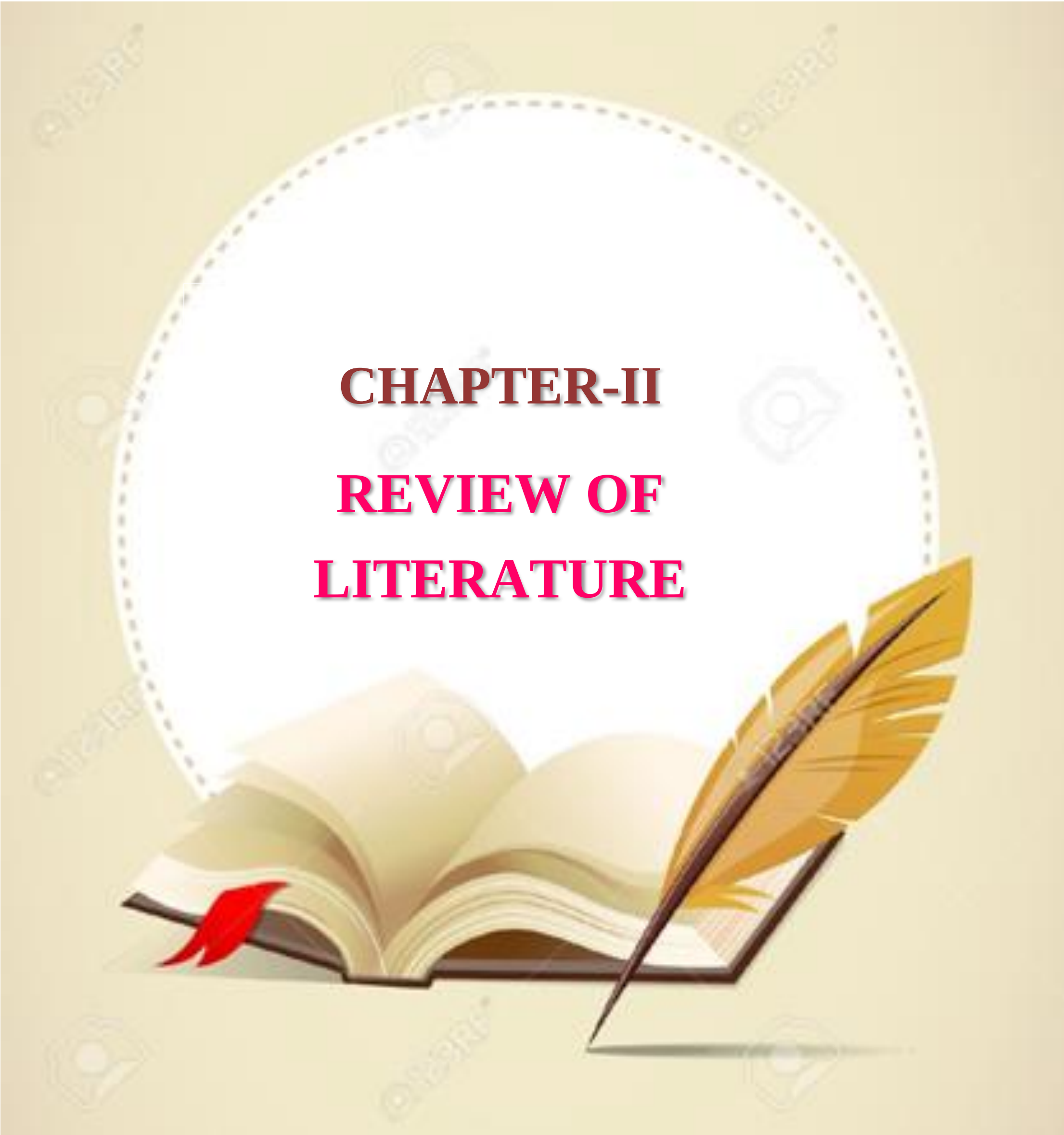
CHAPTER-II

REVIEW OF LITERATURE



CHAPTER - II

REVIEW OF LITERATURE

2.1 Introduction

In this chapter various research papers, books, commission reports which discusses the fiscal federalism, terms of reference of finance commission, Vertical Transfers - allocation of funds between Centre and States, Horizontal Transfers - Criteria used for allocating financial resources among states, Criteria used for allocating Grants-in-aid and views of various research studies which evaluates the recommendations of the Finance Commission have been reviewed.

2.2 Terms of Reference of Finance Commissions

Thimmaiah (2002) discussed the terms of reference of the Finance Commission in the article titled ‘Finance Commission: Decline of a Constitutional Institution’. They pointed out the issues which have attracted the attention of state governments and academics such as; (i) language of the terms of reference as well as the hidden or explicit intentions of the language, (ii) TOR formulated under 'any other matters', (iii) specific binding points included under the terms of reference, (iv) fragmentation or narrowing down of the scope of recommendations to non-plan revenue account of the states, and (v) treating the financial needs of the central government as sacred and beyond the review of the Finance Commission. In case of additional terms of reference they pointed out that this omnibus proviso was used by the central government to limit the scope of recommendations of the third Finance Commission to only non-plan revenue account requirements of the state governments and leave the power to determine and distribute plan assistance to the Planning Commission. Ever since then, the scope of the Finance Commission has been confined to then on-plan revenue expenditure needs of the state governments. Surprisingly, when the ninth Finance Commission was asked to take into account both plan and non-plan revenue expenditure requirements of the state governments, the commission took into account only the non-plan revenue expenditure needs of the states. Such is the influence of tradition and system imposed on successive Finance Commissions. It has become a common practice that under 'any other matter', the central government stipulates a number of guidelines and even conditions to specify the scope of the recommendations for assessing the non-plan revenue expenditure needs of the state governments. Further they pointed out that the debate on the TOR of the Finance Commission has enabled recent Finance Commissions to review the finances of the central government and also to reassess the likely financial surplus which the central government may generate during the period covered by the recommendations of the commission. This is a positive gain to the state government.

RBI (2011) discussed the developments in terms of reference of Finance Commission of India in their study titled Finance commissions in India: an assessment. The article mentions that the terms of reference of finance commissions have been expanded to include relevant issues of topical importance from time to time. Further interventions that some of the issues were included under the terms of reference of Finance Commissions in response to constitutional changes, other were referred to finance commissions as and when they emerged. These issues were discussed with respect to the local bodies, alteration in the pattern of shareable taxes, debt position of States, emphasis on fiscal reforms, broadening the issue of relief expenditure, Specific Grants, and sharing of profits from Petroleum and Mineral oil companies with States. The study summarises that even though the core functions of the finance commissions have remained broadly unchanged with respect to distributing the net proceeds of taxes between the Union and the states and defining the guiding principles of Grants-in-aid of revenues, the role of the finance commissions has considerably expanded as new challenges in the economic and political environment emerged from time to time.

Gupta (2014) in their article titled ‘Paradigmatic Questions about the Mandate of the Fourteenth Finance Commission’ undertaken the debate under the two broad heads i.e. ideological basis and political priorities. While discussing ideological basis they mention that The Constitutional mandate demands that the Finance Commission be able to raise itself above dominant economic ideology. The emphasis on equalisation demands a break from the ceteris paribus assumptions of not just the equity/efficiency paradigm but also a departure from the methodological approach of conceptualizing social disparity as an ahistorical given. It also requires a break with economic orthodoxy that is averse to high levels of public expenditure. While discussing the political priorities head they mentioned that the FRBM Act needs to be reconsidered both in the light of sustainability and relevance for state-level fiscal policy. However, it still indicates a fear of the fiscal deficit which derives from overtly ideological fiscal conservatism and has very little to do with the principles of economic theory. This has been pointed out by many experts since the tenure of the 12th FC when the question of the fiscal deficit gained ascendancy. Further, they gave the set of two arguments that some experts contend that while containing the fiscal deficit is important, there is no need to specify targets for both revenue and fiscal deficits. Others argue that the basis of FRBM Act itself is unnecessary as containing the fiscal deficit is not an economic priority for countries like India, where unutilized capacities entail a demand generating role to the fiscal deficit, without necessarily aggravating inflation. Further they concluded that the TOR leaves little room for the Fourteenth FC to keep itself free of the overriding political and ideological priorities of the government in power in the consideration of the methods by which it will decide on questions of resource mobilization and revenue sharing. The ends will obviously determine the means.

Thimmaiah (2013) in the article titled 'Terms of Reference of the Fourteenth Finance Commission' discussed the terms of reference of the Fourteenth Finance Commission. They pointed out that there are 11 issues under item 3 of the terms of reference of the FFC. Of them, the first three are self-explanatory. Any finance commission has to take these issues into consideration while formulating its recommendations even if they are not explicitly mentioned. They realise that item 3(v) is very important to achieve a higher ratio of tax to GDP. It not only mentions possible additional tax efforts by both the central and state governments, but also the untapped potential available to mobilise additional revenues. They recommend that the FFC should recommend that the central government levy a union excise duty on raw tobacco. To raise the revenue author feels that there is a justification for exempting cereals, pulses, and edible oilseeds from income tax, there is no justification for exempting income from harmful products such as tobacco, consumer products such as fruits and vegetables and cut flowers, and highly profitable export products such as tea, coffee, rubber, and spices. It is necessary that the central government persuade the state governments, preferably through the mechanism of an empowered committee of state finance ministers, to agree to a tax rental arrangement. Under such an agreement, the state governments may be persuaded to lease the power to collect tax income from commercial agriculture to the central government. The central government could promise to transfer the net revenue from this source to the respective state governments, over and above the revenue share recommended by the finance commission. The article brought to notice that the item 3(ix) is a meaningless term of reference because there is a separate ministry of public enterprises with a department of disinvestment. When such a ministry is functioning, it would be a waste of time to ask the finance commission to deliberate issues such as disinvestment, listing of company shares for the disinvestment, and relinquishing non-priority enterprises.

2.3 Resource Transfers from Union to States: Vertical Transfers

Gurumurthi (2003) discussed the issues related to both vertical devolution and horizontal redistribution among the states in the article titled 'Issues before 12th Finance Commission: Review of Vertical and Horizontal System of Tax Sharing'. The article is divided into three parts. Part I looks at the background leading to the constitutional amendment for switching over to the new system of vertical transfers. Part II looks at various issues connected with the new system which the Twelfth Finance Commission may have to examine. While discussing the first part author feels that the potential available under Articles 268 and 269 of the Constitution which had either been under-exploited or not exploited at all should also be studied against the same principle that the government responsible for levy and collection should have a significant interest in the yield of the tax. Further they point out that the alternative system could also possibly help make the central tax structure more equitable and simple. Earlier, it was seen that the decline in the tax-devolution percentage could be attributed to the relatively larger reliance placed by the Centre on non-shareable taxes like customs duty, corporation tax and surcharge on income-tax in preference to income-tax and union excise duties.

RBI (2011) assessed the effectiveness of Finance Commissions in reducing fiscal imbalances through vertical and horizontal distribution criteria in their study titled Finance commissions in India: an assessment. This chapter is organised into five sections. Section 2 provides an overview of Central-State fiscal relations and the constitutional mandate of the Finance Commission in this regard. Section 3 discusses major developments in the mandates of various Finance Commissions. Section 4 deals with changes in the devolution criteria of resources from the Centre to the States since the First Finance Commission and examined the pattern of the Centre's transfers to States through the Finance Commission channel across various award periods. In

Section 5, an empirical exercise is undertaken to estimate the vertical and horizontal components of resource transfers recommended since the Tenth Finance Commission. Section 6 provides the concluding observations. While discussing the vertical devolution article pointed out that successive Finance Commissions recommended larger devolution to the States either by increasing the coverage of shareable items or by increasing the States' share. The article discusses the recommended share of states in union taxes from First Finance Commission to Thirteenth Finance Commission. The article summarises that various Finance Commissions have given due importance to States' concerns with regard to their share in the divisible pool and its composition. With the clubbing of most Central taxes since the Eleventh Finance Commission, the shareable pool of taxes has not only expanded but the States' share in it has also increased.

