Chapter- 4

UNION-STATE FINANCIAL RELATIONS

India is a federal state with constitutional demarcation of financial powers and responsibilities between union and states. The present federal system of finance in India has been achieved through an evolutionary process spread over the last 138 years. Out of colonial necessity finances of British India were highly centralized. The first successful as well as modest scheme towards financial decentralization drafted by Lord Mayo was adopted in 1871 when services of local character were made over exclusively to the provincial governments the next step towards decentralization of finances came in 1877 when heads of revenue were demarcated into centre and provinces.

The system of federal finance or financial decentralization consolidated further with the passing of Government of India Act 1919. Under the Act provincial governments were awarded some sort of financial autonomy for the first time. Meanwhile the government of India Act passed in 1935 envisaged the formation of federal form of government at the centre with autonomy granted to provinces. The Constitution of India adopted in 1950 opted for federal financial arrangements.

FISCAL FEDERALISM AND CONSTITUTION PROVISIONS

According to constitution, the union government is empowered to make legislation in matters related to the entries in List-I of Seventh Schedule, which contains inter-alia provisions for taxations. Till the other day the taxes and duties were classified in following five categories:

- Taxes and duties which are to be levied collected and wholly appropriated by the union: Customs duties including export duties (entry no. 83), corporation tax (entry no.85) taxes on the capital value of assets (exclusive of agricultural land) of individuals and companies and taxes on the capital of companies (entry no. 86). The proceeds were to form a part of Consolidated Fund of India.
➢ Taxes and duties which are to be levied and collected by the union but necessarily to be distributed between the union and the states (Art. 270): Taxes on non-agricultural income (entry no. 82). Only a part of the proceeds was to form part of the Consolidated Fund of India.

➢ Taxes and duties which are to be levied and collected by the union and may be distributed between union and the states (Art. 272): Duties of excise with exception of alcoholic liquors and narcotics but including medicinal and toile preparations containing alcohol (entry no. 84). Such proceeds form part of the Consolidated Fund of India but a part of such proceeds could be paid out of Consolidated Fund of India if the parliament so decides.

➢ Taxes which are to be levied and collected by union but are assigned to the states where they are leviable (Art. 269): Estate duty of succession in respect of property other than agricultural land (entries no. 87 & 88), terminal taxes on goods and passengers carried but railway, sea or air as well as taxes on railway fares and freights (entry no. 89), tax (excluding stamp duties) on transaction on stock exchanges and futures markets (entry no. 90), taxes on sale and purchase of newspapers and on advertisements published (entry no. 92) taxes on inter-state sale and purchase of goods other than newspaper (entry no. 92 A) taxes on the consignment of goods in inter-state trade or commerce (entry no. 92 B).

➢ Duties which are to be levied by union but are to be collected and appropriated by states (Art. 268): Stamp duties in respect of bill of exchange, cheques, promissory notes, bills of lending, letters of credit, policies of insurance, transfer of shares-debentures, proxies and receipts (entry no. 91).

There is a constitutional division of functions and powers between the two layers of government. Almost in all the federations, federal government is endowed with vast powers. The need for a virtually unlimited federal taxing power is obvious. It is the federal government which is in a position to meet any emergency that may arise. Tax imposed by federal government is not meant only

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to raise resources but is also meant for the promotion of anti-cyclical and other economic policies. Federal government is only government which can reduce the economic imbalances among the provinces. The poor states can not be left dependent on the largesse of wealthier ones. In all the federations, it is the central government that has large resources at its command in relation to the responsibilities. The resources are more elastic in nature owing to national base available to the centre. Efficiency in tax administration for certain revenues required central administration. It may be reasonably presumed that some kind of comparative cost advantage principle is used for allotting sources of revenue, which have a national base, and whose cost of collection would enjoy economics of scale would automatically go to the federal government. The states governments have power to tax only the local tax base. The states are expected to tax persons and all types of transactions falling only with in their jurisdiction.

“The methods of allocating taxing power in federation may vary between two polar extremes; one may calculate the foreseeable revenue requirements of each level of government and allocate sources of taxing in accordance with these needs.” In this context Richard M. Bird opines, “The gap between the sources of revenue and expenditure of states is required to be filled by the federal government under certain obligatory and discretionary conditions by transferring a portion of its revenue to the state governments.”

The Union-State Governments each have under its own independent control financial resources sufficient perform its exclusive functions. In this deal “own-source” of revenues of each level of government should suffice to finance the expenditures for which it is responsible without recourse to intergovernmental fiscal transfers. Only thus can the desired position of both local autonomy of action and local responsibility for those actions are attained.” Fiscal balance in this sense would seem to require the assignment to each order of government of separated and independent revenue sources

sufficient to finance the expenditures assigned to that jurisdictional level.” As clear cut separation of resource raising power to enable all the levels of government to meet their expenditure requirement may not be feasible in a federation, where the federal government is deliberately given large powers for purposes of maintaining economic stability, inter-state distribution of resources to reduce disparities for purpose of defense and other crucial functions.

