they should not, for example, attract or keep labor in a region where productivity is low, which would happen if services were mainly welfare-oriented. In sum, grants which speed development in poor areas can reduce the differential between the poorest and richest States. Table 9 below shows recent trends in the various types of per capita transfers to each of the States.

The first impression looking over the table is that there seems to have been no systematic favoring of the lower income States in the overall pattern of awards and Plan finance. The middle income States have apparently benefitted at the expense of both high and low income States. This appears to be equally true for Finance Commission, Plan and overall transfers alike. In sum, no systematic trend seems discernable.

Table 9

Per Capita Transfers

All-India Average = 100

Type of Transfers / Plan Period	II			III			Annual Plans			IV			V		
State	Finance Commission	Planning Commission	Total	Finance Commission	Planning Commission	Total	Finance Commission	Planning Commission	Total	Finance Commission	Planning Commission	Total	Finance Commission	Planning Commission	Total
1. Punjab	100	176	124	94	109	120	79	112	118	87	120	96	71	100	103
2. Haryana	100	176	124	94	109	120	85	145	84	77	127	122	70	92	98
3. Maharashtra	92	79	87	97	74	94	103	70	85	105	78	103	89	67	66
4. Gujarat	121	106	96	143	95	118	92	90	94	91	97	93	87	108	104
5. West Bengal	146	96	134	94	79	99	87	80	80	107	80	104	115	69	112
6. Tamil Nadu	83	110	85	91	96	100	95	88	87	95	80	83	83	89	80
7. Kerala	96	97	101	128	126	135	172	130	120	116	133	117	138	122	119
8. Orrisa	117	155	144	182	136	150	205	112	147	141	118	130	156	143	140
9. Assam	183	121	142	165	151	199	195	180	200	143	198	188	152	164	170
10. Karnataka	129	121	97	117	116	107	141	112	122	89	95	107	80	96	
11. Andhra Pradesh	100	107	100	111	107	120	100	110	118	101	88	104	106	100	96
12. Uttar Pradesh	79	66	68	68	84	73	79	87	76	91	97	77	92	117	100
13. Rajasthan	100	127	121	114	140	143	100	145	155	108	138	173	135	125	126
14. Madhya Pradesh	91	127	109	91	119	107	77	107	93	88	102	73	79	85	82
15. Bihar	83	76	104	77	82	84	67	82	88	93	96	80	88	96	88
All India	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Actual Transfer, Rs. per Capita	24	29	75	35	57	121	39	40	120	94	60	262	100	48	196

Note: 1) States are arranged in (descending) order of per capita SDP for 1969/70.

2) Finance Commission transfer includes devolutions and statutory grants, Planning Commission transfer includes Normal Plan assistance only.

3) The 15 States included are those to whom "Normal" plan assistance is given under the Gadgil formula. Hence the exclusion of Jammu and Kashmir, Nagaland, etc.

Source: K.R. George, Economic and Political Weekly, March-1978.

Regressing the per capita transfer and its various components on per capita incomes in cross-section regressions for each Plan period yields little correlation between the two. 1/ While the coefficients are largely negative -- indicating the desired progressive trend in transfers--few of them are significantly different from zero, even at a 10% confidence level, so that neither the contention that higher transfers have been given to richer States nor its converse can be confirmed, certainly for later years. 2/ In the Second and Third Plan periods, however, there was a fairly close negative relationship between transfers and per capita incomes. 3/

1/ Double log regression: $T = aY^{B}$, where T = transfers and Y = per capita income.

2/ For the contention that higher transfers to poorer States to be established would require a negative relationship in $\ln T = a + B \ln Y$. A coefficent of B greater than one, indicates that richer States get not only higher absolute transfers, but higher proportionate transfers as well. B = 1 indicates that transfers are proportionate to incomes (i.e., rich States get a higher absolute transfer). B between zero and one indicates that richer States still get higher absolute transfers, but that the transfer risen proportionately less than the States' income.

3/ While the focus on the relationship between transfers and per capita incomes is somewhat limited, the relative ranking of States on the basis of per capita income and an index of interstate equality, built up from various indicators, does not change much; conclusions regarding the progressivity of transfers are therefore also not likely to alter.

Table 10: REGRESSION COEFFICIENTS: RELATION OF FEDERAL TRANSFERS TO STATE PER CAPITA INCOME [a]

Plan Period	Finance Commission Transfers	Normal Plan Transfers	Total Transfers
II	- .13 (-1.35)	- .40* (-5.03)	- .25* (-3.50)
III	- .26** (-2.4)	- .29* (-4.1)	- .32* (-4.1)
Annual	- .14 (- .32)	+ .04 (.13)	+ .10 (.95)
IV	- .24 (-1.3)	.95 (1.3)	.17 (.61)
V	- .46 (- .88)	- .38 (-1.57)	- .20 (-1.73)

/a Plan mid-years, all-India prices used.
t - statistics in parentheses;
Asterisks indicate significance at:
* 99%
** 95%

Fifteen States were included in the sample, which excluded the hill states.

Although overall, there is no evidence that transfers have been regressive, it is clear that some poorer States have received a very low share of the transfer, and some richer States have received proportionately more. Table 9 indicates that the poor and populous states of Bihar, Madhya Pradesh and Uttar Pradesh, during the Annual, Fourth and Fifth Plans, received transfers from all three sources which were lower than the averages received by all States together. 1/ A similar pattern is followed by the assistance given by the Planning Commission and the Finance Commission. At the other extreme, Punjab and Haryana have received consistently high Plan transfers, and in the Fifth Plan period, discretionary transfers too, since the overall transfer to both States is higher than either the statutory or Plan transfers. Breaking transfers down by source, it appears that the poorer States have received closer to the all-India average from Plan transfers than from Finance Commission or discretionary transfers (Orissa is an exception here).

1/ Similar arguments are made in "Trends and Issues in Indian Federal Finance," National Institute of Public Finance and Policy, New Delhi, 1978.

Some of the reasons for the apparent lack of consistency in the State-wise distribution of assistance are easily seen from the transfer formulas themselves. In the Finance Commission's award, income and excise taxes have long made up the bulk of the transfer. Income taxes have been distributed on the basis of population and collections. The 10% weighing given to collections is, by definition, under a progressive income tax, a regressive weight benefitting richer States. 1/ In the past, it has benefitted Maharashtra, Gujarat, Tamil Nadu and West Bengal. Population --also a heavy in the past weight for the excise tax-- 2/ is a scaling factor and has no explicit bias: in effect, however, the per capita weighing may be somewhat regressive since many rich States are also populous ones.

Grants-in-aid from the Finance Commission have attempted to take backwardness into account quite explicitly. The "equalization grants" for certain public services described earlier are an example of this. To the extent that the Commission has also had to use grants-in-aid to relieve the States' budgetary gaps, grant debt relief, and give other special purpose grants, the progressive effect of these grants has been somewhat mitigated. Judging from evidence of one study, it appears that grants have, in general, been distributed more equally than tax devolutions, but these results (based on gini coefficients) must be interpreted with caution, as they do not preclude some poor States from being made worse off, as long as the overall distribution is better. 3/

Referring back to Table 10, Plan transfers also do not appear to have been successful in terms of achieving regional balance as defined here The Gadgil formula through which they are distributed contains both progressive and regressive elements: 10% of the divisible pool is earmarked for States with per capita incomes less than the all-India average and 10% is allocated on the basis of "special problems." On the other hand, the weights for tax effort, and irrigation and power could be seen as regressive. Table 9 corroborates the unsystematic outcome of Plan transfers: Punjab and Haryana for example have consistently (until the Fifth Plan period) received very high per capita Plan transfers.

1/ The richer industrial States see this weight as justified in view of the high costs of the services they need to provide, especially in large urban centers. These States would like to see the weights given to collections increased, and an additional weight given to urbanization. Both would imply a more regressive distribution of assistance cetibus paribus.

2/ The formula devised by the Sixth Commission distributed tax shares 25% on the basis of an index of backwardness and 75% on population. This formula was changed by the Seventh Commission to .25 (population) + .25 (1/State Domestic Product) + .25 (poverty ratio) + .25 (revenue equalization). See Section V.

3/ "Trends and Issues in Indian Federal Finance"; op cit.

The remaining transfers also have implications for regional balance: a priori, however, these implications cannot be analyzed because many are discretionary, and there is no formula which guides such transfers. It is clear from Table 9 that there are cases where these transfers have increased inequality of the overall transfer: Gujarat and Punjab during the Annual Plan Period and Punjab and Haryana in the Fifth Plan, for example. There are cases too, were poorer States have benefitted from the discretionary transfers: Rajasthan in the Annual and Fourth Plan periods, and Bihar under the Annual Plans received transfers which increased their overall per capita transfer vastly over the statutory and Plan components alone. Other than to point out these features, since the non-Plan, statutory transfers contain discretionary components, not much can be said other than ex-post about their effect on regional equity. In principle, of course, discretionary transfers have great potential from the redistribution point of view. However, there is a conflict between the use of discretionary transfers and the States' demand for more automatic transfers in accordance with a predetermined formula. The solution, to devise a progressive formula, is not easily reached, since few States are willing to cede any changes in their relative shares and progessive formulas are difficult to settle on by general consensus.

The final point to be made has to do with the coordination between the Finance Commission and the Planning Commission for the goals of equal regional development. Because a large share of State Plans are financed through the States' own surplus on revenue account, to which the Finance Commission's devolutions contribute, large devolutions through the Finance Commission award will enable certain States (those with the smaller predevolution deficits or with surpluses) to finance larger Plans. To the extent that it is the better-off States whose surpluses are increased most by a Finance Commission emphasis on devolution, there is a compounding of regional bias. Maharashtra, Haryana and Punjab, for example, have in the past been in surplus even before receiving transfers from the Finance Commission, a situation which during the period of the Sixth Commission award made their post-transfer surpluses some 300% greater than the all-States' average. This eventuality is largely inevitable: whenever uniform formulas are used to distribute funds to diverse entities, large inequalities are made possible.

In the choice between grants and tax-sharing, the Commissions are faced with the desire to distribute funds in a non-discriminatory manner while still favoring the worst-off States to promote balanced regional growth. In opting for more devolutions, regional balance can be taken into account through a "progressive" tax sharing formula; however, the population factor generally also weighs heavily in these formulas (as a scaling factor or indicator of need), and since many populous States are also "rich" states, it is almost impossible to develop formulas which are monotonically progressive. Even with the "poverty population" as a factor, such formulas are difficult to develop since many rich States also have large poverty groups. Only in the rich agricultural States does high per capita income correlate with reduced rural-urban dichotomies and a better income distribution; in the industrial States this is not, as a rule, true. Under the present system in which devolutions are automatic, grants are the best means of tailoring the revenue sharing directly for the goals of horizontal equalization. However

the ad hoc nature of grants may result in their being viewed as arbitrary, and because they are not automatic and States have no statutory right to them as they do to shared taxes, they run counter to the trend desired by the States of increased State autonomy.