Thimmaiah (2013) discussed the composition of devolution in the article titled 'Terms of Reference of the Fourteenth Finance Commission'. This article emphasises on pattern of financial devolution under the recommendations of First to Thirteenth Finance Commissions in which they have shown the relative shares of the states in tax and grants-in-aid from Central revenues and observed that compared to the shares recommended by successive finance commissions, the actual tax shares distributed to states was less, except in the case of the First, Sixth, and Twelfth Finance Commissions. Thus the state governments have continued to lose in the fluctuating composition of devolution of central revenues under the recommendations of successive finance commissions. While discussing the financial transfers recommended by Finance Commissions in the form of vertical and horizontal components they pointed out that the Eleventh Finance Commission's recommendations used a higher share for achieving horizontal federal fiscal equity than the Tenth, Twelfth, and Thirteenth Finance Commissions. According to them sharing one third of gross revenue with states could make good balance in tax-sharing between the Centre and the state. While discussing the new scheme of vertical devolution author feels that the Twelfth Finance Commission may consider recommending an increase in devolution on a graduated scale, from 29 per cent in the first year and slowly increase it to 33.33 per cent over the five-year period to be covered by its recommendations. In this connection, it may be pointed out that the Eleventh Finance Commission recommended an indicative ceiling of 37.5 per cent of the Centre's gross revenue receipts, which include plan and discretionary transfers.

While fixing a ceiling for discretionary transfers was rather strange, it is not even practical in the case of plan transfers.

George (2014) agrees to the state's concern to raise tax share of States in Central taxes in their article titled 'Fourteenth Finance Commission in the context of emerging Central-State Fiscal relations'. According to them there is scope for substantially raising the share of states in Central taxes. Firstly, the economic reforms in the country followed since 1991 provided for privatisation, public private participation and foreign participation. Economic services are more amenable than social services, for privatisation, public private participation and foreign participation. Most of the key economic services are in the domain of the Central government, whereas, most of the social services are in the states' domain. They further consider that for limiting transfers under CSS. While the number of schemes seem to have come down by mergers there appears to be no corresponding decrease in outlays. According to them in case of expenditure on civil administration of the Central Government, there is considerable scope for reduction as most of the functions are passed on to private and global participants. Besides, if the Commission decides to reduce the CSS and special packages to individual states, the scope for reduction in the Centre's expenditure on civil administration will be enhanced substantially.

Mitra (2014) discussed 'tied versus untied transfer of resources' in the article titled 'reduced fiscal autonomy in states'. Here author raises the concern regarding whether the nature of transfers made to the States are actually free from conditionalities. While discussing the broader trends in devolutions from Centre to States they find that the ratio between Non-plan grants and Plan grants has declined substantially, indicating the increase in the tied nature of fund transfers to States. The trends of central transfers to States show that while total grants as a proportion of Gross Devolution and Transfers (GDT) have increased slightly over the last two decades, Non-plan grants as a proportion of both total grants as well as GDT shows stagnation. While Plan grants have been increasing during this period, the Non-plan grants, which form a major part of the untied transfers to States, have declined thus imposing restrictions on States in their expenditure decisions. The share of States in gross central tax revenue, which is devolved according to FC recommendations, has also followed the same pattern and does not show significant variations. Author expects from the recommendations of the 14th FC that Commission would give sufficient attention to the problem of untied resource transfers to State Governments and explore the possible remedies in the domain of sharing of untied resources with State Governments as well as provide incentives to the States to engage in long term commitments towards social sectors.

2.4 Horizontal Transfers

Sarma J. V. M. (Jul. 12-18, 1997) proposes a fiscal behavioural model to help identification of the criteria and derive weights for deciding the revenue shares, based on their observed degree of association with the fiscal balance of states. The approach is illustrated by estimating the model using panel data. According to them Inter-Governmental sharing of financial powers and the resultant fiscal transfers have always been controversial in a federal system. To some extent, the issue is unavoidable. The transfers are needed not only to correct the inherent fiscal mismatch between the revenue sources and expenditure needs of the federating units, but also to reduce the possible inequalities with respect to their revenue-capacities and unit costs of providing public goods and services. In Section I the issues involved in the federal transfers in India are briefly reviewed like how share of Income tax and excise duty were distributed between Centre and State. According to them the main issues in horizontal sharing are the near-subjective identification of the criteria, use of different sets of criteria for different components and arbitrary assignment of weights. Further they discussed the criteria used by different finance commissions for tax sharing and grants-in-aid. In Section II the framework, for the proposed model is explained. According to them the first and foremost task towards reforming the horizontal sharing of the federal transfers is to be clear and firm about the objectives of such transfer. In Section III the estimation of the model using panel data and the method of deriving state wise shares are illustrated. While concluding they mention that the approach of the Indian Finance Commissions has, so far, been to concentrate only on the common factors such as population, poverty, backwardness, etc, and somehow relate the fiscal devolutions to these factors. The state-specific factors are altogether ignored. Also, the weights assigned to the common factors are prone to subjective determination. Further, the devolution criteria differ for different portions of the devolution funds. Finally, the gap filling grants-in-aid determination fails to make any distinction between the capacity factors on the one hand, and the state-specific behavioural and the temporary random factors on the other.

Ravi Kumar T. (Dec. 15-21, 2001) examined the progressivity of the formulae determining the horizontal sharing of taxes in the four i.e. 8^{th}, 9^{th}, 10^{th} and 11^{th} Finance Commissions awards and the criteria constituting the formulae in terms of shares accruing to different income categories. The paper also attempts to determine the changes in progressivity brought about by the different Finance Commissions. For analysis purpose author had considered the Shares of the 14 major states scaled up to 100 per cent and Income categories as given in the Eleventh Finance Commission report. The gain in the horizontal share was derived as the difference between the share as per the actual award of the Finance Commission and the share that would have accrued, if the previous Finance Commission's formula had been left unchanged. They observed that the gains and losses in the shares of individual states from the actual Finance Commission awards have not necessarily followed in the same direction as the income category they belonged. Bihar and Orissa are the two states that gained throughout in the shares of income tax while no state had a similar experience in case of excise duties. Maharashtra and Punjab lost continuously in case of shares in income tax with the experience being repeated for the former state in case of excise duties also. Further they conclude that the award of the eleventh Finance Commission in terms of the formula used for determining the inter se shares of the states is clearly more progressive than any of the earlier three Finance Commission awards with major redistribution away from the high and middle-income states towards the low-income states.

Kannan, Pillai, Kausaliya, & Chander (2004) examined the efficacy of Finance Commission awards in bringing about fiscal stability among the states in the article titled ‘Finance Commission Awards and Fiscal Stability in States’. Their empirical analysis reveals that though transfers helped to reduce the overall gross fiscal deficit of the states, the issue of reducing horizontal fiscal inequity is yet to be addressed. The authors find wide interstate disparity in respect of transfers and suggest streamlining disbursement criteria on the basis of individual state characteristics rather than a general approach across states. The paper is organised five sections. Section II sets out briefly some of the key elements of the fiscal transfer system along with a few country experiences, Section III is a quick overview of the states' finances in recent years. Section IV is an examination of the changing profile of the terms of reference and distribution criteria of successive finance commissions in fulfilling efficient and equitable distribution of financial resources among the states. Section V traces movements in federal transfers and Section VI sets out the various facets of federal transfers. Section VII empirically examines the impact of federal transfers from the perspective of fiscal health of the states and overall fiscal balance of the government sector. Section VIII contains a few concluding observations. They pointed out that in the inter-se distribution of shares in income taxes up to the Seventh Finance Commission; more weightage was given to the size of population. However, beginning with the Eighth Finance Commission the focus has shifted to per capita income and backwardness, while the share of population has been considerably reduced. The Tenth Finance Commission introduced an additional criterion of tax effort in the inter-se sharing of income tax.

Tapas & Trebesch (2004) examined the transfer system that operates in India through the institution of the Finance Commission in the article titled ‘Use of Socio-Economic Criteria for Intergovernmental Transfers’. The article’s focus is on an evaluation of the need, appropriateness and manner of use of various socio-economic criteria in the design of transfers mandated by Finance Commissions over the years, placing them in the context of international experience. While evaluating the transfers they pointed out that the awards of the 10^{th} FC were characterised by departures from the trend. It completely dropped the derivation criterion for the first time. It also used the same distribution formula for the states' shares of both income tax and excise duty, a step recommended by researchers for some time, but not very popular in certain quarters because of the marked emphasis on equalisation. The formula included the criteria of area, index of infrastructure and tax effort for the first time, besides the more orthodox criteria of population and (some variant of) per capita income. Finally, it recommended an alternative scheme of tax sharing with a fixed share of all union tax revenues to be set aside for distribution to states on the basis of a single formula. This recommendation was accepted with some modifications in the definition of the distributable pool, and necessary constitutional amendment was carried out. The 11th FC gave its recommendations under the new system, essentially continuing with the same criteria as used by the 10^{th}, with one minor change. Fiscal discipline was substituted for tax effort. For evaluating the criteria of distribution they have grouped the criteria in to four categories i.e. I. equalising fiscal capacity: income-based criteria, II. Evening out different levels of expenditure needs, III. Fiscal performance criteria: bringing about budgetary balance and IV. Collection/assessment criterion: returning tax revenues to originating jurisdictions. The study observed that for the expenditure needs side, several variables have been used in computing statutory transfers in India. Population, the most neutral variable representing expenditure needs, has been consistently used, but with progressively declining weights. The peculiar requirement of using only 1971 population may be partly responsible for the declining weight; else, we think it deserves a much higher weight. We also think that the population data have not been used to maximum effect, the use of the details available could significantly improve the formula. In particular, an index of the percentage of population requiring special attention of the government (scheduled castes, scheduled tribes, and children below a certain age, senior citizens, and the seriously disabled) could be a very good indicator of expenditure needs. Including such a variable in the distribution formula with a reasonable weight would strengthen equalisation and allow the weight on population per se to be reduced. Care has to be taken to select variables that are not outcomes of government policy to avoid problems relating to moral hazard (this is the reason we are critical of the poverty criterion). Geographical features like area and other characteristics that may cause cost disabilities (e g, hilly terrain) are also assessed to be appropriate, although it is necessary to take into account the costs associated with highly congested urban areas too. Criteria like an infrastructure index are best avoided, primarily due to incentive problems; instead need-based variables ought to be used. Further they pointed out that the Finance Commissions have superimposed fiscal performance indicators on the other two types of indicators discussed above. These are in principle bad criteria to be determining transfers, and can be justified only as temporary ones called into service for firefighting operations, in the context of all round deficits. Even if the latter was the case, a simplistic variable representing revenue balance would actually only be counter-equalising; an appropriate multiple indicator based criterion has to be devised. Finally, they believed that any significant transfers based on the origin of tax revenues is not logically maintainable; however, there is a case for a small amount to be transferred on this basis, or an approximation thereof.

Hajra, Rakhe and Gajbhiye (2008) analysed the trend and composition of fiscal transfers in India and puts forwarded some options/proposals which the ThFC may consider in the article titled ‘Issues before the Thirteenth Finance Commission: Correction of Horizontal and Vertical Imbalances’. According to them in the context of fiscal efficiency, apart from tax effort, the ThFC may give adequate weight to non-tax collection effort. The ThFC may also consider providing more purpose-specific grants for the social sectors such as education, health, etc, along with considering ‘‘the need to enhance social sector expenditure’’ as a criterion for horizontal sharing. In the concluding observation the paper raised a few options important among them are as follows. According to them in the context of fiscal restructuring, the ThFC may emphasise the criticality of quality of fiscal adjustment for higher capital outlays and enhancement of infrastructure and social sector spending with beneficial impact on growth and employment. Second, in the process of fiscal transfers, the ThFC may opt to include the efforts to increase non-tax revenue as a criterion for horizontal devolution and may consider giving due weight to the need to enhance social sector expenditure as a criterion for horizontal sharing. Third, ThFC may consider more purpose-specific grants which would enable enhancement in the level of human development across the states on the lines of the Canadian and Australian federations. The ThFC may also revisit the idea of “matching grants” in view of its stringent nature. Fourth, the ThFC may consider abolishing the post-devolution non-plan revenue deficit grant in view of the elimination of revenue deficit in the post-FRL phase.

Kurian (2008) discussed the issues that the Thirteenth Finance Commission has to address to enable it to design a scheme of transfers that is just and fair to all states in the article titled Equalising Transfers through the Finance Commission. The study exhibits that there is a differing significance of central transfers to the rich and to the poor states now. For example, gross devolution and transfers (GDT) constitutes just 2 per cent of state income in Haryana whereas it is more than 25 per cent of state income in Bihar. Similarly, central taxes account for about 75 per cent of the tax receipts in Bihar as compared to just about 10 per cent in Haryana. According to them the formula for tax sharing cannot be made too skewed to achieve the objective of equity. Already large states like Bihar and Uttar Pradesh, which contribute comparatively smaller shares to the central tax kitty receive significantly higher shares as devolution. In contrast, states like Gujarat and Maharashtra, which account for a very high proportion of central tax revenues, receive only a very small share by way of devolution.