The constitution provided the centre with sources of revenue which were likely to grow with development of the industrial and commercial sectors of the economy increase in exports and import and growth of consumption. The most notable were taxes on income other than agricultural income corporation tax, customs duties and other excise duties.

The states were given resources which barring sales tax and state excise duties would grew as agriculture became more of an industry and the rural sector began to be taxed adequately. However, the scope of central taxes from which transfers have been made, has been limited on account of the exclusion of the corporation tax and custom duties. The states have found difficult, politically and administratively to carry the taxation of land and water and other rural services for enough. In Indian sources of taxes are divided between centre and the units under the vast planning the states have been burdened with a number of developmental activities which calls for a great deal of financial sources. The central policy affects the prosperity of the state as it has not only got more resources but there are several constitutional provisions of which it gets surplus revenues, loans and grant from international sources.

The centre has a lot of discretion in the matter of helping the units. Grants are always made on conditions. It is here that the centre is able to influence the policies of the state governments. The finance minister of a state cannot hope to have discretion in putting forth a new policy especially when the state is poor in resources. Grants-in-aid and gifts by centre are the powerful means whereby strings can be attached by the centre to influence the policies of the state and even bring pressure indirectly to carry through central directions. In the VIII
schedule certain large taxing power vested in the centre.” Art. 275 give the centre power to make grants. All these are ways and means of entering into the financial structure of the state. Centre government also gives loans to the states, the central government functions as a money lender with a profit motive. For example, “the centre obtained loans from international agencies at two percent interest and passed it to the states at 10% interest.” Also, the centre reduced the period of repayment from forty or fifty years to ten or fifteen years while passing on the funds to states.

There is one federal government which forms the upper layer of government and there are states or provinces which form the lower layers of government. It should be remembered that in a federation no federating state is a sovereign state. “The federation is the union of states which there is a dual state authority”173 Both layers of government make decisions concerning the provision of certain public services in their respective geographical jurisdiction. Federal Fiscal system of country in invariably associated with formation of federations. Initial assignments and re-assignments of powers and functions determine the strength of the central government and the states”.174 Most of federations have come to exist either through a process of aggregation of pre-existing unit or by the process of devolution and decentralization. According to Richard Bird, “only the foremost sort of federation is likely to correspond to the conventional picture of a federal government in the strict sense of a system. The central and sub-national governments are each, with in a sphere, coordinate and independent. The central Government in India controls monitory policy and deficit financing which has also given rise in vertical imbalance. The Indian States have failed to raise sufficient revenues to finance their burgeoning expenditure175.

174 Excellent exposition of five classes of functions, namely (a) Regulatory, (b) Supply, (c) Revenue, (d) Redistribution, (e) Stabilization functions are available in Breton. A and Anthony Scott, 1978.
175 Rao, M, Govinda and Sen Thaper K Fiscal federalism in India Theory and Practice Macmillan, 1994, Delhi p 136
Thus we look two approaches to analyze inter-governmental relations. One is the “Aggregation model” and other is the “Devolution Model.” When a federation is an outcome of the “devolution model” the centre happens to be more dominating than when a federation emerges out of aggregation. According to Bird, with regards to inter-governmental grants for example, “the devolutionist will in all likelihood tend to stress the inducement (substitution effect) because his real interest is in imposing central preferences on local governments while the aggregationist will stress the additional resources (Income effect) received by the locality because his interest in realizing local aspirations the former is therefore prone to recommend conditional grants and the latter unconditional grant.” Thus, the distribution of powers and functions is dependent upon the centripetal and centrifugal forces prevailing at the time of formation of a federation.

The Central government accepts primary responsibility for stabilization and fair distribution of income and supply of such public goods which maximize the welfare of the entire country. In all the federations it is the federal government, which is endowed with expansive resources, and this layer enjoys surplus, while the federating units have to perform expensive functions and have resources emerging from the local base, which do not commensurate with their expenditure requirements.

The states invariably experience huge revenue gap or non-correspondence, the very fact that the federal government commands resources, while states have to look for federal fiscal transfers gives rise to problem of Vertical Fiscal Imbalances. Horizontal Fiscal Imbalances (HFI) arises due to the differences in the resource raising capacity and fiscal need of various similarly situated states. Horizontal fiscal imbalance is also inevitable mainly because of diversity in natural resources and disparities in economic structure and socio-economic levels of development of federating units. It determines on one hand the varying degree of fiscal capacity and the fiscal need of the states on the other

hand. HFI coupled with the Vertical Fiscal Imbalances (VFI) increases the need for federal fiscal transfers to the states in any federation.  