Whatever the outcome of the Finance Commission's deliberations, the Planning Commission must begin where the Finance Commission leaves off, since without some coordination of efforts their results may conflict. The difficulty is that much of the assistance provided through the Planning Commission also accrues in block form, distributed among the States according to a formula, with the result that a compounding of regional bias is not only possible, but likely, since this formula also puts heavy weight on population.

IV. CENTER-STATE FISCAL RELATIONS: AWARD OF THE SEVENTH FINANCE COMMISSION

The report of the Seventh Finance Commission was submitted to the President on October 28, 1978, and to Parliament on November 24, 1978. The recommendations follow a similar framework to those of earlier Commissions and yet are striking in certain aspects. Over the recent period, there had been some dissatisfactions with, and acknowledgement of, the inadequacies of the Sixth Commission's solutions to the problematic issues in Center-State finances. The following were some of the salient issues:

(i) The burden of State indebtedness to the Center posed, for some States, serious problems. States borrow from many sources: internal market borrowing, provident fund and life insurance funds, accommodation, loans from commercial banks, etc. However, by far and away, the biggest creditor to the States is the Central Government: 72% of total State medium- and long-term debt outstanding at the end of 1978/79 was owed to the Center. If to this are added short-term borrowings, the ways and means accommodation and the overdrafts extended by the Reserve Bank of India, the proportion is higher still. That the volume of State debt is so large should not be surprising, since planned development necessarily involves a substantial volume of capital outlay; nor is it necessarily bad, since, as the Finance Commission points out, capital outlay has consistently exceeded outstanding debt. Because the major part of the States' growing debt burden is attributable to Plan finance, the issue of debt burden is a difficult one. The problem has been examined by numerous Finance Commissions and was referred again to the latest. The difficulty arises because Plan loans from the Center are utilized by the States in various ways, some of which are "productive" (i.e., income-producing), and some of which are not. Among the Plan heads of capital outlay are irrigation and power, for example, which are typical of much capital outlay. Such outlays could be expected to pay their own way although, in practice, they seldom do. Transport and communications also involve capital expenditure which is not generally recoverable. Plan investment in industries, minerals, and small-scale industry is, in principle, recoverable capital expenditure. On the other hand, minor irrigation and soil conservation, while capital in nature, cannot be considered to pay its own way. Plan expenditures on health,

education and the like, have, of course, very little capital components and offer no monetary return. 1/ Until the beginning of the Fourth Plan, Plan assistance was linked to individual schemes, with the grant/loan proportion and terms of the assistance designed for the scheme in question. From 1969 onwards, however, when block Plan assistance was introduced, the link between loans and the schemes for which they were used could no longer be established. The need to take account of "unproductive" capital expenditures was recognized in the system of Plan transfers by giving block assistance on a 30% grant and 70% loan basis. In its examination of these provisions, the Finance Commission implies that the 30% grant component may be inadequate, noting that over one-half of the current capital outlay of the State Plans will not produce sufficient revenues to cover even the interest costs. 2/ Its recommendation is that the loan-grant proportion of financial assistance should be fixed with due regard to the end use of the assistance.

(ii) Another major issue in the dialogue was that of regional balance. The Finance Commission award and recommendations have a dual impact: not only do they affect State revenue budgets, but they affect the size of the State Plan and the developmental expenditures a State can undertake, since the surplus (or deficit) which emerges on revenue account -- and which the Finance Commission's transfer largely fixes -- determines to some extent the size of the Plan. The size of a State Plan is determined jointly by the level of funds forthcoming through the Planning Commission's transfer and what the State itself can contribute from its surplus on revenue account or mobilize through additional taxation. 3/ To the extent that this surplus is large, or made larger by the Finance Commission award, the State has greater flexibility in determining both the size and the composition of its Plan.

The devolutions awarded by the Sixth Finance Commission left eight States with a surplus on revenue account 4/ and filled the revenue gaps of the 14 others with grants-in-aid totalling Rs crores 2,509. The size of these surpluses ranged from Rs 252 per capita for Punjab to Rs 26 for Madhya Pradesh, a ratio of just under 1 to 10. The problem of such disparity in the

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1/ States also onlend Plan resources, in turn, to local bodies, the public (farmers, co-operatives, etc.), the Electricity Boards (loans in perpetuity, in most cases, since the loans are akin to equity investments) and other State corporations. In these cases recovery can also be a problem.

2/ The Seventh Finance Commission Report, p. 114.

3/ There are other sources of Plan finance, such as open market borrowing and States' own capital income, but these figure less importantly.

4/ Gujarat, Haryana, Punjab, Karnataka, Maharashtra, Tamil Nadu and Madhya Pradesh. Haryana, Punjab, and Maharashtra were already in surplus even before the devolution.

surpluses is one which the States have repeatedly noted in their Memoranda to the Finance Commission, and it has also become somewhat of a concern to the Finance Commission itself.

(iii) Yet another concern of the States has been the low buoyancy of their overall revenues. Since the Finance Commission award covers five years, the projections of States' expenditures and revenues made by the Finance Commission are crucial in determining the devolutions and grants-in-aid needed by them over the period. The allowance made for inflation, which affects the States' revenues as well as expenditures, is also of great importance. The States acknowledged that while every attempt might be made to estimate expenditures correctly, towards the end of the projection period, the real transfer has frequently been inadequate. This was especially true of the Sixth Commission's award which was allegedly insufficiently flexible to deal with the large price increases of 1973 and 1974. The bulk of this award (58%) was made up of income tax receipts and grants-in-aid, with the 14 deficit States receiving gapfilling grants, bringing their projected budgets into balance, but not providing any surplus as cushion. Annual transfers under the Sixth award grew at an annual rate of 11% while nominal GNP increased by 13% per annum.

(iv) With so much attention to planning and the creation of new capital assets, little attention (or resource transfers) has been given for maintenance of Plan schemes, implying more rapid depreciation and costly re-investment. Maintenance budgets are typically small and often sacrificed to achievement of Plan targets or revenue expenditures in other sectors. Not only are inadequate financial resources earmarked in the State budgets for maintenance expenditures, but there exists no body with responsibility for looking after maintenance of assets.

(v) Standards of administration at the State level have also become an area of concern. As the Seventh Finance Commission noted, there are vast disparities in administrative standards between the Center and the States, and also among the States themselves. The capabilities and efficiency of administration have a significant bearing on the quality of public services provided, as well as on development programs. To the extent that States do not have sufficient resources to maintain or develop higher administrative standards, they may be doomed to a lower level of performance. Since States do have to perform important functions in education, health, sanitation, roads, agriculture and irrigation, among other sectors, such differences take on importance.

(vi) Yet another issue in the recent dialogue has been the perceived centralization of expenditures and the concomitant contention that the States' role in the development process is being eclipsed. The increase in Central expenditures in State expenditure subjects, primarily through Centrally sponsored and Central sector schemes in agriculture, from 22% in the Fourth Plan period to over 30% of normal Plan assistance during the Fifth Plan is the primary example of this concern.

(vii) One of the thornier issues facing past Commissions has been the question of relief assistance to States devastated by natural calamaties. The procedures laid down by the Sixth Finance Commission, by which the Center has been guided for the past five years, were found to have serious inadequacies, many of which were brought to light in the wake of the cyclone which hit Andhra Pradesh and Tamil Nadu in 1977. The Sixth Commission, like many of its predecessors, had made provisions for relief expenditures over the award period, based on average expenditures from 1956/57-1971/72 on relief payments, water, relief works, fodder, etc., but excluding the cost of repairs or restorations of public assets. To encourage economy, the Sixth Finance Commission specified that any assistance required above these margins be given through the channel of advance Plan assistance, to be set off against normal Plan assistance to the State by the end of the period. They had also specified that non-gratuitous relief expenditures, such as public works, draw on Plan projects. Some States viewed this last requirement as placing Plan implementation in jeopardy and felt that the terms of advance Plan assistance, 30% grant, 70% loan, were far too hard, since so much of the expenditure was of a non-capital nature. It is generally acknowledged now that the practice adopted from 1974/75-1978/79 resulted in some dislocation of State budgets and was inadequate for the large non-Plan expenditures needed following serious damage to public assets and destruction of part of a State's economic base. The fact that up until now the previously granted advance Plan assistance has not been adjusted lends support to an inference that there are real limitations to the scope for such adjustments when the amount of aid is large relative to Central assistance or relative to a minimum acceptable Plan size.

Most of these issues are dealt with in the Seventh Commission's report: (i) Debt Relief. With respect to debt relief, the Commission acknowledged that much of Central lending to the States had not been on terms which paid regard to the end-use for which the funds were destined, 1/ and recommended debt relief on outstanding Central loans. Following the Sixth Commission, the Seventh judged that a general write-off was not considered desirable because the resource mobilization efforts of the States might be discouraged. Instead, the recommendation was that repayment periods and terms be linked more closely with the end-use of the loans, a linkage which has to be estimated since most Central loans are given as unearmarked block assistance. The Commission estimated end-use by assuming that States use increasingly costly funds for increasingly productive investments. 2/

1/ The observation is probably true, in the sense that income and non-income generating end use pay identical interest charges. They probably do represent the marginal cost of additional borrowing to the Center.

2/ Short-term loans such as ways and means advances, small savings loans and special loans to certain States have been excluded. In increasing order of cost these are: surplus on revenue account, recoveries of loans advances, reserve funds, loans from the Center, market loans, life insurance and provident fund loans, etc.

Thus, grants are assumed to be used for "unproductive" expenditures with the balance of such expenditures financed by low-cost loans; remaining low-cost sources are then used for "semi-productive" expenditures and for any such expenditures which remain, the next highest cost source is assumed to be used, etc.

The Commission's recommendation was that unproductive debt be written off. This is Rs 942 crores, or 7% out of a total debt outstanding at end of 1978/89 of Rs 13,462 crores. This implied very different things for different States, providing a 100% write-off of outstanding debt for Nagaland, where all investment has been "unproductive," and none for some other States who have no "unproductive" debt. 1/ The balance of loans outstanding, with "semi-productive" or "productive" end-use (these proportions range from 100% "semi-productive" for Gujarat to 100% "productive" for Punjab) are to be consolidated into a single amount. Recovery will be over 30 years at 4.75% for "semi-productive" and over 15 years at 5% for "productive" loans. The Commission also recommended that the small savings loans from the Center be converted into "loans in perpetuity" requiring interest payments only and no amortization. The reasoning behind this was that since only the net collection of small savings is re-lent to the States, the Center does not need the States' repayments to meet its own liabilities, and there is no need, other than pro forma, for the States to repay principal.