RBI (2011) thrown light on the various criteria used by first Finance Commission to Thirteenth Finance Commission in their study titled Finance commissions in India: an assessment. This study pointed out that the basic objective of the FC transfers has been to (i) correct the differentials in revenue capacity and cost disability factors inherent in the economies of the States and (ii) foster fiscal efficiency among the States. The criteria used in the past for these purposes can be grouped under (a) factors reflecting needs, such as population and income measured either as distance from the highest income or as an inverse; (b) cost disability indicators such as area and infrastructure distance; and (c) fiscal efficiency indicators such as tax effort and fiscal discipline. The summarises that while determining the formula for horizontal distribution of inter se shares of States, the basic aim of the Finance Commissions has been to correct the differentials in revenue capacity and cost disability factors inherent in the economies of States and to foster fiscal efficiency among States. The choice, definition and weight of the variables used to define a devolution formula kept changing across the Finance Commissions. While the greater weight to 'fiscal capacity distance' in the tax devolution formula of the Thirteenth Finance Commission is expected to facilitate convergence among the States, the increase in weight for 'fiscal discipline' would encourage a reversion to the path of fiscal consolidation. The study conclude that despite the efforts made by various FCs to capture State/region-specific socio-economic variations in their scheme of transfers, the impact of FC transfers on horizontal equity has been somewhat limited as vast gaps continue to exist between the actual and desired level of transfers for equalization; the recommended transfers have been progressive as the horizontal equity principle was generally followed and States with lower per capita fiscal capacities had a higher per capita share than others and vice versa. The study also pointed out that in a federal set-up like India where regional variations in terms of per capita income, tax base and population are quite large, the equalization component of central transfers assumes greater significance. A comparison of recommended and benchmark transfers across different Finance Commissions also confirms that the degree of equalization (the ratio of actual amount of equalisation transfers recommended by the Finance Commission to the amount needed for equalisation) was the highest in the case of the Eleventh Finance Commission as the gap between the recommended and benchmark equalisation transfers was minimum.

Bhaskar (2013, April) raised some questions in the article titled 'Issues before the Fourteenth Finance Commission'. While discussing the question 'should the commission encourage better fiscal performance in states more explicitly?' they have summarised arguments for the use of equity and efficiency parameters. While mentioning the arguments in favour of equity they pointed out that the revenue raising capacities across states and their cost disabilities have to be bridged. While mentioning the arguments in favour of efficiency they state that equity is an important parameter for horizontal distribution. It leads to adoption of a gap-filling approach for determining eligibility for grants. Given that poor fiscal performance may lead to higher grant eligibility, States may then become susceptible to perverse incentives while managing their fiscal. To resolve this, it is necessary to introduce efficiency parameter in the distribution formula. Further they mentioned that in our resource constrained economy, it is the duty of the finance commission to catalyse States to fully exploit and better utilise all available resources. This is best done by adopting the efficiency parameter in the horizontal distribution formula. They observed that States which have received relatively higher devolution on equity consideration have often been unable to perform efficiently.

Mohan and Shyjan (2009) examines the impact of Central devolution of taxes and distribution of grants to various States and groups of States namely, High income, Middle income and Low income in the working paper titled ‘Tax Devolution and Grant Distribution to States in India Analysis and Roadmap for Alternatives’. The study focuses on the impact of devolution of taxes and distribution of grants in the context of persisting horizontal imbalances. Further they make Suggestions for change in the criteria for devolution of taxes and distribution of grants. The author observed on the basis of per capita Gross State Domestic Product that during the period 1980-81 to 2006-07, the devolution of taxes have had an equalising impact. The share of Lower Income States has gone up and that of High Income States has fallen. This could be due to the change in criteria of devolution adopted by the Finance Commissions. At present, there is no weightage for the collection of Central Taxes from the State, which was previously there. Another feature to be noted is the stagnant share of the Middle income States and a minor fall in their share during 2000-06, the period of the Eleventh Finance Commission. Further regarding the criteria used for tax devolution give an opinion that tax devolution, Distance weighted by Population seems to be an appropriate criterion as it provides more to States with lesser fiscal capacity. When various weights have been given to Distance and Population and alternative shares for various States computed, we find that Horizontal imbalances by way of differing fiscal capacities are better addressed by giving Distance a substantial share weighted by Population.

Dholakia (2010, July) in their article titled ‘A Comment on the Distribution Formula of the 13th Finance Commission’ pointed out that out of the four different criteria used by the Thirteenth Finance Commission for inter se devolution of taxes, the criteria of fiscal capacity and fiscal discipline, which are given a weightage of about two-thirds in the formula, are inadequate, inconsistent and subjective. The allocation outcome based on such a formula, along with the discretionary nature of grants neither reflects equalisation nor efficiency and hence provides confusing signals to states for their future fiscal behaviour and growth orientation. According to them outcomes of increasing weightage of Index of Fiscal Discipline criteria and inclusion of Fiscal Capacity criterion instead of distance from highest per capita income criteria in tax devolution formula are a bit confusing at best and undesirable at the worst, as they do not give clear-cut signals to the states for improving either their growth performance or fiscal performance in the future. Further author shows that how Fiscal Capacity Index is having problems in calculation for State’s like Haryana, Goa and Maharashtra yields either zero or a negative number and therefore the THFC has decided Rs 100 per capita entitlement for each of them without much justification. This makes the devolution to them ad hoc and subjective. The use of certain subjective norms cannot be completely avoided while dealing with such issues, but in this case the problem could have been logically and objectively resolved. While mentioning the problem in Index of Fiscal Discipline criteria they pointed out that neither the level of fiscal self-sufficiency, nor the change on margin matters, but only the “percentage change” matters. Hence all those states whose initial performance is good may not benefit much, in spite of an improvement if the percentage “change” from their high base is not high! There is no regard to the degree of self-sufficiency achieved. Also there is no regard to the fact that the level of difficulty involved in moving from initially high figures like 60% or 70% is much more than moving from a small initial base like 11% or even 30-40%. They conclude that the allocation resulting from these indicators provide confusing signals to states for their future fiscal behaviour and growth orientation. Moreover, the use of only one criterion by the THFC for measuring fiscal discipline can also lead to avoidable manipulation by state governments. The commission could have avoided these shortcomings by devising the horizontal distribution formula with greater care and objectivity. It is always better, both analytically and practically, to separate (i) pure discretion that can be achieved through grants as well as clear equity-oriented weightage in the tax devolution; and (ii) the devolution based on pure objective fiscal performance criteria. With such a formulation states could be incentivised to perform better without sacrificing equity concerns.

George (2014) discussed horizontal inequity and the non-plan revenue surpluses of states under the article titled ‘Fourteenth Finance Commission in the context of emerging Central-State Fiscal relations’. According to them given the large disparities among the states, it is not just enough that the FCs bring about some progressivity in their aggregate transfers. If the Commissions have to make even a small dent to the problem of disparities, they will have to provide for progressivity in the non-plan revenue surpluses. The influence of the Finance Commission in determining the size of the States’ plan is not often appreciated. It is the balance in the non-plan revenue account (balance in current account) provided by the FCs which determines inter alia the size of the plan. What is also not realised is that it is the policy of the Finance Commission with regard to tax sharing and grants that to a large extent determines this surplus in the non-plan account. They gave an evidence of the fourteenth Finance Commission’s award period in which they have shown that some of the backward states like Bihar, Orissa, Uttar Pradesh, Rajasthan and West Bengal had been left with very limited non plan surpluses, while the counterparts like Goa, Haryana, Karnataka and Gujarat are flush with such funds. The implication is that the less developed states start with a major handicap with respect to their 12^{th} plan financing. This is reflected in the per capita plan outlays of these States.

2.5 Grants-in-aid

Kannan, Pillai, Kausaliya, & Chander (2004) examined the efficacy of Finance Commission awards in bringing about fiscal stability among the states in the article titled ‘Finance Commission Awards and Fiscal Stability in States’. While discussing the grants-in-aid they pointed out that only Second and Third Commissions were given the mandate to make recommendations to provide for the deficit on Plan account. Thereafter, except for the Ninth Finance Commission, no other Commission had assessed the revenue component of Plan expenditure and recommended grants to meet the deficit in Plan expenditure. However, the Eleventh Finance Commission was required to take into consideration the Plan and non-Plan revenue expenditure of the states for the provision of grant-in-aid, keeping in view the need for generating surplus for investment and reducing the deficit.

Isaac & Chakraborty (2008) reviewed the transfers to local self-governments in their article titled 'Intergovernmental Transfers: Disquieting Trends and the Thirteenth Finance Commission'. They initially highlighted the expenditure of local self-governments and gave some international comparison. Where they pointed out that the ratios for India are one of the lowest among developing countries. After giving information regarding allocation by last three Finance Commissions for LSGs they feel that the ThFC has to take a bold initiative to give up the incremental approach and adopt a target of a minimum level of LSG expenditure ratio to GDP or either combined expenditure of the government to be attained as an outcome of its recommendations. Part of this devolution would have to come from the sharply enhanced devolution from the Centre and a portion from the devolution from the states. The article conclude that the major problems of the intergovernmental transfer system in India in recent years have been the increasing vertical imbalance, proliferation of conditional and tied grants through various CSS, low level of fiscal decentralisation and plethora of authorities (not envisaged in the Constitution) including the multilateral lending institutions deciding the course of fiscal policy at the state level. The larger question is whether there is scope for intergovernmental fiscal relations to grow and mature in a manner that provides fiscal autonomy to the states within the basic framework of the Constitution. That would be possible, if and only if we are able to develop an incentive compatible transfer system without compromising on sub-national fiscal autonomy. We can only hope that the Commission on Centre-State Relations, which has a larger mandate, and also the Thirteenth Finance Commission will take into consideration the reality of evolving federal fiscal relations so that their recommendations provide a road map, which would help improve the fiscal autonomy of the states.

Mohan and Shyjan (2009) in their working paper titled 'Tax Devolution and Grant Distribution to States in India Analysis and Roadmap for Alternatives' made some suggestions for distribution of grants. They pointed out that the statutory grants are distributed on the basis of normative criteria and the estimates of gap in non-Plan revenue account and the actuals have vastly differed. Moreover, the impact of statutory grants has not been equalising as seen earlier and there is wide fluctuation in the shares of different States. They observed that disbursing grants for filling gaps needs to be reconsidered. Any gap filling (for differing fiscal capacities) needs to be done through tax devolution and grants should be specific purpose based on criteria. Further they suggest that the gap in State level indicators in education, health, infrastructure etc. needs to be measured using transparent criteria and grants for achieving a specified level distributed. The filling of post-tax devolution deficits in non-Plan revenue account using estimates of future expenditure and revenue estimates amounts to doing again through grants by not so transparent methodology, what the tax devolution does on the basis of transparent criteria.

Finance Commissions in India: an assessment (2011) this chapter assesses various grants given by the Finance Commissions. Principles governing the design of grant-in-aid: shift from gap-filling approach to normative approach in this section study initially points out that the amount of grants-in-aid provided to the States by different FCs has been in respect of their revenue gaps. Grants-in-aid under the FC are meant to fill a gap which represents the State’s expenditure not covered by its own revenue and share in Central tax. Further study reveals that grants-in-aid are considered as an important instrument to make the scheme of transfers more comprehensive and address issues spelt out in the TOR. Unlike the devolution formula for Central taxes, grants provide greater scope to make corrections for cost disabilities faced by many States. The study summarises that grants recommended by the FCs have generally been unconditional and largely based on the projected gaps between non-Plan revenue expenditure and post-tax devolution revenue receipts. This approach has often been criticised as it does not provide for fiscal discipline at the State level. However, of late there has been an increasing emphasis on a normative assessment of resource requirements and expenditures while recommending grants to States.

Bhaskar (2013) raised some questions in the article titled ‘Issues before the Fourteenth Finance Commission’. While discussing the question that ‘should the commission confine itself to its constitutional mandate?’ they observed that ToR of the First Finance Commission did not include any consideration items. The terms of reference of the Second to Sixth Finance Commissions confined the consideration items to the determination of the principles which should govern the grants-in-aid to states. From the Seventh Finance Commission onwards, the consideration items started appearing in the ToRs as a broader swathe directed at influencing the commission's recommendations more expansively. Further they have categorised the grants in the form of core functions and non-core functions grants. According to them some grants like the revenue deficit grant, the local bodies grant, and the drought relief grant do fall within the core functions of the finance commission. However, other grants like the up-gradation grant, the special problems grant, the health sector grants, and the education sector grant may not fall under this core category.

Mathur (2013) assessed the Finance Commission's finances to municipalities in the article titled 'Finances of Municipalities: Issues before the Fourteenth Finance Commission'. While discussing the criteria they pointed out that the Eleventh Finance Commission included an "index of decentralisation" in the allocation criteria, the Twelfth replaced it with an "index of deprivation", The Thirteenth Finance Commission has restored the "index of devolution" but preferred to use utilisation of funds, i e, the extent to which the grants given to municipalities have been utilised as an indicator of devolution. Further, they make an observation that the finances of municipalities in India are in a highly unsatisfactory state, adversely affecting, on the one hand, the productivity of cities and towns and, on the other, the quality of life. The unsatisfactory state of their finances is best assessed by the fact that municipal expenditure on services that they provide is just about 1.24% of the GDP and their revenues are 1.16% of the GDP which include transfers from the states and central government (2007-08). Municipalities in India raise 2.3% of the publicly raised revenues. In comparison, municipalities in South Africa are able to generate resources that are about 6% of GDP and Brazil is able to mobilise as much as 7.4% of GDP. The study conclude that the two constitutional amendments of 43 Y and 280(3)(c) which are a part of the 74th amendment and which aim at the strengthening of the finances of municipalities, have not been accorded the attention they deserve. The approach to dealing with the finances of municipalities has been ad hoc, with serious shortcomings both in respect of determining the gaps in resources as well as building up incentive structures for bringing about long-term sustain ability in their finances. The fiscal implications of urbanisation are phenomenal; failure to adequately appreciate them and to take appropriate action will have adverse consequences for India's growth and development trajectory.

Mitra (2014) in the article titled 'reduced fiscal autonomy in states' discussed some of the issues related to grants. According to them Growing role of the Planning Commission, rise in the number of Centrally Sponsored Schemes and transfer of resources to States tied to the broad/specific objectives of the Central Ministries have been the basis for regular criticism of the Central Government. In such a backdrop, the Finance Commission has been looked upon by the States as the main source of untied transfers comprising the States' share in central taxes and statutory Grants-in-aid. The author feels that the grants-in-aid, which are over and above the FC recommendation of sharing a specific proportion of the divisible pool of central taxes with States, have also been perceived by the States as untied resources. However, in the recommendations of the FCs over the last decade, grants for core mandate have been replaced by grants for certain non-core functions. According to them the upgradation grant received by States through FC since the 7th FC has been one of the non-core function grants. The upgradation grants were also allocated by specific sectoral requirements of States. The 10th FC introduced the special problems grant in addition to the upgradation grant. In the 12th and 13th FCs, the heads for non-core function grants to states have become more specific. With the help of table author showed that; instead of the upgradation grant there are newer heads of non-core function grants were come up, which show an increasing share in total grants to States. The author from the Fourteenth FC expect that this Commission will explore the possible remedies in the domain of sharing of untied resources with State Governments as well as provide incentives to the States to engage in long term commitments towards social sectors.

2.6 Recommendations of the Eleventh Finance Commission

Godbole (2001) assessed the EFC's restructuring programme in the article titled 'Finance Commissions in a Cul-de-sac'. While discussing the EFC's restructuring programme they raised few pertinent questions. First, while each finance commission must lay down the norms for achieving better fiscal management and efficiency, such norms must have some relation to the ground realities. Otherwise, as has happened time and again in the past, each finance commission will be covering the same ground again and again with the fiscal situation, in the meanwhile, sliding from bad to worse. Second, in the interest of transparency, the commission must provide detailed explanation as to why certain norms are proposed and why these can be considered as reasonable. Third, the finance commission should analyse the assumptions made by the previous finance commissions and the extent to which they have proved to be correct. The commission should indicate how similar deficiencies are proposed to be avoided in its report. Fourth, the finance commissions' recommendations on fiscal restructuring hardly ever come up for any discussion at the political level in a Centre-State forum such as the National Development Council (NDC) or the Inter-State Council (ISC). As a result, the recommendations of the finance commission remain only on paper and hardly ever form part of any decision-making process either at the Centre or at the states. The only recommendations of the commission which matter to the Centre or the states are those relating to the vertical and horizontal devolution of central funds. Fifth, the government of India must start the practice of placing the report of the finance commission before the ISC or the NDC before decisions thereon are announced by the central government. The state governments must have an opportunity to have their points of view put across formally in a Centre-State forum. Other-wise, this can again lead to the unseemly spectacle, as in 2000, of chief ministers of certain states protesting publicly against the recommendations of the commission. While discussing the constitutional issues author feels that the additional term of reference, which pertained only to the devolution to the states, was given by the president without consulting the state governments. A practice needs to be established to settle the terms of reference of the commission only after consulting the state governments. The article conclude that finance commissions repeating the same set of recommendations for better fiscal management and reinventing the wheel every five years will not lead us anywhere. It is time we realise that we are in a street with a dead-end.

Babu, Devendra (2009) reviewed the financial position of panchayats in India in the article titled ‘Fiscal Empowerment of Panchayats in India: Real or Rhetoric?’ The analysis is based on the secondary sources of information. It reveals that the panchayats have very little fiscal autonomy. The locally raised revenues are very negligible. The funds flow from higher level governments is very low and lack any devolution design or principles. They also examined the role and impact of State and Central Finance Commissions on the Panchayat finances. While discussing the Central Finance Commissions and Panchayat finances they pointed out that unlike the Tenth FC, the Eleventh FC had a ToR to look into the resources of local bodies and to recommend grants on the basis of recommendations of SFCs. To its dismay, the Commission had to face a number of obstacles like late constitution of SFCs and non-submission of ATRs etc. In spite of these constraints it took a dynamic view and recommended a total of Rs.8000 crore (Rs.1600 crore per year) to PRIs for five years from 2000-01 to 2005-06. It had recommended a set of criteria for horizontal distribution of grants and one of the innovative criterion was "Index of Decentralisation" The intention behind this criterion was to force the states to empower PRIs with functions and resources. They further point out that the states were strongly protesting (during 1970s and 1980s) against the Centre's dominance over the resources and making inroads into the states' subjects, have now forgotten this in state - PRIs relation. The Centre's dominance over the resources is revealed from a large body of literature on the subject, discussions in the National Development Council meetings and constitution of Sarkaria Commission (Government of India, 1988). There was no proper implementation of the legislative measures incorporated in the Constitution as well as in the state PR Acts relating to finances of the PRIs. Many of the provisions, specially the fiscal provisions, are not mandatory and this has become handy for most of the states to have bigger say in PRIs resources. They conclude that the availability of resources for PRIs in the combined revenues of all level governments is very negligible. This means, as brought out earlier, the resources are concentrated at the states and the Central level. Hence the Centre should insist on the states to transfer/implement its programmes/schemes through PRIs and bringing DRDAs under the control of panchayats.

Gandhi (2004) discussed the role and implications of Eleventh Finance Commission's recommendations to the States in the article titled 'Eleventh Finance Commission: A critique'. They have started with the role of Eleventh Finance Commission in terms of appointment, its terms of reference and share of taxes and amount of grants allotted to the states. Further they discussed the criteria and weights allotted to horizontal transfers. They also discussed the states which have gained and which states have loss due to the Eleventh Finance Commission transfers. Gandhi felt that there is no gain saying that the gap filling approach has been instrumental in creating economic dualism developed States have become richer and less developed ones poorer. Equally the implications of eleventh finance Commission will penalize the performing States and encourage the non performing States.

Ravi Kumar (2001) examined the progressivity of the formulae determining the horizontal sharing of taxes in the last four Finance Commission awards and the criteria constituting the formulae in terms of shares accruing to different income categories in the article titled 'Regional Development Criteria and Horizontal Devolution under the Finance Commission Awards'. The paper also attempts to determine changes in progressivity brought about by the different Finance Commissions i.e. eighth, ninth, tenth and eleventh FC. The article observed that there has been no clear movement towards increased progressiveness in the awards of the last four FCs with different income categories gaining at different times in terms of shares of the two major taxes. This was also true for individual states. In respect of the changes brought in the horizontal distribution formulae by the last three FCs, only that of the tenth FC actually increased the progressiveness of the awards in terms of comparison with the tax shares that would have resulted from the retention of the previous FC’s formula. Further they observed that the award of the eleventh FC in terms of the formula used for determining the inter se shares of the states is clearly more progressive than any of the earlier three FC awards with major redistribution away from the high- and middle-income states towards the low-income states. The losses and gains are, moreover, spread over almost all the states in the different income categories. Of the five states gaining from the eleventh FC award as compared with shares deriving from the tenth FC award, four are low-income states. The award marks a significant departure from a narrow band around which horizontal progressivity was fluctuating over the period of the last three FC awards. The change from the tenth FC formula by the eleventh FC, however, redistributed away from both the low and middle income states to the high income states. The ongoing criticism of the eleventh FC horizontal distribution formula by several of the richer states does not; however, seem to have taken this aspect into consideration.

2.7 Recommendations of the Twelfth Finance Commission

Kannan and Mohan (2004) reviewed the Terms of Reference (TOR) of the Twelfth Finance Commission with special reference to Kerala. The article also critically examined the emphasis on fiscal deficit reduction without paying attention to its quality and finds that this has led to the Centre and the states resorting to a softer option of cutting productive capital and necessary maintenance and social sector expenditure. This is likely to have adverse consequences on equitable growth and to impede the process of relieving the economy of structural constraints on growth. The study suggests incorporating the concept of quality of fiscal discipline. While discussing the devolution of funds to local bodies they suggest that Panchayats' and municipalities' revenue enhancing powers should be utilised more effectively in the levy of existing professional and building taxes. Many non-monetary perquisites, which escape professional taxation, should be evaluated and taxed. This will not amount to double taxation, as profession tax is deductible in computation of central income tax. Building valuation guidelines for levy of building tax need periodic up gradation and should be realistic so that litigation free revenue can be mobilised. Further they suggest for levy of user charges, which will help local bodies in floating municipal bonds for mobilising funds through the market routes. They suggest an enlarged role for the Finance Commissions in the traditional areas and leave the question of economic and fiscal reforms to respective governments in consultation with the Centre. They feel that progress in achieving fiscal consolidation can of course be used by the Finance Commissions as a criterion for tax and grant devolution. But the concept of fiscal consolidation has to be much broader based with attention to details of expenditure and revenue components than mere targeting of fiscal deficits. This is necessary to achieve the objective of economic growth with equity.

Bagchi (2005) took an overview of the papers presented in the symposium and presented some of the issues in the article titled ‘Symposium on Report of Twelfth Finance Commission Introduction and Overview’. After giving and brief introduction and highlights of Finance Commissions article discusses the scheme of tax devolution and grants as given by Twelfth Finance Commission. The article discusses the two papers one by Raja Chelliah and the other by Govinda Rao and Pratap Jena, which presents a critique of the approach of the TFC going over its major recommendations regarding both revenue sharing, and restructuring-cum debt relief. The article pointed out that despite the generous transfers made by the TFC through tax devolution and grants, disparities in revenue capacity of the states remain pretty large. Per capita revenue of Bihar as assessed by TFC together with the states’ share in central taxes and grants recommended for 2005-10 is only about 40 per cent of that of Haryana and Kerala. The situation does not seem to have changed very much under the TFC as compared with that under the EFC. The coefficient of variation in normatively derived per capita revenue has gone up among the major states. Further they observe that despite generous transfers made by the TFC through tax devolution and grants, disparities in revenue capacity of the states remain pretty large. Per capita revenue of Bihar as assessed by TFC together with the states' share in central taxes and grants recommended for 2005-10 is only about 40 per cent of that of Haryana and Kerala. The situation does not seem to have changed very much under the TFC as compared with that under the EFC. The coefficient of variation in normatively derived per capita revenue has gone up among the major states.

Ghosh (2005) discussed the Need for Restructuring State Government Debt in the article titled ‘Twelfth Finance Commission and Restructuring of State Government Debt: A Note’. The article analysed the trends in Fiscal, Revenue and Primary deficits of States and Centre as percentage of GDP. Author feels there are some reasons for restructuring the debt of the states such as the first is the adverse impact on expenditure. The second is the fact that for some years now, the states have been paying higher interest rates than the central government, or even prime private borrowers, for a variety of reasons. The rules imposed by the Reserve Bank of India, which require case by case permission to states for accessing commercial debt if they are running revenue deficits, have also operated to make borrowing difficult and have driven several states to high-conditionality debt from multilateral agencies such as the World Bank and the Asian Development Bank. While discussing the TFC’s recommendations for restructuring State debt author pointed out that the TFC has introduced several measures with respect to states’ taking on new debt, but these are not likely to be universally welcomed by the state governments. Thus, even though loans from the National Small Savings Fund (NSSF) and other small savings carry high interest rates, the TFC has provided no relief on this score. Since this is the principal source of Plan loans for many states, it is likely to involve a continued increase in their debt servicing burden. In this situation, a review of the NSSF management costs and interest rate structure was called for. Further, there is still the debt servicing burden of earlier high cost loans from banks and financial institutions which plagues most of the state governments. This issue also has not been addressed by the TFC.