The Center accepted these debt relief recommendations with a slight modification. The total amount of debt relief needed by the States to deal with the non-Plan capital gaps will remain as recommended, but the amortization payments on small savings loans will be suspended only for the period of the award: the Center wishes to preserve its options, presumably, should it require additional resources in the future. The Commission also suggested that the same principles used in its Report to determine the required debt relief (with respect to end-use and terms of loans) be followed by the Government for all future Plan and non-Plan loans. How this is to be done--for example, by varying the terms for Plan assistance for each State according to the sectoral distribution of Plan investment--was not elaborated. The Center accordingly, dismissed this point as impracticable. The debt relief accorded by the Sixth and Seventh Finance Commissions' awards, as a percentage of total repayments due to the Center, remains about the same, 50%. Other comparisons are difficult to make because the estimates of the non-Plan capital gap were constructed so differently by the two Commissions. The Seventh Commission did not include many sources of capital receipts, such as the provident funds, in their estimates of capital revenue because these are traditionally earmarked for financing State Plan expenditures. Thus, although debt relief as a percentage of the capital gap fell from 99% under the Sixth Commission's award to 61% under the Seventh, the latter estimated a far larger gap, so the percentage figures are not comparable.

1/ Punjab, Andhra Pradesh, Gujarat, Haryana, Bihar, Karnataka, Madhya Pradesh, Maharashtra, Sikkim, Tamil Nadu, and U.P.

(ii) Coordination and Regional Balance. The large devolution has resolved many of the problems arising out of the failure to coordinate Plan and non-Plan assistance. The devolution leaves fourteen out of the twenty-two States with a revenue surplus; out of the eight deficit States receiving grants-in-aid to fill the budgetary gaps, seven are Northeast Council States or hill States, and the recipients of many types of special assistance. The magnitudes are shown in Table 11. In sum, only one State ineligible for special assistance under other arrangements -- Orissa -- is left in deficit after the devolution. 1/ This is a significant change from the Sixth Commission award in which fourteen States were left with deficits, including eight which were non-hill States. Moreover, the Seventh Commission did more than fill budgetary gaps: when the "upgradation" grants are included, all 22 States are in surplus. In general, the Seventh Finance Commission devolutions appear to be both larger and more evenly spread than those of the Sixth. The mean per capita surplus resulting from the Seventh Commission's award is Rs 203; the mean per capita transfer is Rs 723. Both are shown in Table 11. The per capita average transfer under the Sixth was only Rs 567 and the surplus Rs 43 per capita.

1/ There are five States in surplus before devolutions: Maharashtra, Punjab, Haryana, Gujarat and Karnataka in that order.

Table 11

Per Capita Transfers and State Budget Surpluses

Sixth and Seventh Finance Commissions

	Sixth Finance Commission		Seventh Finance Commission	
	Per Capita Surplus 1/ Rs.	Per Capita Transfer Rs.	Per Capita Surplus 1/ Rs.	Per Capita Transfer Rs.
Andhra Pradesh	0	178	217	340
Assam	0	300	74	355
Bihar	0	149	205	393
Gujarat	126	138	423	361
Haryana	223	120	676	302
Himachal Pradesh	0	600	22	940
Jammu and Kashmir	0	504	40	816
Karnataka	80	164	343	343
Kerala	0	254	112	361
Madhya Pradesh	26	170	282	383
Maharashtra	149	25	596	340
Manipur	0	870	93	1808
Meghalaya	0	3830	48	1326
Nagaland	0	2700	84	4663
Orissa	0	263	15	449
Punjab	252	80	597	310
Rajasthan	0	219	85	350
Tamil Nadu	44	131	159	365
Tripura	0	880	23	1284
Uttar Pradesh	0	152	233	375
West Bengal	0	185	157	360
Mean	43	567	203	723

1/ After devolutions and grants in aid.

As noted earlier, the reduced disparity in the surpluses is important because of its effects on State Plans and State development expenditures. Any inequities in the distribution of the surplus carry over into the Plan sphere, magnifying the variance in Plan expenditure across States.

(iii) Buoyancy of Revenues. The final important issue answered by the report is that of buoyancy of revenues. The award, by doubling the proportion of total excise tax revenues to be shared with the States (from 20% of the total to 40%) gives the States a very large slice indeed of the government's most buoyant source of revenues and the States now have much more protection against inflation.

Despite its broad scope and thorough attention to many important matters, there are a number of issues which the Finance Commission's Report does not address. One such issue is continued adherence to the custom of sharing each divisible tax or grant-in-lieu-of-tax, of which there are five, on the basis of distinct formulas. A dissenting note deals with this issue, noting that there is little sense in continued use of this procedure, since its justification is largely legalistic. There are also other disadvantages to this procedure. The biggest is the difficulty in fine tuning the distribution of the award when it consists of five different formulas, each with distinct weights. This is not to suggest that it is impossible to be precise in awarding each State the "desired" share, since it is a matter of tax elasticities, projected growth rates and adjusting formulas so that the weighted average conforms to the ideal, but rather to note that the desired share could be awarded more simply. However, choosing a single formula which achieves the desired distribution is also far from easy, as the note of dissent points out, since any formula will require additional special grants to equalize the level of surplus among States.

The Seventh Finance Commission does not state explicitly what allowance has been made for price increases in projecting States' revenues and expenditures. It is clear that they have been explicitly allowed for, since revenues at least, were projected using partial elasticities with respect to prices. The Commission anticipated that inflation would not be a problem, and that "except in a situation of more than marginal increase in prices, the States should be able to manage their finances smoothly 1/." Because of the increase in the share of excise taxes in the devolutions in the overall package relative to grants-in-aid, there is greater protection against inflation than in past awards, although it remains to be seen whether it is sufficient to deal with the high inflation rates of 1979/80.

In seeking to emphasize the importance of low population growth, it was decided during the Sixth Finance Commission's award period that wherever population was a relevant weight, 1971 population figures should provide the basis for allocation of both Plan and revenue account assistance. The years which have gone by have not seen interstate differences in fertility reduced. Indeed, the variance is quite high, with total fertility rates ranging from a low in Kerala of 4.17 to 7.1 in Uttar Pradesh. This is a distinctly regressive weight and becomes more so as 1971 population is increasingly unrepresentative of actual population through the 1979-84 period.

The problem of course is to avoid giving the States an incentive to lag on progress in the population area, while at the same time not tilting the balance unduly against the poorer States.

(iv) Maintenance. The Commission dealt with the maintenance issue by revising upwards the maintenance expenditures which would be allowable in the States' budget forecasts for assets completed by 1978/79. 1/ These re-estimates were based on the physical capital of each State: the values of buildings, lengths of roads and irrigation systems, etc., and the norms of expenditure required for each of these types of capital assets. The Commission hoped that by establishing a new base for levels of allowable maintenance expenditure in 1978/79 and higher growth rates for such expenditures over the period of the award, the inadequate care of existing assets will become less of a problem. Whether these hopes will be met depends on the new base levels of necessary expenditure, their projected growth and, as much as anything, on the effectiveness of the monitoring system.

(v) Standards of Administration. The Commission has dealt with this in a dual manner: additional grants-in-aid were been given to States for upgrading their administrative infrastructure, and allowances were made for higher levels of pay for State level employees, including teachers and employees of local bodies. In the revised budget forecasts, allowance was made for States whose pay scales are less than the all-States' average to bring them up to this level. The revised expenditure budgets also allow the dearness allowances granted by the Center to be matched. Six categories of expenditure were selected for minimum infrastructure standards: tax administration, treasury, judicial, direct administration and secretariat services, police and jails. As with maintenance estimates, standards were measured in terms of physical norms: the ratio of the number of police to violent crimes, the ratio of pending to completed court cases, etc., to determine the relative position of, and the grants needed by, the various States. 2/ Similarly, provisions were made to prevent grants from being diverted to other heads of expenditure, so that disbursements of each State's entitlement will depend on an auditor's report of expenditures in the preceding year. The amount allocated over the five years is Rs 43,679 lakhs. 3/

(vi) Centralization. The changes in the rules on centrally sponsored sector schemes are inteded to address the these issues.

1/ Recommendations were also made that expenditures be monitored to insure that allocations are spent, since the experience of the Sixth Commission had been that funds provided for maintenance were diverted to other uses.

2/ Recommendations were also made that expenditures be monitored to insure that allocations are spent, since the experience of the Sixth Commission had been that funds provided for maintenance were diverted to other uses.

(vii) Relief Expenditure. It is very difficult to judge a priori how effectively relief measures can deal with an emergency situation since provisions are based on probable incidence of calamity, and the law of averages does not always work in the short run. The Seventh Finance Commission has been more liberal than the Sixth; the scheme is intended to enable States to maintain financial equilibrium throughout the years covered by the Report, while also avoiding wasteful expenditures. For drought situations, the Commission has provided that for expenditures needed over and above margin monies, the State should make a contribution up to 5% of total annual Plan outlay from its Plan to provide relief employment. This would be covered by advance assistance, adjustable over five years against the State's share in the Gadgil formula. Plan projects such as CAD, drought-prone areas, etc., could be implemented earlier, if appropriate, to provide relief employment. If 5% of Plan outlays remains insufficient, the Center would provide any necessary additional assistance on 50% grant and 50% loan terms.

For other calamities, the Commission has recommended that the Center give 75% of any excess over the margin monies as non-Plan grants, not as adjustable advance Plan assistance. The remaining 25% would be borne by the States. Determining the amounts of relief expenditures needed by the States is the task of the Center, and it is in the interests of the States themselves that these estimates be accurate, since States have to bear a considerable burden of these expenditures. In sum, the Seventh Finance Commission provisions are more flexible than before and should be sufficient to deal with relief expenditures adequately.

Summary

In sum, the Seventh Finance Commission award and recommendations deal explicitly with many of the major issues in Center-State fiscal relations. The result is a sizeable increase in the transfer to the States. In nominal terms, the award is almost double (198%) that of the Sixth Commission and in real terms this increase is only very slightly less than this. As a proportion of total Central receipts the proposed award is 17.3%, up from 14.6% devolved by the Sixth Commission. In relation to the States' budgetary position, under the new award, 43% of their projected non-Plan revenue expenditure will be covered by Central transfers and grants-in-aid (including upgradation grants for administration), an increase from the 40% of the Sixth Commission's award). The following tables show the details of this award.