Oommen (2005) reviewed the recommendations of the twelfth finance commission with special reference to local bodies in the article titled ‘Twelfth Finance Commission and Local Bodies’. They pointed out that the TFC has contributed significantly towards healthy fiscal federalism. But local bodies are yet to be put prominently on the public finance map of India. This is needed to facilitate an inclusive and equitable economic growth and to secure better horizontal equity. The available local data are of poor quality and need drastic improvement. Future finance commissions and their counterparts at the state level will have to play a more important role to make fiscal decentralisation a working reality in Indian fiscal federalism.

Reddy (2006) analysed the implications of the recommendations of the TFC for backward states after briefly examining the equity aspects of overall transfers recommended by it in the article titled ‘Twelfth Finance Commission and Backward States’. The paper is organised into six sections. Section II looks at the equity aspects of overall transfers. In which they have observed that excluding Goa and Punjab, the correlation coefficient between per capita grants and per capita GSDP works out to –0.6618 and that between per capita tax devolution and per capita GSDP to –0.9429. Despite the progressiveness of TFC transfers, post-tax devolution non-plan revenue account surplus is much higher for the high and middle income states than the low income states. This will enable the better-off states to have higher plan outlays. Section III examines the norms adopted by TFC, while making its assessment of revenue and expenditure of states. Section IV contains an analysis of the scheme of debt relief to states. Section V analyses the implications of allowing states to directly access the market and transferring assistance in respect of externally aided projects on a back-to-back basis. Section VI contains a few concluding observations on the recommendations of the TFC. Here the author pointed out that the benefit of sizeable specific maintenance grants for roads and buildings has mostly gone to better-off states. The scheme of debt write-off recommended by the TFC was guided more by the need for fiscal consolidation rather than providing relief to debt-stressed states. The relief package is unfavorable to debt-stressed and poorer states. In the process, the scheme of debt write-off may fail to provide much needed relief to debt-stressed states and may in turn derail the process of fiscal consolidation. The TFC has broken new ground by recommending delinking of plan grants from loans and disintermediation in loans to states. These recommendations, though sound in principle, have ignored the growing regional imbalances and the specific problems of backward states.

2.8 Recommendations of the Thirteenth Finance Commission

Chakraborty (2010, November) in their research paper titled ‘Deficit Fundamentalism vs Fiscal Federalism: Implications of 13th Finance Commission’s Recommendations’ categorised some of the important recommendations under the following heads:

(1) Enhanced vertical devolution from 30.5% to 32% of the divisible pool of taxes.

(2) Revised road maps for fiscal consolidation at the centre and the states.

(3) Suggested design of the goods and services tax (GST).

(4) A large number of sector and state-specific grants.

(5) Grants for local bodies amounting to 2.5% of the central pool of taxes.

This paper examines what some of these recommendations mean for the states, given their overall operating fiscal constraints and the fiscal inequality across them. The paper also considers whether states will be able to adhere to the fiscal re-structuring paths proposed by the THFC for them and what their fiscal implications will be. Towards this, it undertakes a detailed review of the finances of two states and constructs their future fiscal profiles in accordance with the norms proposed by the THFC for fiscal consolidation from 2010-11 to 2014-15. The paper has five sections. Section 1 evaluates the THFC's recommendations related to tax devolution and its horizontal distribution principle from the equity and efficiency perspectives. Sections 2 and 3 analyse the implications of the revised road maps for fiscal consolidation recommended for the states. Section 4 analyses one of the major state-specific grants – grants for elementary education, its design and implications. In the section 5 summarises the findings and draws conclusions that although the increase in the vertical share will help the states, the horizontal distribution formula does not appear to have made any significant departure from the past in terms of greater progressivity of transfers. Also, as explained, the design of the horizontal distribution formula is such that the fiscal capacity distance and the index of fiscal discipline are in conflict with each other and serve opposite purposes – while the former tries to increase the capacity of states to spend more, the latter tries to limit their expenditure in relation to own revenues. Both the indicators together in the same formula penalise states twice over for the same reason. The design of the grant for elementary education is such that it has the potential to reduce the expenditure of states instead of augmenting it. On the revised road map for fiscal consolidation, it needs to be emphasised that suggesting state-specific, year-wise, fiscal adjustment paths not only limits the fiscal manoeuvrability of states but also impinges heavily on their fiscal autonomy. This approach of the THFC seriously compromises the idea of the Finance Commission itself, which, in accordance with the spirit of the Constitution, is required to protect the fiscal autonomy of states. It is high time that India as a federal country starts seriously thinking about how to get out of this kind of technocratic approach to a subject that goes beyond the deficit numbers and a very narrow idea of fiscal prudence. The prime issue here is nurturing federalism in the country by correcting vertical and horizontal imbalances without compromising fiscal autonomy, and that cannot be done in a dictatorial way. Even though the Finance Commission is an independent arbiter, it should refrain from making recommendations that clamp down heavily on the fiscal autonomy of states. It is overdue that the issue of intergovernmental transfers be looked at not from a narrow technocratic perspective or from an implicit view of a benevolent centre giving funds to begging states, but from the right perspective of federalism where the states and the centre are treated as equal partners in development.

Rakshit (2010) in their article titled ‘Fiscal Consolidation and Inclusive Growth: The Finance Commission Approach’ discussed recommendations of the Thirteenth Finance Commission in five section. First section is introductory. In the second section they summarised the “fiscal consolidation” programme (FCP). The next section provides an appraisal of the analytical underpinning of the FCP and its appropriateness for the Indian economy. Section 4 examines the recommendations for relaxing the FRBM targets in times of cyclical or other shocks. The final section concludes the analysis. The study conclude that the THFC recommendations, made in the context of the fiscal stress during the global crisis, include (1) relaxation of FRBM targets for purposes of macro-stabilisation; and (2) a fiscal adjustment programme (FAP) for 2010-15 to (a) raising both public and private investment through creation of fiscal space for government capital expenditure and avoidance of crowding out; and (b) ensuring fiscal viability. Further they pointed out that the commission’s emphasis on allowing for macrostabilisation under the FRBMA and on FAP as a means of raising productive investment is unexceptionable, so are many of the reforms suggested in this context. However, the lack of an adequate analytical framework has made the overall recommendations less than satisfactory. The inadequacy is reflected in a failure to identify the basic condition calling for anti-recessionary measures and their optimal combination, a neglect of distortionary and GDP-reducing effects of subsidies, viewing expenditure on HRD as current rather than capital, a neglect of conditions governing crowding in and crowding out; treatment of disinvestment as part of investible resources; and a clubbing of domestic and external debt and of debt held by the public and the RBI.

Das-Gupta (2010) examined the recommendations of the Thirteenth Finance Commission in the article titled 'The 13th Finance Commission and Improving Fiscal Outcomes: An Assessment'. Author pointed out that in one case, the grant is tied to an outcome indicator with no information on inputs and outputs needed to achieve improved outcomes. In other cases, grants are tied to inputs and the link to outputs but, through them, outcomes are not made clear. Quantitative milestones in terms of inputs, let alone outputs, are specified in only a few cases. Further, grants have not been embedded within a comprehensive expenditure framework. Article in the concluding remarks suggests that the Thirteenth Finance Commission has not chosen the best possible route to meet its mandate of recommending ways to make public expenditure more outcome oriented. However, elsewhere in its Report, it has a number of important suggestions that should help achieve output-oriented outlays, though these do not add up to a comprehensive reform package for output-oriented expenditure reform. Two major problems with its approach, according to this writer, are not noting the importance of unit costs of public outputs and inadequately treating the distinction between outputs and outcomes. The latter is a problem also found in central government output budgets. The THFC still deserves our admiration and thanks for what it has achieved. Perhaps the major problem lies in its terms of reference, which ask a human agency to accomplish a superhuman task in an impossibly short time frame.

Rao (2010) critically appraised the recommendations of the Thirteenth Finance Commission in the article titled 'The 13th Finance Commission's Report: Conundrum in Conditionalities'. This paper examines the approach of the THFC with regard to its terms of reference (ToR) and analyse the recommendations related to its main task – tax devolution and grants – as well as the conditionalities attached to many awards. The important point is that in recommending 12 different types of grants with a variety of conditionalities attached to them, the THFC has fragmented the transfer system. The article is divided in five sections first section is an introductory section and fifth section gives concluding remarks. Section 2 analyses its general approach with regard to the ToR and summarises the major recommendations to do with the revised road map for fiscal consolidation and the introduction of the GST. Section 3 examines the recommendations taking into account the substantive ToR related to tax devolution and grants in aid. In particular, it examines the THFC's innovation of bringing in the fiscal capacity distance as a factor in tax devolution in place of per capita income. Section 4 analyses the conditionalities. The last section consists of a few concluding remarks. The article pointed out that despite some tinkering with one of the indicators, ThFC approach to tax devolution suffers from the same limitations as those of earlier commissions. More alarmingly, the inability to offset the fiscal disabilities of the states has led it to recommend as many as 12 different types of grants with a host of conditionalities. There are serious questions over the design and implementation of these conditions, in addition to monitoring compliance. Besides, the commission's recommendations on the goods and services tax have been resented by the states and this has actually taken the reform agenda backwards. All this lends weight to the suspicion that yet another opportunity to reform the transfer system has been lost.

Srivastava (2010) examined the key recommendations of the THFC having a bearing on these two aspects of transfers, placing them in a long-term perspective in the article titled 'Vertical Sharing and Horizontal Distribution of Resources: The Equity and Efficiency Trade-off'. This study falls into five sections. Section 1 looks at the recommendations of the THFC on the vertical sharing of resources, and Section 2 examines the recommendations having an impact on the horizontal distribution of resources. Section 3 looks at grants, while Section 4 reviews the overall design of transfers by decomposing these to identify their vertical and equalising content. Section 5 comprises concluding observations, including suggestions for the improvement of the transfer mechanism in the longer term. While discussing the vertical sharing of resources article pointed out that the share of states in combined revenue receipts does not depend only on UFC transfers but also on other channels of transfer. The Eleventh Finance Commission (EFC) for the first time recommended an indicative benchmark for all revenue account transfers, at 37.5% of the centre's gross revenue receipts. This was progressively raised by the TWFC to 38% and to 39.5% by the THFC. Thus the THFC has increased both the states' share of the shareable pool of central taxes and the indicative benchmark for all central transfers from the centre's gross revenue receipts by 1.5 percentage points. Author observed that for vertical transfers, the THFC has emphasised the objective of stability in the relative shares of the centre and the states after transfers. For horizontal transfers, the THFC has successfully achieved 90% of the equalisation objective. Author feels that the design could have been even better if it had not introduced an unnecessary modification in the application of the distance formula, which will result in discouraging tax effort, an effect further compounded by dropping the tax effort criterion from the tax devolution scheme. Further author observed that there are some unnecessary constraints in designing a suitable fiscal transfer methodology in the Indian context. The first is the time lag in information – the use of 1971 population data and dated per capita GSDP data are two basic constraints. Second, no effort is being made to develop a better indicator of fiscal capacity at the macro level than the per capita GSDP of states. As state tax systems move closer to destination-based taxation such as a comprehensive GST, these constraints will become even more serious. It seems pointless to insist on continuing to use 1971 population data as the UFCs are able to achieve a significant amount of equalisation measured with reference to more up to date information.

Roy (2011, April) responded to address a few substantive points raised by Chakraborty (2010) and Rao (2010) with reference to the ThFC report (ThFC 2009) in their article titled 'A Response to Conundrums and Fundamentalisms Perceived in the THFC Report'. They agree to the argument of Chakraborty (2010) that the fiscal capacity and fiscal distance components can potentially contradict each other. According to them this is true for all weighted formulae. If, all the bases for the weights were correlated positively, then there would be no need for a weighted formula in the first place. One of the bases would suffice. This is well recognised. Thus, population and area have been in the formula in every commission report, and could well work in conflicting directions. According them both the papers engage in counterfactual exercises based on partial equilibrium reasoning to establish how states or groups of states have "lost out" as a consequence of one or other decision of the commission. This approach treats the centre and the states as permanently locked in an adversarial relationship in which the battles lost and won are the partial equilibrium gains and losses to either side. In my view, in a situation where rapid economic growth and a recent and unprecedented history of successful fiscal consolidation has been an integral feature of the fiscal landscape, more attention needs to be paid to the gains that all stakeholders (the centre, states, local bodies and the non-state development actors) can reap from persisting with these efforts. Further the point out that the commission's award is arrived at through a process of holistic, not additive, and reasoning. The process is evolutionary in approach, linked to the contemporary imperatives of India's development challenge as discussed in some detail in the report. The resulting recommendations are certainly not revolutionary. But, in my view, they are fit for the purpose.

Chakraborty (2010) brings together a set of eight papers critically evaluating various aspects of the THFC's recommendations in the article titled 'Report of the 13th Finance Commission: Introduction and Overview'. The paper points out some of the noticeable features of the THFC recommendations are as follows. (1) Enhancing the vertical share of tax devolution from 30.5% to 32%. (2) A design for the GST and a compensation package linked to adherence to the proposed design. (3) A revised road map for fiscal consolidation and ensuring compliance to it by linking it to transfers. (4) Devolution of a specified share of central taxes to local bodies as grants. (5) A large number of specific-purpose grants to address the issues defined in the ToR such as climate change, sustainable development, and improving the output and outcome of government expenditure. The papers bring out the strengths and weaknesses of various recommendations made by the THFC. According to them despite various shortcomings, many of the recommendations, if implemented in the right spirit, will benefit the management of public finances in the country. Drawbacks aside, a major strength is the effort that has been made by the THFC to move towards a more direct measure of fiscal capacity than per capita income and its use in the horizontal distribution formula. It is critically important that efforts are made to have proper estimates of fiscal capacity at the state level so that fiscal capacity equalisation, a core task of the UFC, becomes more objective and free of the many limitations pointed out in the use of the fiscal capacity distance. Further they point out that the important recommendation is granting a predictable share of resources from the central pool of taxes to local bodies, unlike the ad hoc grants of an absolute amount awarded by earlier UFCs. However, the large number of specific-purpose transfers tethered to conditionalities recommended by the THFC seriously undermines the very idea of fiscally autonomous lower levels of government in a multi-level fiscal system. While it is true that there is no limit on the quantum of grants in total transfers, it is important that they should not unnecessarily impinge on the fiscal autonomy of states. According to them some of the grants, as the papers show, have serious design problems and may not actually augment expenditure, especially that for elementary education. Finally, though the revised road map for fiscal consolidation provides different fiscal adjustment paths to different states to reach the target of a fiscal deficit of 3% of GDP by 2014-15, it reinforces the view of the Twelfth Finance Commission that 3% of GDP is the optimal sustainable fiscal deficit target for states. In reality, this is not so because state-specific levels of sustainable deficit differ depending on state-specific growth, the interest rate on debt and the level of primary deficit.

2.9 Fiscal Federalism – General Observations

Khatkhate, D. R. and Bhatt, V. V. (Feb. 21, 1970) proposed to survey the problems that have arisen in the field of Centre-State financial relations and indicated the broad principles which should determine modifications in existing practices. While discussing the problems they mention the problem of the procedures, forms and mode of assistance, especially in regard to the assistance given by the Planning Commission. Unlike the statutory assistance given under the award of the Finance Commission, the Plan assistance is generally for specific purposes. Initially, the relative roles of the Finance and Planning Commissions was discussed and the points at which they overlap indicated, Secondly, the existing procedures of Central assistance were broadly discussed and their adequacy or otherwise in the changed economic context in India was considered with a view to suggesting improvements in those procedures. Further they mention that the various Finance Commissions devised their own schemes for determining the quantum of statutory assistance to States. By and large, the emphasis is on the need to meet the budgetary gaps of the States. The estimates submitted by the State Governments to these two bodies are not consistent. As the Finance Commission is engaged in filling the revenue gap through statutory grants, the States are tempted to present figures which underestimate their resources. On the other hand, in their sub-mission to the Planning Commission, they consistently overestimate their resources, as the more they promise to rise, the more they are likely to get. Further they mention that the working in isolation of these two Commissions leads some wealthy States to fudge the figures. Since the statutory assistance under the Finance Commission's award is given only to those States which have a gap in their non-Plan revenue account, these States are indifferent to the Finance Commissions and if at all they show any interest, they maneuver a false gap in the revenue account. The position is the opposite when they approach the Planning Commission. The datum which one body considers as relevant is totally ignored by the other. The Finance Commission ignores the Plan expenditure of the States which is in fact supposed to be the leveler of regional disparities. The Planning Commission, on the other hand, leaves out of its consideration the non-Plan revenue gap which is the basis of the Finance Commission's award. According to Khatkhate and Bhatt the

Planning Commission is generally preoccupied with the growth objective while the Finance Commission concerns itself predominantly with the equity objective. While discussing the Spirit of the Federal Principle they mentioned that the States have adhered to the pattern of expenditure as proposed by the Planning Commission even when it was not suited to their needs or, when the assistance was not linked to a specific pattern, utilised it in a manner different from that proposed by the Commission. Further the proposal of the National Development Bank has been made. Khatkhate, D. R. and Bhatt, V. V. suggest that the budget should establish not only the link between the plan objectives and the policy instruments but should also specify clearly the expected performance in various fields.

Thimmaiah, G. (Oct. 17, 1970) commented on Khatkhate D.R. and Bhatt V.V.'s article on Centre-States Financial Relations in Context of Planned Development published in Economic and Political Weekly on Feb. 21, 1970. According to him Khatkhate D. R. and Bhatt V. V. have failed to throw any new light on the problems they have explained ,and their proposed reforms are such as will create other equally complicated problems while attempting to solve some of the existing ones. While criticizing other points he mentions that the creation of a modified permanent Finance Commission and the establishment of a National Development Bank, are not new either. R N Bhargava argued for a permanent Finance Commission as long ago as in 1956 and many writers (on Indian federal finance have since supported this view, though for varying reasons. Similarly, the proposal that a National Development Bank be established for the purpose of distributing Central assistance, in the form of discretionary grants and loans, for States' plans was first made by the Study Team on Financial Administration (Venkatappaiah Team) set up by the Administrative Reforms Commission. 'Later, it was supported by D T Lakdawvala. In their paper, Khatkhate and Bhatt have not even referred to any of these earlier proposals.

Centre-State Financial Relations: I: Scope of the Finance Commission (May 12, 1973) initially states the constitutional provisions to be considered by Finance Commission. According to them Firstly, the percentage of Union tax revenues (under Articles 270 and 272) to be transferred to the states is not laid down. Secondly, none of the Articles lays down the principles on the basis of which distribution has to be made among the states. Both of these are matters which are left to be decided periodically on the advice of a quasi-judicial body called the Finance Commission, to be appointed every five years, or earlier, if considered necessary (Article 280). While discussing the constitutional provisions article states that the Constitution does enjoin upon the Finance Commission to suggest principles for the determination of grants-in-aid, it, at the same time, stipulates that these grants-in-aid should be given to the states "in need of assistance". The Constitution does not, however, lay down how the states' respective "need of assistance" has to be measured. Could this not be taken to mean that the Finance Commission has been given complete freedom to lay down its own yardsticks for the measurement of the states' "need of assistance"? While ending article it mentions that the Finance Commission enjoys the greatest amount of freedom in the matter of both grants-in-aid as well as tax-transfers from the Union to the state government.

Centre-State Financial Relations: III - A Possible Line of Departure from Gap-Filling (Jul. 21, 1973) seeks to offer some ideas about how the Sixth Finance Commission may make a departure from the gap-filling approach to Centre-State relations adopted by earlier Commissions. According to this article Finance Commissions should instead undertake to provide the states with funds which, together with the resources that they can raise on their own, are adequate to en-able them to not only maintain their administrative and social services at or above a certain minimum level, but also to maintain their existing capital assets after having paid their employees, including teachers and local body employees.

Centre-State Financial Relations: III - A Possible Line of Departure from Gap-Filling (Aug. 25, 1973) gives three possible alternative approaches for the Sixth Finance Commission. According to this article one way would be for the Commission to work out first the budgetary gaps of the states following the conventional procedures followed by its predecessor Commissions and then to work out the additional sums which will be required by the state governments for upgrading the level of their administrative services and for the maintenance of existing capital assets according to whatever norms the Finance Commission deems desirable. In the second alternative they suggest that Sixth Finance Commission would be to depart radically from the old practice of effecting maximum resource transfer through tax devolution and instead to transfer through tax devolution only as much as would not give rise to non-Plan revenue account surplus for any state and then to meet the deficits of those states which come up with non-Plan revenue account gaps. While suggesting the third possible alternative they completely discard the pretence of meeting the gap in the non-Plan revenue accounts of the states. Instead what the third alternative seeks to do is to effect a transfer of resources from the Centre to the states, within the framework of the Constitution, in such a manner that it fulfills the following objectives: (i) all the states can maintain or come up to the minimum desirable level of social services with the help of the resources thus transferred from the Centre; and (ii) the states which are back-ward in respect of administrative services and maintenance of existing works are enabled to upgrade both their administrative services and maintenance of works.

Rao V. K. R. V. (Nov. 3, 1973) in the first part discusses the terms of reference of the Sixth Finance Commission, with special reference to the changes, made therein and the implications of these changes for the Commission's recommendations. About the NDC formula they mention that it is not suitable for distribution under Article 275 because distribution under Article 275 is only for states in 'need of assistance', while the NDC formula is for determining assistance to all the states. Moreover, the NDC formula requires 10 per cent of the assistance to be distributed only among the states whose per capita income is below the all-India per capita income. It is well known that state estimates of income are not reliable and contain varying margins of error; and when it comes to comparing them and using the differential for policy purposes, it is very necessary to see that due account is taken of this factor. Further Rao comments that it is possible to the Finance Commission to take inter-state disparities in state Plans into consideration in determining the grants-in-aid under Article 275 at the same time to take a view of the increase in state administrative expenditure and other things. In the second part Rao deals with the specific questions on which the Commission has to make its recommendations i.e. the question of the proportion of income tax receipts that should be made available for distribution to the states and the criteria on which they should be distributed among them. About surcharge he mentions that Surcharges on income tax should be linked with the special needs of the Central government and be limited in duration, with the additional safeguard that if they were continued for a period of more than five years, it would automatically become a part of the divisible pool. Further Rao mentions that the income tax paid by companies is a part of income tax and was so historically; and classifying it as corporation tax and thus excluding it from the divisible pool of income tax receipts was in fact a violation of the spirit of the Constitution. Its exclusion has only reduced the elasticity of the income tax as a statutory part of state revenues and this has not been adequately compensated by raising the share of the states from 50 to 75 per cent in its proceeds especially in view of the fact that the increase given has its own independent justification. The final part of the article contains some general observations for better coordination and rationalisation of Union-State financial relations. Like there is need for setting up an inter-State-Union Council on the lines provided for in Article 263 of the Constitution. Such a body could bring about joint thinking and necessary coordination between the Centre and the states in matters of tax policy, tax avoidance, and tax evasion. Further Rao mentions the need of an organisation, which will be specifically in charge of loan-raising and loan-utilisation, whereas the existing position is confused, with the Reserve Bank, the Central Ministry of Finance, the Planning Commission, and, to some extent, the state governments, all playing a somewhat uncoordinated role in this matter.

George K. K. and Gulati I. S. (Feb. 16, 1985) comments that the states would not be able to meet adequately the expenditure functions assigned to them unless they could have access to additional resources. In this paper, an attempt has been made principally to review the major changes in resource flows from the Centre to the states and in the magnitude and nature of financial dependence of the states in the course of the last thirty years or so. With the help of table they have explained the share of states in the combined resources of the centre and states during 1951-84. George and Gulati analyse the trends in the development expenditure of centre and state during 1951-1984. From the table it seems that the Share of Developmental Expenditure in the total Revenue expenditure of the Centre and state has been increased but the share of states in the aggregate developmental expenditure (on Revenue Account) of Centre and states was declined. Further they explained the share of transfers to the states in the total central resources during 1951-1984. Table shows the declining trend in the Central loans to states as per cent of Centre's Capital Account Receipts (including Deficit Financing) at the same time Total Revenue Account Transfers (Taxes + Grants) as percent of Centre’s Gross Revenue Account Receipts which were 23 percentages in the Ist plan increased to 35.9 percentage in the VIth plan. Further George and Gulati discussed dependence of the states on central transfers, aggregate central transfers (gross) through various agencies (i.e. statutory transfers, plan transfers and discretionary transfers), composition of Central budgetary transfers to the states during 1951 to 1984 and aggregate (gross) budgetary transfers during 1956-1981. While discussing the equity in inter-state distribution they criticized that the low-income states, as a group have received relatively lower than average per capita transfers of all the three types. The three agencies, the Finance Commissions, the

Planning Commission and the Union ministries, do not seem to have had equity uppermost in their minds in effecting the inter-state distribution of the transfers within their respective ambit.