Tables 12 and 13 show the breakdown of the total award and its distribution among the States. Shareable taxes makeup 77% of the award, with the income tax and excise tax contributing 23% and 54%, respectively. Other taxes comprise an additional 15%, with specific grants making up 8%. The value of the budgetary relief items, including the margins for natural calamities, are approximately equal to 10% of the transfer.

Table 12: TOTAL SEVENTH FINANCE COMMISSION TRANSFER TO THE STATES FOR THE PERIOD 1979/80/1983/84

	Item	Rs crores
1.	Shareable Taxes	16,138.85
	(i) Income Tax	4,791.39
	(ii) Basic Union Excise Duty	11,347.46
II.	Specific Transfers	3,158.20
	(i) Additional Excise	1,867.07
	(ii) Excise on Power	1,145.88
	(iii) Railway Fare Compensation	81.25
	(iv) Estate Duty	64.00
III.	Grants (Article 275)	1,609.92
	(i) General	1,173.12
	(ii) Upgradation	436.80
	TOTAL TRANSFER	20,906.97
IV.	Allowances for Relief and Contingency Provisions	2,155.80
	(i) Debt Relief	2,155.80
	(ii) Provision for Natural Calamity Relief	ND
	(iii) Provision for Prohibition Compensation	ND
	Grand Total I+II+III+IV	23,062.77

Source: Seventh Finance Commission Report

ND: Not determined -- amounts were not been determined at this time of writing.

Table 13

India

Seventh Finance Commission Transfers

1979/80 to 1983/4

	Income Tax (Share)	Excise (Share)	Railway Fares (Shares)	Grants-in-Aid General	Grants-in-Aid Upgradation	Debt Relief	Total Award (Share) 1/
Andhra Pradesh	384.41 (8.0)	873.53 (7.7)	5.68 (7.07)	-	19.60	135.63 (6.3)	1,522.49 (7.3)
Assam	120.84 (2.5)	316.94 (2.8)	2.00 (2.5)	-	21.71	112.20 (5.2)	518.65 (2.5)
Bihar	457.10 (9.5)	1,478.01 (13.0)	7.72 (9.5)	-	63.02	182.65 (8.5)	2,212.87 (10.6)
Gujarat	285.52 (6.0)	465.59 (4.1)	4.29 (5.3)	-	-	108.02 (5.0)	963.87 (4.6)
Haryana	87.16 (1.8)	133.56 (1.2)	1.60 (2.0)	-	-	38.29 (1.8)	308.57 (1.5)
Himachal Pradesh	28.51 (0.6)	59.12 (0.5)	0.11 (0.1)	207.07	7.74	30.37 (1.4)	325.07 (1.6)
Jammu and Kashmir	39.19 (0.8)	95.21 (0.8)	0.60 (0.7)	199.56	18.28	133.79 (6.2)	376.89 (1.8)
Karnataka	260.75 (5.4)	553.42 (4.9)	2.61 (3.2)	-	-	39.53 (1.8)	1,005.00 (4.8)
Kerala	189.26 (4.0)	457.98 (4.0)	2.12 (2.6)	-	4.18	115.09 (5.3)	770.34 (3.7)
Madhya Pradesh	352.46 (7.4)	990.29 (8.7)	4.75 (5.8)	-	63.58	147.34 (6.8)	1,597.46 (7.7)
Maharashtra	524.80 (11.0)	752.68 (6.6)	12.89 (15.9)	-	-	160.78 (7.5)	1,714.06 (8.2)
Manipur	9.01 (0.2)	24.74 (0.2)	-	146.32	9.95	11.85 (0.6)	194.03 (0.9)
Meghalaya	8.53 (0.2)	22.70 (0.2)	-	92.61	4.86	5.94 (0.3)	134.15 (0.6)
Nagaland	4.07 (0.1)	11.01 (0.1)	0.21 (0.3)	218.35	4.33	18.59 (0.9)	240.59 (1.2)
Orissa	179.15 (3.7)	531.29 (4.7)	1.41 (1.7)	136.92	32.26	96.48 (4.5)	984.45 (4.7)
Punjab	130.04 (2.7)	139.12 (1.2)	3.10 (3.8)	-	-	60.57 (2.8)	419.53 (2.0)
Rajasthan	209.10 (4.4)	546.15 (4.8)	4.45 (5.5)	-	19.30	137.98 (6.4)	902.81 (4.3)
Tamil Nadu	385.71 (8.1)	867.06 (7.6)	5.57 (6.9)	-	27.21	49.93 (2.3)	1,503.60 (7.2)
Tripura	12.36 (0.3)	42.33 (0.4)	3.25 (0.4)	136.57	3.61	10.55 (0.5)	199.84 (1.0)
Uttar Pradesh	739.26 (15.4)	2,075.79 (18.3)	15.10 (18.6)	-	112.02	367.63 (17.1)	3,314.74 (15.9)
West Bengal	384.17 (8.0)	910.97 (8.0)	7.03 (8.7)	-	24.52	191.93 (8.9)	1,597.11 (7.7)
Total Allocated	4,791.39	11,347.46	81.25 2/	1,173.12	436.80	2,155.80	20,842.97
% of total award:	23.0	54.0	0.4	5.6	2.0	10.3	100.0

Note: State shares for the excise tax on power (Rs. 1145 crores, total), additional excises (Rs 1867 crores estate duty (Rs 64 crores) were not provided separately in the report. The total includes the excise on power, additional excise, but not estate duty or the states' debt relief.

1/ Assistance to Sikkim is not shown separately; it is included in the total.

2/ Estimated at Rs 16.2 crores per annum, subject to revision. See para. 48.

Source: 7th Finance Commission Report.

APPENDIX I

IV. CENTER-STATE FINANCIAL FLOWS AND WORLD BANK LENDING

World Bank assistance has been provided for a wide range of purposes and projects in India. In recent years, virtually all the activities financed have been in the Central or State Plans. Since the beginning of 1970, approximately 55% and 33% of new Bank commitments have been for Center and State Plan projects, respectively. Program loans, the last of which was committed in 1977, made up another important category of Bank lending. Direct lending to borrowers, such as IFFCO Fertilizer, Trombay Power and ICICI, among others, makes up less than 12% of new commitments over the period. Financial flows between the Center and the States governed by the pattern of fiscal arrangements described in Section I, are involved in many of these types of lending, and the fiscal arrangements therefore have implications for the implementation and disbursement performance of Bank-financed projects. In the following paragraphs these flows and their implications for different types of Bank-assisted projects are discussed.

The importance of Center-State fiscal arrangements comes to the fore in Bank-financed State Plan schemes. When the Bank assists a project in the State Plan, the loan agreement is with the Central, not the State, government. Disbursements are also made to the Center, to be transferred to the State "in accordance with the standard arrangements for central assistance to the States for development". 1/ These standard arrangements have been discussed in Section I. In effect, aid disbursements did not go specifically to the recipient sponsoring State, but became part of the Center's total resource pool and are distributed amongst the States in accordance with their shares under the Gadgil formula. Thus, all States benefit from the participation of any State with the World Bank or any foreign assistance agency, since aid enlarges the pool of resources which the Center can distribute.

Under this arrangement, no problem of resource mobilization on the part of the States was perceived to exist, since the overall size of the State Plan had been negotiated at the Annual Plan discussions to be consistent with the State financial capacity, and this consistency between financial capacity and Plan size had nothing to do with the composition of Plan projects - only with the total outlay required for the Plan.

This line of reasoning notwithstanding, there are differences between Bank projects and other purely internally designed projects in the State Plan. There is the need for States to cooperate with the Bank in

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1/ The disbursements show up in the capital account of the Central government budget under "capital receipts". The reasons for this arrangement are that the States are constitutionally barred from direct foreign aid relations.

project preparation and implementation, the need for international bidding and the like. Bank timetables are strict and implementation delays or slippage are taken seriously, so that if there is a problem of local resource availability, diversion of project funds to other areas can carry serious consequences. Bank projects, moreover, often imply higher technical standards, more supervision and staffing. States may therefore not be keen on Bank projects, if these perceived extra costs are not compensated in some way. The indirect gains, from the increase in the divisible pool might be more attractive, leaving other States to incur the costs. "Additionality" was introduced in 1976 to compensate these costs, and to induce States to come forward with projects appropriate for Bank financing. 1/

The question which must be asked is how well "additionality" achieves this purpose. The additional resources for the States, on the assumption that the Bank finances 50% of project cost, are about 35% of project cost. There is little doubt that this level of additionality does improve quality, enable States to take advantage of Bank technical assistance, and improve design standards. If, however, avoidance of implementation delays due to local resource shortfalls is an objective, additionality may or may not be sufficient since the State is still responsible for 65% of project cost. However, the likelihood of financial shortfalls must be reduced, since additionality increases the States' resources over the Plan period and the likelihood is that implementation can therefore proceed quickly. The main difficulty is likely to be timing: the expenditure must be met by the States first, although they are eventually reimbursed 35%. The third purpose of additionality is to increase the attractiveness of Bank projects to the States. The mechanism through which this occurs is the reduction in the "price" to the States of Bank projects relative to the tax-price of internally financed Plan projects. While evaluating its impact on Plan projects is an uncertain exercise at best because of the fungibility of State revenues, for many Bank-financed projects, a case can be made for concluding that additionality does affect project selection in view of the fact that many Bank projects (especially in agriculture) differ considerably in nature and design from past State investments in the field.

Additionality changes the distribution of Central assistance among the States. States in which a large share of the Plan is financed by foreign aid will receive a larger share of resources than those whose Plans are assisted by the Center in the traditional manner. Moreover, this gain can only come at the expense of these other States for whom the divisible pool is reduced, and who will therefore receive less assistance than they would under the traditional manner of sharing. This aspect has worried some States who fear that they will be worse off. There are also fears that the system gives the Center additional influence through the choice of which projects to propose for Bank financing.

1/ As with all Central assistance to the States, additionally is provided on a 70% loan, 30% grant basis, on the terms prevailing for Central transfers at the time. The additional funds do not flow to the States on Bank or IDA terms.

Fiscal flows are also important in Bank-financed Centrally sponsored schemes. When the Bank assists a Centrally sponsored scheme, the loan agreement is again between the Bank and the Central government and disbursements are also made to the Center to be transferred to the States though the "normal procedures". The Central assistance given, in turn, to the States for these schemes may take the form of either loans or grants, may cover both capital and current expenditures and may finance the entire project or require a matching contribution from the States. In the budget, Centrally sponsored schemes show up as outlays of the Center, and as capital receipts and outlays of the States. In its role as a co-partner in these projects, the Center's handling of its intermediary function is important for the smooth implementation of projects. Under present arrangements Central assistance is initially disbursed to the States on a prorata basis, before the expenditures have been carried out. For later periods, funds are released on the basis of States' actual expenditures, with a final adjustment on receipt of audit certificates by the relevant Central Ministry. While this arrangement is intended to forestall early delays in project implementation, States maintain that outlays are often held up because of delays in authorizing disbursements. Thus, local resource availability can hinder project implementation even if the project is fully financed by the Center. Uncertainties may also arise for the States out of the fact that funds for Centrally sponsored schemes are sanctioned annually and not for the entire Plan period. Decisions to commit resources and personnel ideally require more lead time than the annual sanctions from the Center permit.

The Bank has financed many projects in the Central Plan--railways, telecommunications, rural electrification, and power projects--to name just a few. Such projects do not, in general, involve any fiscal flows between the two levels of government. When the Center assists a Central Plan project, whether the project is implemented by a government department, departmental undertaking or public undertaking, the Bank's loan agreement is directly with the Central Government, and the loan proceeds are disbursed to the Center also. From a budgetary point of view, the disbursements are entered as a capital receipt in the Center's budget, and the entire transaction takes place within the Central sphere. Because foreign assistance is fungible and the Bank may be financing a scheme which the Center would have implemented in any case, there may be some <u>indirect</u> flows to the States, but these cannot be estimated in any way.

<u>Program loans</u> were made directly to and disbursed to the Central Government and entered in the Center's budget as a revenue receipt. Earmarked for imports of specific industrial raw materials and components, program loans provided general budgetary support for the Government's overall program of foreign exchange expenditures, enabling higher levels of spending on Plan as well as non-Plan account. As with Central Plan schemes, little can be said about the relation of program loans to Center-State financial flows. As a result of the loosening of the Center's budgetary position, some of the resources may find their way to the States, and could be manifest through a higher level of Central assistance for State Plans or Centrally sponsored schemes. It is unlikely that it would induce greater assistance to the States

through revenue transfers, since these are fixed by the Finance Commissions for five years. In any case, the linkages are uncertain and cannot be estimated.

The last category of Bank loans is a small one, loans made directly to borrowing institutions, such as ICICI or IDBI. These loans are not contractually with the Government and are disbursed to the institutions themselves. Direct lending therefore, has no implications for Center-State transfers.

Appendix II

Recommendations of the Finance Commissions

Period of the Award:	(I) 1951-56	(II) 1956-60	(III) 1960-64	(IV) 1964-68	(V) 1968-73	(VI) 1973-79	(VII) 1979-84
Finance Commission Award: Tax Devolution							
Income Tax: % devolved to States distributed as:	55% 80% population, 20% collection	60% 90% population, 10% collection	66% 80% population, 20% collection	75% 80% population, 20% collection	75% 90% population, 20% collection	80% 90% population, 20% collection	85% 90% population, 20% collection
Excise Duties: % devolved to States distributed as:	40%, 3 commodities 100% population	25%, 8 commodities 90% population, 10% backwardness 1/	20%, 35 commodities Population and backwardness 2/ 3/	20%, all commodities 80% population, 20% backwardness 4/	20% all commodities 80% population, 20% backwardness 5/	20%, all commodities 75% population, 25% backwardness 6/	40%, all commodities 25% population, 25% 1/PC income, 25% poverty ratio; 25% revenue equalization
Additional Excise Duties: % devolved to States distributed as:		guarantead amount equivalent to collection of erstwhile State Sales tax on sugar, tobacco and textiles 7/	as earlier	as earlier	as earlier consumption; estimated as 50% population, 50% sales tax collections	as earlier consumption; estimated as 70% population, 10% production, 20% SDP	as earlier State consumption of textiles, tobacco and sugar estimated using 8/ State consumption data
Estate Duty: % devolved to States distributed as:	100% as income tax	100% 1% to union territories. Revenues from movable property distributed according to population; immovable property distributed in proportion to such property located in each State	100% as earlier	100% 2% for union territories; the balance as earlier	100% as earlier	100% 2.5% to union territories, balance as earlier	
Railway Passenger Fare Tax: % devolved distributed as:		100% route mileage in the State	Rs.12.65 crores grant, route mileage	Rs. 16.25 crores grant, route mileage	ad earlier	as earlier	Rs.16.25 crores grant distribution of passenger journeys originating in each State
Jute Export Duty: % devolved distributed as:	grant in lieu of shared export duties was given to jute producing States, for 10 years	as before	no further grants, 10 years completed	-	-	-	-
Finance Commission Award: Grants in aid and Loans							
Principles considered for recommending grants:	1. Budgetary needs and the revenue gap. 2. Help to States which faced additional burden due to partition. 3. Assistance to less developed States with special grants. 4. Grants for unforeseeable factors like relief works based on tax effort. Recommended grants for 10 States excepting Bombay, Madras and Uttar Pradesh.	1. Requirements of the States for development during Second Five Year Plan. 2. Provision for uncertain contingencies. 3. Ad hoc assistance for border policing and Assam for Naga disturbances. 4. Grants-in-aid for problems arising out of reorganisation of States. Recommended grants for 11 States excepting Bombay, Madras and Uttar Pradesh.	1. Fiscal Needs. Non-Plan programs. 2. Short-term and Long-term committed expenditures. 3. Development of social services and communication facilities. 4. Maintenance and upkeep of the existing plan projects. 5. 75 percent of the revenue component of the five year plan should be covered (but the Union Government did not accept this proposal). Recommended grants for the development of communication facilities Rs. 9 crores to 10 States. General grants for 14 States.	1. Did not make any specific grants. 2. Grants for debt servicing, keeping in view expenditure and economy. Recommended special grants for 6 States and general grants for 10 States.	1. Did not favour specific grants. 2. States' needs on revenue account. 3. The interest charges on their debt and the maintenance and upkeep of Plan schemes completed by 68-69. 4. Fiscal management. 5. Special problems of certain States. 6. Provision for amortization or repayment of debt including fresh borrowing from 1969-70 to 1973-74. Recommended grants for 10 States.	1. Grants for maintenance and upkeep of Plan schemes completed by 1973-74. 2. Interest charges in respect of debt. 3. The requirements of certain States to upgrade general administration. 4. Closing budgetary gaps. 5. Specific grants for social services and to reduce regional disparities. Recommended general grants for 19 States.	1. Grants for improvement of administrative infrastructure. 2. Relief expenditure, if necessary. 3. Closing budgetary gaps.

1/ No index specified.
2/ No weights specified.
3/ Comprised of: % scheduled castes, population per hospital bed, value addad in manufacturing, gross value of agricultural production, ratio of workers to rural population, ratio of enrollments in grades I - V to population in age group 6 - 11 and percentage of urban to rural population.
4/ Comprised of different factors from IV Commission and includes: scheduled tribes'population, factory workers per 1,000,000,net irrigated area per cultivatior,railways and roads per 100 k^2, school children relative to children of school going age and hospital beds per 1000.
5/ Composed of hospital beds per 1000, scheduled tribes population, transportation network, irrigated areas and school children relative to children of schoolgoing age.
6/ Backwardness was defined in relative terms as: $(Y_{punjab} - Y_i)$, The difference between a state's per capita income and the per capita income of the richest State, Punjab.
7/ Taken over by the Center in 1957.
8/ See para 104.
Source: S. Venu, the Finance Commission of India.

Summary of Major Recommendations, Seventh Finance Commission

Income Taxes (Article 270)

The Seventh Finance Commission has recommended that the States' share of the income tax (excluding corporation tax, union surcharge and the agricultural income tax) should be increased. The Union Territories' share in the net proceeds will be raised from 1.79% to 2.19%, and 85% of the balance rather than the present 80% will be devolved to the States. The formula for distributing the proceeds among the States will remain as before: 90% on the basis of (1971) population and 10% on the basis of state-wise net assessments from 1972/73-1976/77. In their memoranda to the Commission, many States had argued that the corporate income tax 1/ and union surcharges on the personal income tax 2/ be included in the divisible pool (both are retained by the Center at present), since they were held to be the most buoyant components of the income tax. 3/ The Commission refrained from suggesting anything on this debate but conceded that the States were justified in requesting an increase in the divisible pool, in view of the Center's recent move to increase the union surcharge from 10% to 15%.

Excise Taxes (Article 272)

The Commission has doubled the proportion of excise duties shared with the States, from 20% of the net proceeds to 40%. The distribution among the States has also been changed quite radically; the Sixth Commission continued with tradition in allocating the proceeds 75% on the basis of population, 25% on an index of backwardness. 4/ The Seventh has put far greater emphasis on inter-state inequalities in its distribution formula, in which four factors are equally weighted: population, 1/per capita SDP, the

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1/ This was shareable under the income tax until 1959, when it was reclassified separately.

2/ Introduced in the early 1960's.

3/ The greater buoyancy derives from the more progressive effective rates of taxation under the latter two taxes when the effect of exemptions under the personal income tax is taken into account.

4/ $(Y_i - Y_{max})\ Pop_i$, where Y_i is per capita income of State i and Y_{max} is the per capita income of the richest State, Punjab.

poverty ratio 1/ and revenue equalization. 2/ This last weight acknowledges that some States have a low revenue potential, not for poor tax effort, but because of their very low per capita income.

A dissenting note by Raj Krishna contained an alternative formula and proposed that both income and excise taxes be distributed on a different basis. The Krishna formula makes the share of each State a function of population, the poverty ratio and 1/per capita income. This represents the "income adjusted poverty population." The formula is more progressive than the majority formula.

The Commission's final note on the excise tax issue is its concurrence with the Center's decision to return the entire net proceeds of the recently imposed 1977/78 excise duty on electricity generation to the States in the proportion in which it was collected. While this answers the States' concerns with regard to the revenue pre-empted by the Center, it does not change the fact that the States have lost a tax-source of their own. They will be unable to change the tax rate and may also have difficulties in re-setting tariffs should the Center pre-empt a rate increase by a tax increase. 3/

Additional Excises

The Commission was also asked to determine the principles on which the additional duties of excise, levied since 1956 in lieu of erstwhile state sales taxes on the same articles, should be shared. 4/ The Seventh Finance Commission agreed with the earlier Commissions that the appropriate basis for distribution of the revenues is consumption: Unfortunately, the 27th round of

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1/ The formula is: Percentage of people below a specified level of per capita income (adjusted for public expenditure) in a State as a percentage of such people in all States.

2/ The formula is: $(Rev_i - Rev_{max}) Pop_i$, where Rev_i is the norm per capita revenue for the State given its per capita income (the norm is based on a regression of tax revenue on per capita income) and Punjab has the maximum per capita revenue.

3/ This begs the question of what electricity tariffs should be, and states' willingness to apply them.