Chelliah R. J., Rao M. G. and Sen T. K. (Nov. 21, 1992) discussed issues before Tenth Finance Commission (TFC). First they discussed briefly the principal theoretical issues in federal finance. In this discussion attention is concentrated on the economic case for decentralised provision of public services, the emergence of the federal finance problem in the form of vertical and horizontal fiscal gaps, different methods of effecting transfers' from the centre to the states and the criteria for determining the optimal design of federal transfers, keeping in view not only the objectives of the transfers but also the nature of response to the design on the part of the recipient units, i.e. the objectives of the transfers as well as their incentive effects. Further in section III the broad trends in the central and state finances and in the financial relations between them were reviewed. This review is intended to provide the empirical basis from which the TFC could proceed to consider its tasks. The next two sections briefly analyse the terms of reference of the TFC and the tasks before it. In the final section they discussed major issues to be considered by the commission and the considerations that must be borne in mind in deciding those issues. Such as proportion of central revenues to be transferred, principles of grant-in-aid, assessment of growth of revenues of centre and states, assessments of growth of revenue expenditures and alternatives were suggested for phasing out revenue deficits and reduce states' fiscal deficit. While concluding they criticize the terms of reference of the Finance Commission that the traditional emphasis on tax effort and tax potential without any reference to tax reform or rationalisation at the state level and the absence of any reference to one of the aims of the structural adjustment programme, namely, reducing the role of the government and the area of public enterprises clearly shows that the Finance Commission's terms of reference have been drawn up outside the framework of the structural reform programme. Further they also mentions the widespread feeling and knowledge that government leaders and government servants are using revenues in many unproductive ways and often for their own benefit rather than for the benefit of the people at large and suggest that the budgetary equilibrium should be sought to be achieved more through the pruning of government expenditures than through the raising of higher tax revenues.

Rao H. (Dec. 19-26, 1992) gave brief introduction of constitutional provisions regarding fiscal transfers in India. They further reviewed the different criteria used for devolution of income tax and excise duty and justification for using the same given by different Finance Commissions i.e. First Finance Commission to the Ninth Finance Commission. According to them review of the approaches of the various Finance Commissions with regard to union excise duties brings forth several issues for scrutiny: (I) the taxes on income and union excise duties both are revenue-sharing devices. Both are guided by the same economic rationale. Then should these two taxes be treated in totally different manner, just because the wordings while framing the two articles differed? (2) Should a divisible tax like union excise duty which has emerged as the most elastic source of revenue be used for substituting grants-in-aid which is provided under Article 275 of the Constitution? (3) Should the criteria for inter se distribution of these two taxes be different or should one follow a uniform basis of distribution? According to them the federal government can discriminate between the states while giving grants on some ground. Under the revenue-sharing system all states have to be given their dues on some uniform principle. Thereafter they gave the brief history of excise duty. They suggest that both the income tax and excise duty have the same theoretical basis of sharing and common economic rationale and hence they should be treated-alike in the federal fiscal transfer scheme. If need be the Article 272 may even be amended to give the same legal status to excise as is given under Article 270 to income tax. Regarding the second issue they mention that it is totally wrong to use sharing of excise duties to serve the purposes of grants-in-aid. Rao H. insisted that the aim of the commission should be to discourage the states to show larger revenue deficits. According to them by giving a percentage share in the expanding source of revenue, states would be encouraged to incur growing deficits. Regarding the third issue they mention that there is no logic in applying different criteria and principles in the case of shared taxes and duties, as they have a common economic rationale and both are in the nature of ‘revenue-sharing’.

Guhan S. (Apr. 22, 1995) evaluates the recommendations of the Tenth Finance Commission and outlines a scheme of federal fiscal transfers. They explained their article in five sections. The first section talks about the fiscal scenario at the centre and in the states. The trends and dimensional magnitudes of fiscal imbalances were explained on the basis of six tables i.e. Revenue Deficit in the Centre and the States (1974-1995), Fiscal Deficits and Revenue Deficits in the Central Budget (1990-96) –

Increase in the ratio of revenue deficits to fiscal deficits shows an important contributory cause to fiscal deficits, Incidence of Gross Revenue Transfers: Centre and States (1990-95), Channels of Centre – State Gross Revenue Transfers (1990-95), Centre's Revenue Account after Statutory Transfers (1990-95), State's Revenue Account after Statutory Transfers (1990-95). They put forward the observation that the proposed reduction of the fiscal deficit to 5.5 per cent of GDP in 1995-96 from 8.3 per cent in the pre-reform year of 1990-91, with no reduction in the revenue deficit between these two points of time, implies that the only option that the central government has found feasible is to curtail capital expenditures; it has been unable or unwilling to reduce the current account deficit. While concluding the first section they mention that because of and despite stagnant proportions of tax sharing, a persistent disjunction has emerged between the needs of the states and the ability of the centre to meet them. In the second section Guhan S. discussed whether Tenth Finance Commission's recommendations ought to cover the entire revenue account of the states (plan and non-plan) or only the non- plan component and rationale behind it. For this purpose they took the brief review of Ten Finance Commissions i.e. First to Ten. Further they pointed out that it is a matter for much disappointment that the TFC, while reviewing the centre's forecasts, has not referred to the need for better enforcement in the collection of the shareable taxes. For this they give observations of the Tax Reform Committee under the chairmanship of Raja Chelliah. Further they discuss the devolution of shareable taxes in which vertical shares, horizontal shares: criteria used by different Finance Commissions for distribution of income tax and excise duty. They criticize the criteria the infrastructure index for not giving any clear or precise information how it has been computed. In the third section they discussed the other issues like Upgradation Grants, Grants for Local Bodies, Calamity Relief, Distribution of Additional Excise Duties and Grants in Lieu of the Repealed Tax on Railway Passenger Fare. In the forth section they discussed the 'Alternative Scheme for Devolution' given by the Tenth Finance Commissions in its chapter XIII. According to them the essence of the alternative is that the base for the devolution of taxes from the centre to the states need not be confined, as at present, to income taxes and excise duties but could include the gross proceeds from all taxes that are, or may be levied and/or collected by the centre. The rationale for the same given on several strong grounds and in the concluding fifth section recommended an Alternative to the Alternative.

Vithal B. P. R. (Oct. 7, 1995) pointed out initially the broad features of the TFC's scheme. While discussing alternative approach of Tenth Finance Commission they mention that in the case of income tax it has taken 50 years to give up any share based on collection, even when this is a union tax. One can imagine what the resistance will be to giving up origin-based taxation when the tax becomes a state tax and further discussed the difficulties involved in it. Further they discussed the scheme recommended by Guhan. The needs of the less developed or problem states and subject to a limiting provision regarding revenue deficit were discussed. Since there is likely to be general agreement regarding the pooling of the gross receipts of all central taxes, this can be a regular amendment to the Constitution. According to them what is needed now is a suitable mechanism for formally eliciting different views on the TFC scheme and examining these with a view to evolving a consensus. Under the existing constitutional provision a Finance Commission has to be appointed in June 1997. If action is not taken before then the old cycle will start once again and constitutional inertia will set in. The present opportunity is, therefore, available only till then and it is important to see that we do not lose it.

Godbole M. (Jan. 6-12, 2001) criticizes the reports of the Finance Commissions. While criticizing the assumptions they mention that the assumptions on which awards are made by the finance commissions are wide of the mark. No effort is made by the incoming finance commission to examine and present, as a part of its report, any analysis of the extent to which the assumptions made and the approach adopted by the preceding finance commission have proved to be right. No effort is also made to analyse if any of the major recommendations made by the preceding finance commission were effectively implemented by the Centre and the states. While commenting on the implementations regarding the fiscal discipline they mention that many of the important recommendations were not implemented by the central or the state governments and recommends that the government of India must start the practice of placing the report of the finance commission before the Inter-State Council (ISC) or the National Development Council (NDC) before decisions thereon are announced by the central government. Further they discussed the constitutional issue regarding article 275 and EFC recommendations. According to them central law on fiscal responsibility and budget management may be passed which would be applicable not only to the centre but to all the states.

Jha Shikha (Jun. 29 - Jul. 5, 2002) in their article titled “Strengthening Local Governments: Rural Fiscal Decentralisation in India” evaluates the fiscal success of recent efforts towards reforming and strengthening rural governments in India through the process of rural decentralisation initiated with the 73rd Constitutional Amendment Act in' 1992. It measures the extent of fiscal decentralisation that has taken place in order to evaluate how far the rural governments have effective control over expenditure decision-making. The analysis is based on budget data of rural governments in seven Indian states for the decade of the 1990s and presents recommendations to make fiscal decentralisation more effective. Jha rightly pointed out to make Rural Decentralisation More Effective like Set the expenditure responsibilities of PRIs clearly for each level, Make higher spending responsibilities commensurate with higher devolution of power to raise resources, Raise state transfers to PRIs in the form of untied grants and raises some questions. They feel that to flourish PRIs into strong governments they need substantial nourishment in the form of better institutional capacity, larger resources and, most importantly, higher authority to spend them on improving local services.

Rao and Singh (2007) examined the recent and potential reforms in India's fiscal federal system and summarized key federal institutions in India, including tax and expenditure assignments, and mechanisms for Center-state transfers. Further they discuss the institutional process by which reforms can and do take place, including the role of academics, political influences, and especially institutions such as the Finance Commission. They show that in contrast to the past, recent commissions have played a greater role in articulating an agenda for fiscal federal reform, which then proceeds through political bargaining. This change has taken place in the context of, and been influenced by, broader economic reform in India. Article pointed out that the Finance Commission's role over the last decade has thus come to include recommending major institutional reforms that transcend a narrow determination of intergovernmental transfers. Author strongly feel to bring out one of the most important fiscal reform that the system of Center-state transfers be simplified, and that the Finance Commission be given a greater role in governing these explicit transfers. Another is that tax reforms can include some realignment of tax assignments to remove anomalies and to reduce the extent of vertical transfers. In these cases, there are some possibilities for creating politically feasible policy reform packages. This article also assessed some aspects of the local government reforms and discussed how reforms of the Center-state transfer system, and of the Planning Commission's role, could aid the effectiveness of local governments. Finally, the discussion of Center-state transfers was related to the issue of financing states' capital expenditure through more effective borrowing mechanisms.

George, K. K. (2014) in their article titled ‘Fourteenth Finance Commission in the context of emerging Central-State Fiscal relations’ made observation that the Finance Commissions the only constitutional body means for allocating Central funds to the States, has now become a pale Shadow of its constitutional of self. According to them a major part of the blame has to be borne by the successive FCs themselves who became willing accomplices of the Central Government for eroding their own role. They seem to have been gradually forgetting to whom they are accountable. The FC under the Constitution is meant to be arbiters between the Central Government (CG) and the State Governments (SGs). According to them the ToRs are framed without consulting with the States. It is as though in addition to appointing umpires of its choice the rules of the game are written by one of the teams in its favour each time. These ToRs are unnecessary as the Constitution itself has defined the ToR of the FCs.

Oommen (2015, February) in their article titled ‘Fiscal Federalism, Local Governments’ pointed out that India is the most fiscally centralized country in the world. Even the unitary government of communist China is far more decentralized than India. Further author expects that the primary rationale of strengthening the panchayats (making them virtually smart) and also following the letter and spirit of the 73rd/74th Constitutional Amendments is that every citizen irrespective of his or her choice of residence should have the basic amenities of sanitation, drinking water, housing, electricity, connectivity (both road and internet) and other public services is something that needs immediate attention. It is important to incentivize the LGs to mobilise their own source revenue that Punjab, Rajasthan and Haryana abolished property tax-the main source of local governments in 80 per cent countries of the world and several other retrograde actions are also matters of grave concern. However, it is equally important to work towards a transfer system that will enhance the fiscal capacity of local governments to offer comparable levels of public services for all citizens, the tribal in remote areas as well as for the elite citizens of New Delhi of course with comparable revenue efforts.

To Sum up -

- The literature accepts that the alternative system as suggested by Tenth Finance Commission helped to make the central tax structure more equitable and simple. Earlier, it was seen that the decline in the tax-devolution percentage could be attributed to the relatively larger reliance placed by the Centre on non-shareable taxes like customs duty, corporation tax and surcharge on income-tax in preference to income-tax and union excise duties.
- The studies also pointed out that successive Finance Commissions have given due importance to States' concerns with regard to their share in the divisible pool and its composition. With the clubbing of most Central taxes since the Eleventh Finance Commission, the shareable pool of taxes has not only expanded but the States' share in it has also increased. Further literature pointed out that the Eleventh Finance Commission's recommendations used a higher share for achieving horizontal federal fiscal equity than the Tenth, Twelfth, and Thirteenth Finance Commissions. According to them sharing one third of gross revenue with states could make good balance in tax-sharing between the Centre and the state. Some of the studies agree to the state's concern to raise tax share of States in Central taxes. Further studies suggest for limiting transfers under CSS. They feel that if the Commission decides to reduce the CSS and special packages to individual states, the scope for reduction in the Centre's expenditure on civil administration will be enhanced substantially.
- The studies also found that the ratio between Non-plan grants and Plan grants has declined substantially, indicating the increase in the tied nature of fund transfers to States. The trends of central transfers to States show that while total grants as a proportion of Gross Devolution and Transfers (GDT) have increased slightly over the last two decades, Non-plan grants as a proportion of both total grants as well as GDT shows stagnation. While Plan grants have been increasing during this period, the Non-plan grants, which form a major part of the untied transfers to States, have declined thus imposing restrictions on States in their expenditure decisions. The share of States in gross central tax revenue, which is devolved according to FC recommendations, has also followed the same pattern and does not show significant variations.

- While commenting on the horizontal criteria some of the studies criticise that Indian Finance Commissions has, so far, been to concentrate only on the common factors such as population, poverty, backwardness, etc, and somehow relate the fiscal devolutions to these factors. The state-specific factors are altogether ignored. Some studies suggest that the formula for tax sharing cannot be made too skewed to achieve the objective of equity. Already large states like Bihar and Uttar Pradesh, which contribute comparatively smaller shares to the central tax kitty receive significantly higher shares as devolution. In contrast, states like Gujarat and Maharashtra, which account for a very high proportion of central tax revenues, receive only a very small share by way of devolution.
- Some of the studies observed that the gains and losses in the shares of individual states from the actual Finance Commission awards have not necessarily followed in the same direction as the income category they belonged. Further, some of the empirical analyses reveal that though transfers helped to reduce the overall gross fiscal deficit of the states, the issue of reducing horizontal fiscal inequity is yet to be addressed.
- The studies observe that unlike the devolution formula for Central taxes, grants provide greater scope to make corrections for cost disabilities faced by many States. The grants recommended by the FCs have generally been unconditional and largely based on the projected gaps between non-Plan revenue expenditure and post-tax devolution revenue receipts. This approach has often been criticised as it does not provide for fiscal discipline at the State level.
- The finances of municipalities in India are in a highly unsatisfactory state, adversely affecting, on the one hand, the productivity of cities and towns and, on the other, the quality of life. The two constitutional amendments of 43 Y and 280(3)(c) which are a part of the 74th amendment and which aim at the strengthening of the finances of municipalities, have not been accorded the attention they deserve. The availability of resources for PRIs in the combined revenues of all level governments is very negligible. This means, as brought out earlier, the resources are concentrated at the states and the Central level. To flourish PRIs into strong governments they need substantial nourishment in the form of better institutional capacity, larger resources and, most importantly, higher authority to spend them on improving local services.

References :-

Babu, Devendra (2009). FISCAL EMPOWERMENT OF PANCHAYATS IN INDIA: REAL OR RHETORIC?. The Institute for Social and Economic Change, Bangalore. Retrieved from: http://203.200.22.249:8080/jspui/bitstream/2014/7106/1/ISEC-WP-229.pdf

Bagchi, A.. (2005). Symposium on Report of Twelfth Finance Commission: Introduction and Overview. Economic and Political Weekly, 40(31), 3388–3395. Retrieved from http://www.jstor.org/stable/4416958

Bhaskar, V. (2013, April). Issues before the Fourteenth Finance Commission. Economic and Political Weekly, xlviii(17), 31-36.

Centre-State Financial Relations: I: Scope of the Finance Commission (May 12, 1973), Economic and Political Weekly, 8(19), 873-877.

Centre-State Financial Relations: III - A Possible Line of Departure from Gap-Filling (Jul. 21, 1973), Economic and Political Weekly, 8(29), 1295-1298.

Centre-State Financial Relations: IV - A Possible Line of Departure from Gap-Filling (Aug. 25, 1973), Economic and Political Weekly, 8(34), 1561+1563+1565-1567.

Chakraborty, P. (2010). Report of the 13th Finance Commission: Introduction and Overview. Economic & Political Weekly, XLV (48), 35-37.

Chakraborty, Pinaki (2010, November). Deficit Fundamentalism vs Fiscal Federalism: Implications of 13th Finance Commission's Recommendations. Economic & Political Weekly, XLV (48), 56-63.

Chelliah R. J., Rao M. G. and Sen T. K. (Nov. 21, 1992), Issues before Tenth Finance Commission, Economic and Political Weekly, 27 (47), 2539-2550.

Das-Gupta, A.. (2010). The 13th Finance Commission and Improving Fiscal Outcomes: An Assessment. Economic and Political Weekly, 45(48), 78–83. Retrieved from http://www.jstor.org/stable/25764186.

Dholakia, Archana R. (2010, July 31). A Comment on the Distribution Formula of the 13th Finance Commission. Economic & Political Weekly, xlv (31), 16-17.

Finance commissions in India: An Assessment (2011). State Finances: A Study of Budgets 2014-15, Reserve Bank of India.

Gandhi, P. J. (2004). Eleventh Finance Commission: A critique. In Chaubey, P. K. (Ed.). Fiscal Federalism in India. (pp. 150-155). New Delhi: Deep and Deep publications Pvt. Ltd.

George, K. K. (2014, October). Fourteenth Finance Commission in the context of emerging Central-State Fiscal relations. Budget Track, 10(1-2), 11-15.

George K. K. and Gulati I. S. (Feb. 16, 1985), Centre-State Resource Transfers, 1951-84: An Appraisal, Economic and Political Weekly, 20(7), 287-295.

George, K. K. (2014, October). Fourteenth Finance Commission in the context of emerging Central-State Fiscal relations. Budget Track, 10(1-2), 11-15.

Ghosh, J.. (2005). Twelfth Finance Commission and Restructuring of State Government Debt: A Note. Economic and Political Weekly, 40(31), 3435–3439. Retrieved from http://www.jstor.org/stable/4416965

Godbole M. (Jan. 6-12, 2001), Finance Commissions in a Cul-de-sac, Economic and Political Weekly, 36(1), 29-34. Retrieved from http://www.jstor.org/stable/4410138

Guhan S. (Apr. 22, 1995), Report of Tenth Finance Commission, Economic and Political Weekly, 30(16), 877-886.

Gupta, C. D. (2014, October). Paradigmatic Questions about the Mandate of the Fourteenth Finance Commission. Budget Track, 10(1-2), 9-10.

S. Gurumurthi. (2003). Issues before 12th Finance Commission: Review of Vertical and Horizontal System of Tax Sharing. Economic and Political Weekly, 38(7), 648–655. Retrieved from http://www.jstor.org/stable/4413219

Hajra, K. S., Rakhe, P. B. & Gajbhiye, D. (2008). Issues before the Thirteenth Finance Commission: Correction of Horizontal and Vertical Imbalances. Economic and Political Weekly, 43(12-13), 89-96.

Isaac, T. M. T., & Chakraborty, P.. (2008). Intergovernmental Transfers: Disquieting Trends and the Thirteenth Finance Commission. Economic and Political Weekly, 43(43), 86–92. Retrieved from http://www.jstor.org/stable/40278107

Jha Shikha (Jun. 29 - Jul. 5, 2002), Strengthening Local Governments: Rural Fiscal Decentralisation in India, Economic and Political Weekly, Vol. 37, No. 26 pp. 2611-2623

Kannan, K. P., & Mohan, R.. (2004). Twelfth Finance Commission: View from Kerala. Economic and Political Weekly, 39(23), 2361–2375. Retrieved from http://www.jstor.org/stable/4415121

Kannan, R., S. M. Pillai, R. Kausaliya, & Jai Chander. (2004). Finance Commission Awards and Fiscal Stability in States. Economic and Political Weekly, 39(5), 477–491. Retrieved from http://www.jstor.org/stable/4414584

Khatkhate, D. R. and Bhatt, V. V. (Feb. 21, 1970), Centre-States Financial Relations in Context of Planned Development, Economic and Political Weekly, 5(8), 367+369-373+375.

Kurian, N. J.. (2008). Equalising Transfers through the Finance Commission. Economic and Political Weekly, 43(29), 37–43. Retrieved from: http://www.jstor.org/stable/40277742

Mathur, O. P.. (2013). Finances of Municipalities: Issues before the Fourteenth Finance Commission. Economic and Political Weekly, XLVIII (22), 23-27.

Mitra, S.. (2014). Reduced Fiscal Autonomy in States. Budget Track, 10(1-2), 20-23.

Mohan R. and Shyjan D. (2009). Tax Devolution and Grant Distribution to States in India Analysis and Roadmap for Alternatives. Retrieved from: http://www.cds.edu/wp-content/uploads/2012/09/wp419.pdf

Oommen, M. A.. (2005). Twelfth Finance Commission and Local Bodies. Economic and Political Weekly, 40(20), 2022–2026. Retrieved from http://www.jstor.org/stable/4416632

Oommen, M. A.. (2015, February). Fiscal Federalism, Local Governments. Yojana. Retrieved from http://www.yojana.gov.in/Final%20Yojana%20Febuary%202015%20GS.pdf

Rakshit, Mihir (2010). Fiscal Consolidation and Inclusive Growth: The Finance Commission Approach. Economic & Political Weekly, XLV (48), 38-45.

Rao H. (Dec. 19-26, 1992), Devolution Criteria for Union Excise Duties and Taxes on Income: Should They Be Different? Economic and Political Weekly, 27(51/52), 2717-2720.

Rao, M. G., & Singh, N.. (2007). The Political Economy of India's Fiscal Federal System and Its Reform. Publius, 37(1), 26–44.

Retrieved from http://www.jstor.org/stable/4624780

Rao, M. G.. (2010). The 13th Finance Commission's Report: Conundrum in Conditionalities. Economic and Political Weekly, 45(48), 46–55. Retrieved from http://www.jstor.org/stable/25764182.

Rao V. K. R. V. (Nov. 3, 1973), Rationalisation of Centre-State Financial Relations: Issues before the Sixth Finance Commission, Economic and Political Weekly, 8(44), 1961+1963-1965+1967-1971.

Ravi Kumar, T. (2001). Regional Development Criteria and Horizontal Devolution under the Finance Commission Awards. Economic and Political Weekly, 36(50), 4671–4675. Retrieved from http://www.jstor.org/stable/4411479

RBI. (2011). Finance Commissions in India: an assessment. In State Finances: A Study of Budgets of 2010-11.

Reddy, G. R.. (2006). Twelfth Finance Commission and Backward States. Economic and Political Weekly, 41(32), 3513–3520. Retrieved from http://www.jstor.org/stable/4418568

Roy, Rathin (2011, April). A Response to Conundrums and Fundamentalisms Perceived in the THFC Report. Economic & Political Weekly, xlvi (17), 76-79.

Sarma J. V. M. (Jul. 12-18, 1997), Federal Fiscal Relations in India: Issue of Horizontal Transfers, Economic and Political Weekly, 32(28), 1719-1723.

Srivastava, D. K.. (2010). Vertical Sharing and Horizontal Distribution of Resources: The Equity and Efficiency Trade-off. Economic and Political Weekly, 45(48), 64–70. Retrieved from http://www.jstor.org/stable/25764184

Tapas K. Sen, & Christoph Trebesch. (2004). Use of Socio-Economic Criteria for Intergovernmental Transfers. Economic and Political Weekly, 39(26), 2748–2755. Retrieved from http://www.jstor.org/stable/4415203

Thimmaiah, G. (Oct. 17, 1970), Centre-State Financial Relations: A Comment, Economic and Political Weekly, 5 (42), 1751-1752.

Thimmaiah, G. (2002). Finance Commission: Decline of a Constitutional Institution. Economic and Political Weekly, 37(47), 4664–4668. Retrieved from http://www.jstor.org/stable/4412863

Thimmaiah, G.. (2013). Terms of Reference of the Fourteenth Finance Commission. Economic and Political Weekly, XLVIII (48), 18-21.

Vithal B. P. R. (Oct. 7, 1995), Alternative Approaches to Devolution: Implications of Tenth Finance Commission's, Economic and Political Weekly, 30(40), 2518-2522.