4/ The proviso that the states' share must be no less than what they realized from these taxes in 1956/57 when the taxes were taken over by the Center has not been a constraint on any Commission since the third, because of the buoyancy of these revenues.

NSS data on consumption of the taxed articles -- textiles, tobacco and sugar -- was found to be inadequate by both the Sixth and the Seventh Commissions. The Sixth Commission had recommended a sharing formula based on an index representing a proxy for consumption in which the weights were population (weighted 70%), SDP (20%) and in-state production of the three articles (10%). The Seventh Commission attempted to approximate consumption differently. For sugar the States' shares in the excise is to be based on average dispatches of sugar to each state over the three years ending 1976/77. Consumption of textiles and tobacco was estimated on the basis of per capita income scaled for State population, 1/ on the assumption that consumption of those two items is highly income elastic and that differences per capita income adequately represent the amounts consumed. The Union Territories receive 3.27% and 2.19%, respectively of the net proceeds, of these taxes.

There are two types of grants-in-aid derived from taxes levied and collected by the Center and wholly returned to the States as grants-in-aid (Article 269). The first of these is the grant in lieu of railway passenger fare tax, an erstwhile State tax taken over by the Center and merged with the basic fares in 1961. The principle on which this grant is distributed is meant to assure the States of what they would have earned were the tax still theirs to levy. In the past this meant State shares based on route length falling within each state. 2/ The Seventh Commission has instead made tax shares proportional to the earnings from traffic originating in each State, since the tax was collected at source and was a percentage of the fare, so that own-earnings would have been a function of tickets sold, rather than travel undertaken in each State.

The quantum of this grant is determined by the Railway Committee, and has been Rs 16.25 crores since 1966. The Seventh Commission has estimated that, had the tax been continued in the original form, Rs 63.22 crores would have been earned, and recommends that the government refer the issue of earnings, subject to the profitability and social obligations of Indian Railways to the Railway Convention Committee.

Agricultural property was included in the wealth tax in 1970/71 and the net proceeds have, from the beginning, been passed on to the states as grants-in-aid. The Sixth Commission recommended that tax shares should be proportional to the value of agricultural land located in each State and assessed in each year. In practice, however, because compilation of location

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1/ Average per capita income for the three years ending 1975/76, and population based on the 1971 census.

2/ (Route length in each State as a % of the total) x (total non-surburban traffic earnings) was the formula used by the Sixth Commission.

statistics would have been very burdensome, tax shares were based on the value of agricultural land assessed in each State. 1/ The Seventh Commission, taking cognizance of these complexities, and in view of the very small amounts involved, 2/ has recommended that the tax be distributed so that each State receives an amount equal to the net collection of the tax in the State.

The estate duties on non-agricultural land (Article 269) are also collected and levied by the Center and wholly transferred back to the States. Since the Second Commission, the principle governing distribution of immovable property has been the location of assessed property; for movable property population was used as the basis for distribution. As with the agricultural wealth tax, in practice, distribution of estate duty on immovable property has been on the basis of assessments rather than property located in each State. The Seventh Commission has recommended that adequate data be collected on the location of both movable and immovable property assessed in each year and that the net proceeds of estate duties be distributed accordingly. While recognizing that collecting such data might involve costs and administration difficulties, these should not be allowed to frustrate the principle that the States should get from this tax what they would have obtained had they had the power to levy and collect it themselves.

Other Recommendations

The remainder of the award to the States consists of grants-in-aid. The Seventh Finance Commission has enunciated three objectives for grants-in-aid: (i) to cover the fiscal gaps which are left after devolution to permit expenditure for the level of services specified in their revenue forecasts; (ii) to narrow inter-state disparities; and (iii) to deal with matters of national concern or with the special burdens of some States. Grants-in-aid under the Seventh Commission's award will be Rs 1,173 crores (excluding upgradation grants), much less than the Rs 2,509 crores of the Sixth Commission since all but eight backward States have surpluses totalling Rs 13,582 crores, and will not need grants.

Fiscal Gaps

The States' fiscal gaps for the period are estimated by projecting the States' revenues and expenditures, including tax-sharing and other

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1/ From 1970/71-1973/74, the distribution was on the basis of population, in the absence of even assessment statistics.

2/ Note that because amounts involved are larger, the same formula is not used for the estate duty in para 122.

devolutions. The manner in which revenues and expenditures are projected is therefore crucially important as regards the amount the States receive as grants from the Finance Commission. The following paragraphs review briefly, the substantive changes made by the Seventh Commission in this sphere.

A. Projection of Revenues

(i) Tax revenues were estimated in most cases using the elasticities of each revenue source with respect to GDP. 1/ Partial elasticities were also calculated with respect to prices and real GDP. This is an entirely new procedure; past Commissions had projected tax revenues on the basis of extrapolation of past growth trends.

(ii) Revenues from the excise tax on liquor were assumed to remain constant at the 1978/79 level. To this was added 50% of the difference between revenues in 1978/79 and 1977/78, where the latter is less, representing government compensation for prohibition losses.

(iii) Non-tax revenues were projected to grow at a flat 5%, unless a convincing case was made by a State that it should be otherwise.

(iv) The assumptions made about the additional resource mobilization which can be expected from tax and non-tax sources and state enterprises were based on the Planning Commission's targets, adjusted for the States' performance against such targets from 1974/75-1977/78. This formula ensures that states which exceed targets are not penalized and States which fail to fulfill them are not benefitted. The Planning Commission's target for 1974/75-1978/79 was Rs 327 crores. 2/ The States on balance, had achieved 94.9% of the targets, and additional resource mobilization set by the Finance Commission was Rs 310 crores. Although 14 states fell short of this target in their own projections of additional resource mobilization, the target was, nonetheless incorporated into projected revenue receipts for the forecast period.

B. Expenditures

(i) In the interest of restraining States' non-plan expenditures generally, the Seventh Commission projected most items of expenditure to grow at 5% wherever the States' projections were higher. Exceptions were

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1/ There are some exceptions: taxes on electricity tariff were based on electricity sales and sugarcane revenues were estimated to grow at between 3-4%, land revenues were also estimated separately.

2/ Rs 452 crores was the original target which was reduced by Rs 125 crores on account of electricity duty.

made for Treasury and Accounts Administration where 6-8% of growth was allowed, and for fire services and police where 6% and 6.5%, respectively, were allowed.

(ii) Among non-Plan developmental expenditures, education expenditures allowed to grow at 6-7% depending on the State, medical and hospital costs are also allowed to grow above the norm.

(iii) The Commission also established norms for pension payments and grants to local bodies (2% p.a.), while disallowing States' expenditures on unemployment, relief payments and food subsidies as properly belonging in the Plan sphere.

(iv) The expenditure on maintenance of Plan schemes completed by 1978/79 which becomes "committed" expenditure was accepted at the levels projected by the States.

(v) Debt Service . Interest payment liabilities projected by the States were verified with the Accountants General. The Commission did not include future interest payments due on additional loans likely to be incurred over the period 1979/80-1973/84 (other than the interest liability on Provident Fund accretions). Payments into sinking funds for reduction of debt are also not, in general, allowable.

(vi) The norms allowed in revenue expenditure projections for maintenance of capital assets were revised upwards.

(vii) State Undertakings. For the Electricity Boards, a rate of return of 6% on capital invested is assumed. For road transport undertakings rate of return ranging from 2% - 6.5% are assumed for most states excepting the hill states and West Bengal which are expected to cover operating expenses plus depreciation. For State cooperatives and public enterprises, 5% is the norm to be earned on capital invested in them by 1983/84.

These items provided the basis for the Seventh Commission's re-estimated, re-assessed forecasts on revenue account. The resulting balance assumes better fiscal management on the part of most States than has been evident in the past, especially in matters such as collection of government dues and improved performance and higher returns in departmental undertakings and public enterprises. On the other hand, emoluments for public employees and relief expenditures have been dealth with quite liberally. The reestimated revenue gap shows a pre-devolution projected net deficit of Rs 6,823 crores. This is smaller in real terms than the Rs 6,594 crore deficit estimated by the Sixth Commission.

The Finance Commission has also, for the first time, scrutinized the accounts of the Central government. Revenue receipts were estimated to be Rs 80,126 crores over the quinquennium, of which income tax and excise

taxes would yield Rs 7,192 and 32,607 crores respectively. In the latter case, a higher rate of growth (7%) was assumed than in Center's own projections. The Rs 80,126 crores total also incorporated higher growth rates for corporation tax (9%) and for customs duties (7%). When these changes and reassessment of certain expenditure items are taken into account, there is an overall improvement in the Center's resource position of Rs 4,626 crores.

Centrally Sponsored Schemes in the Fifth Five-Year Plan

Department/Name of Scheme

AGRICULTURE AND ALLIED SECTORS

Directorate of Extension

1. Farmers' Training & Education in Districts (Contg.)
2. Strengthening of Extension machinery in the States (New).
3. Adaptive Research/Trials in the States (New).

Agricultural Statistics

4. Timely reporting of area and yield of principal crops.
5. Establishment of an agency for reporting agricultural statistics in Kerala, Orissa and West Bengal.

Agricultural Inputs

A. Fertilizers

6. Pilot Project for amendment of alkali and acid soils in compact areas (new).
7. Development arrangement for quality control of inputs.
8. Fertilizer promotion in selected districts (new schemes since 78-79).

B. Plant Protection

9. Eradication of pest and diseases in endemic areas (Contg.)
10. Sub-scheme for pests of national importance (New).
11. Project for weed control (New).

C. Agricultural Implements

12. Introduction and popularization of improved agricultural implements (new scheme for 1978/79).

Crop Oriented Programs

13. Intensive Cotton District Program.
14. Intensive Jute District Program.
15. (a) Intensive Oilseeds Development Program.
    (b) Extension of Oilseeds in irrigated areas.
    (c) Sunflower Development.
    (d) Soybean Development.

16. Development of sugarcane.
17. Development of sugarbeet.
18. Development of VFC tobacco.
19. Package program on coconut.
20. Package program on spices.
21. Package program on cashewnut.
22. Development of Horticulture.
23. Intensive Pulses District program.
24. Integrated Dry Land Farming Projects.

Minor Irrigation

25. Strengthening of ground and surface water (MI) Organizations in States.

Soil and Water Conservation

26. Soil and water conservation in the Catchments of river-valley Project.

Forestry

27. Mixed Plantations in Wastelands, Panchayat Lands and Forest Areas.
28. Development of Social Forestry including Reforestation of Degraded Forests.
29. Integrated Soil & Water Conservation Scheme in Himalayan Region.

Animal Husbandry

30. Rinderpest Eradication Scheme.
31. Large Sheep breeding fams.
32. Progeny testing units.
33. Expansion and strengthening of State biological products stations.
34. Assistance to SF/MF/AL for rearing of crossbred heifers.
35. Foot & Mouth Disease Control.
36. Strengthening of A.H. Statistics in States.
37. Central contribution to sheep * wool development corporations.
38. Exotic cattle breeding farms.
39. Grassland development in States.
40. Development of fodder in States.
41. All-India coordinated poultry breeding program.
42. Pilot base farm for goats with extension facilities.
43. Setting up of village clusters of sheep at existing sheep farms.
44. Carcass utilization scheme.
45. Expansion of camel breeding farm, Bikaner.

Fisheries

46. Provision for landing and berthing facilities for fishing crafts at Minor Ports.
47. Development of infrastructural facilities for coastal fishing villages.

Cooperation

48. Agricultural Credit Stabilization Fund (R.D.)
49. Provision of Margin money to coops, for raising bank finance for fertilizer distribution (C.S. & Coop.)
50. Development of consumer coops (C.S. & Coop.)
51. Assistance for rural consumer coops. (C.S. & Coop.)

FAMILY WELFARE PROGRAMS

52. Family Welfare Program.

HEALTH SECTOR

53. N.M.E.P. (Rural)
54. N.M.E.P. (Urban)
55. Small Pox
56. Leprosy
57. T.B.
58. V.D.
59. Cholera
60. Prevention of Blindness including Trachoma
61. Filaria
62. Training of Physiotherapists
63. Training and Employment of Multi-purpose workers
64. Assistance to Post-graduate Dept. in Indian System of Medicines.
65. Establishment of ISM Pharmacies etc.
66. School Health
67. Combines food and drug labs.
68. Est. of Psychiatric Clinics
69. Re-orientations of Medical education

Nutrition

71. Applied Nutrition Program

Rural Water Supply Program

72. Rural Water Supply Program

EDUCATION

73. Appointment of Hindu teachers in Non-Hindi Speaking States
74. Opening of Hindi Teachers training Colleges in non-Hindi Speaking States
75. Book Production at University level in Hindi & Regional Languages
76. Development of Sanskrit
77. Post-Graduate Engg. education and Research
78. Improvement of Polytechnics and Regional Engg. Colleges

POWER

79. Inter-State/Regional Transmission lines

VILLAGE & SMALL INDUSTRIES

80. Rural Industries Program
81. Collection of Statistics

SOCIAL WELFARE

82. Services for children need of care and protection
83. Integrated child Dev. Services
84. Special Nutrition Program
85. Welfare of Destitute women and children
86. Integrated Education
87. Placement of handicapped

DEVELOPMENT OF BACKWARD CLASSES

88. Post Matric Scholarships
89. Girls Hostel
90. Coaching and Allied Schemes
91. Research and Training
92. Machinery for Implementation of Civil Rights Acts
93. Tribal Development Blocks
94. Co-operation
95. Aid to voluntary Organizations
96. Book banks for Medical & Engineering students
97. New schemes for development of scheduled Castes

TRANSPORT

98. Inland Water transport
99. Loans to State Govts. for Developing Roads

100. Loans for Purchase of machinery for execution of Central Road Works
101. Minor Ports
102. Bridges of National Importance

LABOR WELFARE AND CRAFTMEN TRAINING

103. Rehabilitation of Bonded Labor

SEVENTH SCHEDULE OF THE INDIAN CONSTITUTION

(Article 246)

LIST I. UNION LIST

1. Defence of India and every part thereof including preparation for defence and all such acts as may be conducive in times of war to its prosecution and ater its termination to effective demobilization.

2. Naval, military and air forces: any other armed forces of the Union.

3. Delimitation of cantonment areas, local self-government in such areas, the constitution and powers within such areas of cantonment authorities and the regulation of hose accommodation (including the control of rents) in such areas.

4. Naval, military and air force works.

5. Arms, firarms, ammunition and explosives.

6. Atomic energy and mineral resources necessary for its production.

7. Industries declared by Parliament by law to be necessary for the purpose of defence or for the prosecution of war.

8. Central Bureau of Intelligence and Investigation.

9. Preventive detention for reasons connected with Defense, Foreign Affairs, or the security of India; persons subjected to such detention.

10. Foreign Affairs; all matters which bring the Union into relation with any foreign country.

11. Diplomatic, consular and trade representation.

12. United Nations Organization.

13. Participation in international conferences, associations and other bodies and implementing of decisions made thereat.

14. Entering into treaties and agreements with foreign countries and implementing of treaties, agreements and conventions with foreign countries.

15. War and peace.

16. Foreign jurisdiction.

17. Citizenship, naturalization and aliens.

18. Extradition.

19. Admission into, and emigration and expulsion from India; passports and visas.

20. Pilgrimage to places outside India.

21. Piracies and crimes committed on the high seas or in the air; offenses against the law of nations committed on land or the high seas or in the air.

22. Railways.

23. Highways declared by or under law made by Parliament to be national highways.

24. Shipping and navigation on inland waterways, declared by Parliament by law to be national waterways, as regards mechanically propelled vessels; the rule of the road on such waterways.

25. Maritime shipping and navigation, including shipping and navigation on tidal waters; provision of education and training for the mercantile marine and regulation of such education and training provided by States and other agencies.

26. Lighthouses, including lightships, beacons and other provision for the safety of shipping and aircraft.

27. Ports declared by or under law made by Parliament or existing law to be major ports, including their delimitation, and the constitution and powers of port authorities therein.

28. Port quarantine, including hospitals connected therewith, seamen's and marine hospitals.

29. Airways; aircraft and air navigation; provision of aerodromes; regulation and organization of air traffic and of aerodromes; provision for aeronautical education and training and regulation of such education and training provided by States and other agencies.

30. Carriage of passengers and goods by railway, sea or air, or by national waterways in mechanically propelled vessels.

31. Posts and telegraphs; telephones, wireless, broadcasting and other linke forms of communication.

32. Property of the Union and the revenue therefrom, but as regards property situated in a State subject to legislation by the State, save in so far as Parliament by law otherwise provides.

33. Omitted.

34. Courts of wards for the estates of Rulers of Indian States.

35. Public debt of the Union.

36. Currency, coinage and legal tender; foreign exchange.

37. Foreign loans.

38. Reserve Bank of India.

39. Post Office Savings Bank.

40. Lotteries organized by the Government of India or the Government of a State.

41. Trade and commerce with foreign countries; import and export across customs frontiers; definition of customs frontiers.

42. Inter-State trade and commerce.

43. Incorporation, regulation and winding up of trading corporations, including banking, insurance and financial corporations but not including co-operative societies.

44. Incorporation, regulation and winding up of corporations, whether trading or not, with objects not confined to one State, but not including universities.

45. Banking.

46. Bills of exchange, cheques, promissory notes and other like investments.

47. Insurance.

48. Stock exchanges and future markets.

49. Patents, inventions and designs; copyright; trademarks and merchandise marks.

50. Establishment of standards of quality for goods to be exported out of India or transported from one State to another.

52. Industries, the control of which by the Union is declared by Parliament by law to be expedient in the public interest.

53. Regulation and development of oilfields and mineral oil resources; petroleum and petroleum products; other liquids and substances declared by Parliament by law to be dangerously inflammable.

54. Regulation of mines and mineral development to the extent to which such regulation and development under the control of the Union is declared by Parliament by law to be expedient in the public interest.

55. Regulation of labour and safety in mines and oilfields.

56. Regulation and development of inter-State rivers and river valleys to the extent to which such regulation and development under the control of the Union is declared by Parliament by law to be expedient in the public interest.

57. Fishing and fisheries beyond territorial waters.

58. Manufacture, supply and distribution of salt by Union agencies; regulation and control of manufacture, supply and distribution of salt by other agencies.

59. Cultivation, manufacture, and sale for export, of opium.

60. Sanctioning of cinematograph films for exhibition.

61. Industrial disputes concerning Union employees.

62. The institution known at the commencement of this Constitution as the National Library, the Indian Museum, the Imperial War Museum, the Victoria Memorial and the Indian War Memorial, and any other like institution financed by the Government of India wholly or in part declared by Parliament by law to be an institution of national importance.

63. The institutions known at the commencement of this Constitution as the Benares Hindu University, the Aligarh Muslum University and the Delhi University, and any other institution declared by Parliament by law to be an institution of national importance.

64. Institutions for scientific or technical education financed by the Government of India wholly or in part and declared by Parliament by law to be institutions of national importance.

65. Union agencies and institutions for-

(a) professional, covational or technical training, including the training of police officers; or

(b) the promotion of special studies or research; or

(c) scientific or technical assistance in the investigation or detection of crime.

66. Coordination and determination of standards in institutions for higher education or research and scientific and technical institutions.

67. Ancient and historical monuments and records, and archaeological sites and remains, declared by or under law made by parliament to be of national importance.

68. The Survey of India, the Geological, Botanical, Zoological and Anthropological Surveys of India: Meteorological organizations.

69. Census.

70. Union public services; all-India services; Union Public Service Commission.

71. Union pensions, that is to say, pensions payable by the Government of India or out of the Consolidated Fund of India.

72. Elections to Parliament, to the Legislatures of States and to the offices of President and Vice-President; the Election Commission.

73. Salaries and allowances of members of Parliament, the Chairman and Deputy Chairman of the Council of States and the Speaker and Deputy Speaker of the House of the People.

74. Powers, privileges and immunities of each House of Parliament and of the members and the committees of each House; enforcement of attendance of persons for giving evidence or producing documents before committees of Parliament or commissions appointed by Parliament.

75. Emoluments, allowances, privileges, and rights in respect of leave of absence, of the President and Governors; salaries and allowances, and rights in respect of leave of absence and other conditions of service of the Comptroller and auditor-General.

76. Audit of the accounts of the Union and the States.

77. Constitution, organization, jurisdiction and powers of the Supreme Court (including contempt of such Court), and the fees taken therein; persons entitled to practise before the Supreme Court.

78. Constitution and organization (including vacations) of the High Courts except provisions as to officers and servants of High Courts; persons entitled to practise before the High Courts.

79. Extension of the jurisdiction of a High Court and exclusion of the jurisdiction of any such High Court from, any Union territory.

80. Extension of the powers and jurisdiction of members of a police force belonging to any State to any area outside that State, but not so as to enable the police of one State to exercise powers and jurisdiction in any area outside that State without the consent of the Government of the State in which such area is situated; extension of the powers and jurisdiction of memebrs of a police force belonging to any State to railway areas outside that State.

81. Inter-State migration; inter-State quarantine.

82. Taxes on income other than agricultural income.

83. Duties of customs including exports duties.

84. Duties of excise on tobacco and other goods manufactured or produced in India except.

(a) alcoholic liquors for human consumption;

(b) opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.

85. Corporation tax.

86. Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies.

87. Estate duty in respect of property other than agricultural land.

88. Duties in respect of succession to property other than agricultural land.

89. Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freights.

90. Taxes other than stamp duties on transactions in stock exchanges and future markets.

91. Rates of stamp duty in respect of bills of exchange, cheques, promisory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.

92. Taxes on the sale or purchase of newspapers and on advertisements published therein.

92A. Taxes on the sale or purchase of goods other than newspapers where such sale or purchase takes place in the course of inter-State trade or commerce.

93. Offences against laws with respect to any of the matters in this List.

94. Inquiries, surveys and statistics for the purpose of any of the matters in this List.

95. Jurisdiction and powers of all courts, except the Supreme Court, with respect to any of the matters in this List; admiralty jurisdiction.

96. Fees in respect of any of the matters in this List, but not including fees taken in any court.

97. Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists.

LIST II. STATE LIST

1. Public order (but not including the use of naval, military or air forces or any other armed forces of the Union in aid of the civil power).

2. Police, including railway and village police.

3. Administration of justice; constitution and organization of all courts, except the Supreme Court and the High Court; officers and servants of the High Court; procedure in rent and revenue courts; fees taken in all courts except the Supreme Court.

4. Prisons, reformatories, Borstal institutions and other institutions of a like nature, and persons detained therein; arrangements with other States for the use of prisons and other institutions.

5. Local government, that is to say, the constitution and powers of municipal corporations, improvement trusts, district boards, mining settlement authorities for the purpose of local self-government or village administration.

6. Public health and sanitation; hospitals and dispensaries.

7. Pilgrimages, other than pilgrimages to places outside India.

8. Intoxicating liquors, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors.

9. Relief of the disabled and unemployable.

10. Burials and burial grounds; cremations and cremation grounds.

11. Education including universities, subject to the provisions of entries 63, 64, 65 and 66 of List I and entry 25 of List III.

12. Libraries, museums and other similar institutions controlled or financed by the State; ancient and historical monuments and records other than those declared by or under law made by Parliament to be of national importance.

13. Communications, that is to say, roads, bridges, ferries, and other means of communication not specified in List I; municipal tramways; ropeways; inland waterways and traffic thereon subject to the provisions of List I and List III with regard to such waterways; vehicles other than mechanically propelled vehicles.

14. Agriculture, including agricultural education and research protection against pests and prevention of plant diseases.

15. Preservation, protection and improvement of stock and prevention of animal diseases; veterinary training and practice.

16. Pounds and the prevention of cattle trespass.

17. Water, that is to say, water supplies, irrigation and canals, drainage and embankments, water storage and water power subject to the provisions of entry 56 of List I.

18. Land, that is to say, rights in or over land, land tenures including the relation of landlord and tenant, and the collection of rents; and agricultural loans; colonization.

19. Forests.

20. Protectin of wild animals and birds.

21. Fisheries.

22. Courts of wards subject to the provisions of entry 34 of List I; encumbered and attached estates.

23. Regulations of mines and mineral development subject to the provisions of List I with respect to regulation and development under the control of the Union.

24. Industries subject to the provisions of entries 7 and 52 of List I.

25. Gas and gas works.

26. Trade and commerce within the State subject to the provisions of entry 33 of List III.

27. Production, supply and distribution of goods subject to the provisions of entry 33 of List III.

28. Markets and fairs.

29. Weights and measures except establishment of standards.

30. Money-lending and money-lenders, relief of agricultural indebtedness.

31. Inns and inn-keepers.

32. Incorporation, regulation and winding up of corporations, other than those specified in List I, and universities; unincorporated trading, literary, scientific, religious and other societies and associations; cooperative societies.

33. Theatres and dramatic performances; cinemas subject to the provisions of entry 60 of List I; sports, entertainments and amusements.

34. Betting and gambling.

35. Works, lands and buildings vested in or in the possession of the State.

36. Omitted.

37. Elections to the Legislature of the State subject to the provisions of any law made by Parliament.

38. Salaries and allowances of members of the Legislature of the State of the Speaker and Deputy Speaker of the Legislative Assembly and, if there is a Legislative Council, of the Chairman and Deputy Chairman thereof.

39. Powers, privileges and immunities of the Legislative Assembly and of the members and the committees thereof, and, if there is a Legislative Council of that Council and of the members and the committees therefore: enforcement of attendance of persons for giving evidence or producing documents before committees of the Legislature of the State.

40. Salaries and allowances of Ministers for the State.

41. State public services: State Public Service Commission.

42. State pensions, that is to say, pensions payable by the State or out of the Consolidated Fund of the State.

43. Public Debt of the State.

44. Treasure Trove.

45. Land revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records of rights, and alienation of revenues.

46. Taxes on agricultural income.

47. Duties in respect of succession to agricultural land.

48. Estate duty in respect of agricultural land.

49. Taxes on lands and buildings.

50. Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development.

51. Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India -

(a) alcoholic liquors for human consumption;

(b) opium, Indian hemp and other narcotic drugs and narcotics; but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.

52. Taxes on the entry of goods into a local area for consumption, use or sale therein.

53. Taxes on the consumption or sale of electricity.

54. Taxes on the sale of purchase of goods other than newspapers, subject to the provisions of entry 92A of List I.

55. Taxes on advertisements other than advertisements published in the newspapers.

56. Taxes on goods and passengers carried by road or on inland waterways.

57. Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads, including tramcars subject to the provision of entry 35 of List III.

58. Taxes on animals and boats.

59. Tolls.

60. Taxes on professions, trades, callings and employments.

61. Capitation taxes.

62. Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.

63. Rates of stamp duty in respect of documents other than those specified in the provision of List I with regard to rates of stamp duty.

64. Offences against laws with respect to any of the matters in this List.

65. Jurisdiction and powers of all courts, except the Supreme Court, with respect to any of the matters in this List.

66. Fees in respect of any of the matters in this List, but not including fees taken in any court.

LIST III. CONCURRENT LIST

1. Criminal law, including all matters included in the Indian Penal Code at the commencement of this Constitution but excluding offences against laws with respect to any of the matters specified in List I or List II and excluding the use of naval, military or air forces or any other armed forces of the Union in aid of the civil power.

2. Criminal procedure, including all matters included in the Code of Criminal Procedure at the commencement of this Constitution.

3. Preventive detention for reasons connected with the security of a State, the maintenance of public order, or the maintenance of supplies and services essential to the community; persons subjected to such detention.

4. Removal from one State to another State of prisoners, accused persons and persons subjected to preventive detention for reasons specified in entry 3 of this List.

5. Marriage and divorce; infants and minors; adoption: wills, intestacy and succession; joint family and partition; all matters in respect of which parties in judiial proceedings were immediately before the commencement of this Constitution subject to their personal law.

6. Transfer of property other than agricultural land; registration of deeds and documents.

7. Contracts, including partnership, agency, contracts of carriage, and other special forms of cointracts, but not including contracts relating to agricultural land.

8. Actionable wrongs.

9. Bankruptcy and insolvency.

10. Trust and Trustees.

11. Administrators-General and official trustees.

12. Evidence and oaths; recognition of laws, public acts and records, and judicial proceedings.

13. Civil procedure, including all matters included in the Code of Civil Procedure at the commencement of this Constitution, limitation and arbitration.

14. Contempt of court, but not including contempt of the Supreme Court.

15. Vagrancy, nomadic and migratory tribes.

16. Lunacy and mental deficiency, including places for the reception or treatment of lunatics and mental deficients.

17. Prevention of cruelty to animals.

18. Adulteration of foodstuffs and other goods.

19. Drugs and poisons, subject to the provisions of entry 59 of List I with respect to opium.

20. Economic and social planning.

21. Commercial and industrial monopolies, combines and trusts.

22. Trade Unions, industrial and labor disputes.

23. Social security and social insurance; employment and unemployment.

24. Welfare of labor including conditions of work, provident funds, employers' liability, workmen's compensation, invalidity and old age pensions and maternity benefits.

25. Vocational and technical training of labor.

26. Legal, medical and other professions.

27. Relief and rehabilitation of persons displaced from their original place of residence by reason of the setting up of the Dominions of India and Pakistan.

28. Charities and charitable institutions, charitable and religious endowments and religious institutions.

29. Prevention of the extension from one State to another of infectious or contagious diseases or pests affecting men, animals or plants.

30. Vital statistics including registration of births and deaths.

31. Ports other than those declared by or under law made by Parliament or existing law to be major ports.

32. Shipping and navigation on inland waterways as regards mechanically propelled vessels, and the rule of the road on such waterways, and the carriage of passengers and goods on inland waterways subject to the provision of List I with respect to national waterways.

33. Trade and Commerce in and the production, supply and distribution of -

(a) the products of any industry where the control of such industry by the Union is declared by Parliament by law to be expedient in the public interest, and imported goods of the same kind as such products;

(b) foodstuffs, including edible oil-seeds and oils;

(c) cattle fodder, including oil-cakes and other concentrates;

(d) raw cotton, whether ginned or un-ginned, and cotton seed; and

(e) raw jute.

34. Price control.

35. Mechanically propelled vehicles including the principles on which taxes on such vehicles are to be levied.

36. Factories.

37. Boilers.

38. Electricity.

39. Newspapers, books and printing presses.

40. Archaeological sites and remains other than those declared by or under law made by Parliament to be of national importance.

41. Custody, management and disposal of property (including agricultural land) declared by law to be ..... property.

42. Acquisition and requisitioning of property.

43. Recovery in a State of claims in respect of taxes and other public demands, including arrears of land-revenue and sums recoverable as such arrears arising outside that State.

44. Stamps duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty.

45. Inquiries and statistics for the purposes of any of the matters specified in List II or List III.

46. Jurisdiction and powers of all courts, except in Supreme Court, with respect to any of the matters in this List.

47. Fees in respect of any of the matters in this List, but not including fees taken in any court.

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The World Bank
Headquarters:
1818 H Street, N.W.
Washington, D.C. 20433, U.S.A.

Telephone: (202) 477-1234
Telex: WUI 64145 WORLDBANK
RCA 248423 WORLDBK
Cable address: INTBAFRAD
WASHINGTONDC

European Office:
66, avenue d'Iéna
75116 Paris, France

Telephone: 723.54.21
Telex: 842-620628

Tokyo Office:
Kokusai Building
1-1, Marunouchi 3-chome
Chiyoda-ku, Tokyo 100, Japan

Telephone: 214-5001
Telex: 781-26838

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