In the different forms of fiscal adjustments, the various means adopted in different countries including India to reduce Vertical Fiscal Imbalances depend upon the circumstances, which led to the formation of the federation. In most cases federations are unions of pre-existing governments and hence each union has its own special heritage. The various tools adopted for effecting federal fiscal adjustments are: Tax Sharing, Tax Credit, Tax Abatement, Revenue Sharing, Tax Proceeds. Tax sharing and tax assignments are used as a tool to reduce vertical fiscal imbalance. Usually the surplus revenue raised by the central government is shared with the states. “The term revenue sharing is used and applied to such a variety of actual and or potential programs. The idea of divisible taxes consisting of all major federal taxes is to help reduce the dependency of states on conditional transfers. This problem of non-correspondence was sought to be corrected by the centre by transferring resources to states a large chunk of the increment to federal revenues in form of a sort of unconditional grants-in-aid on which the states have right.A Supplementary levy is also the method of achieving fiscal adjustment. In order to augment the state resources some times the states are authorized to levy supplementary taxes on federal tax. Such levies are to be collected by federal government and the proceeds are assigned to the states.

**TAX-BASE SHARING CENTRE AND STATES**

Tax sharing or more precisely tax base sharing is popular method of fiscal adjustments in some of the federations like US and Canada. Under this method the federal government retains the current assignments for tax administration. But it vacates tax room for the states by reducing its own rates for various types

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of taxes. The states are left free to tap the remaining tax base by applying their own tax rates. The tax base is defined and the centre of course decides the scope in consultation with the states. In this method both the centre and states are free to tax the same base. Vertical Fiscal Imbalance is important to know whether the two layers of government are putting enough efforts to mobilize the constitutionally allotted resources and their expenditure policy is judicious. In case the resources mobilization efforts of the federal government is not to its fullest capacity and at the same time if federal government spends on items, which are best suited to be within the state’s sphere or if these is no rational expenditure policy pursued by the government the resource balance of the federal government will fall. The states may also be lacking in tax mobilization efforts and may be spending on non-productive items in that case also the estimation of vertical fiscal can get biased. If central government is mobilizing good amount of revenue and is not spending on non-essential and unproductive items the federal government will have huge surplus and if the states are not pursuing a prudent fiscal policy the non correspondence in the state budgets will widen, thus causing the Vertical Fiscal Imbalance to widen.

To know the direction of Vertical Fiscal Imbalance and measure the extent of such imbalance it is very important to define the resources accruing to different layer of governments meticulously and examine the expenditure requirements of these governments rationally. This apart a few other important questions crop up in this content which needs to be properly looked as:

- Should Vertical Fiscal Imbalance (VFI) be measured after the devolution of taxes and after making adjustments for grants-in-aid and loans given to the states?

- Should Vertical Fiscal Imbalance (VFI) be measured after excluding only conditional grants and loans by the centre to the states?

- Vertical Fiscal Imbalance (VFI) should include shared taxes in the resources of the states excluded the state’s share from the initial revenue of the centre?
Should be take out only that part of the resources which are constitutionally assured such as states own capital receipts and market borrowing and exclude the proceeds of shareable taxes in the central resources and exclude grants from centre’s expenditure. In other words should resource and liabilities of both the layers be assessed before any kind of central transfer of resources made to be states?

Horizontal Federal Imbalance adds to the Vertical Federal Fiscal Imbalance and magnifies the fiscal needs of different state governments. The gap between revenues and expenditures of state governments is required to be filled by financial transfers from the federal government. It is for this reason that the issue relating to Horizontal fiscal imbalances has received a lot of attention in the field of fiscal federalism. Horizontal fiscal imbalance is inevitable mainly because of diversity of natural resources and disparities in economic structure and socio-economic levels of development of federating units. This determines on the one hand the varying degree of fiscal capacity and on the other hand the fiscal need of the states.

All the federating states are not equal in the terms of economic development, socio-economic development, natural resources endowments and fiscal capacity. It is believed that if the federal fiscal imbalances tend to operate discriminately between states and the expected hopes and aspirations which initiated the formation of a federation fail to materialize, instability sets in instability of federation manifest itself in economic instability of its constituent states and the consequent dissatisfaction with the operation of fiscal federalism. The federal government is expected to use federal fiscal transfers to minimize wide intra-state disparities by helping the backward states in a special way for following reasons:

Federal government should use the federal financial transfers to off-set unequal impact of its own taxation as well as expenditure policies on the budgets of the constituent states. Otherwise, discriminatory impact of
taxation and expenditure policies on the budgets of the poorer states may frustrate them

- The federal government should use federal financial transfers to off-set adverse impact of inter-state spill over of expenditure and create the problems of instability in a federation, benefits and the costs of the state governments. If such spill over are unequal between states inter-states fiscal imbalances result and they may give rise to inter-state conflicts and instability of federation. Such imbalances should be minimized by the federal government through appropriate federal financial transfers.

- Federal financial transfers should be used to ensure a minimum level of essential public services to all the citizens all over the federation.

- For reducing inter-state economic disparities, the federal government will have to use federal financial transfers in such a way as to generate economic activities in poorer states.

**Way to Fiscal Transfer:** Horizontal fiscal imbalance may refer to the equity aspect. Indeed, in the literature on public finance two terms are used to analyze the problem of equity viz. vertical equity and horizontal equity. Horizontal equity means those who are equals in respect of some relevant circumstances should be treated equally i.e. in a non-discriminating manner. A corresponding concept of vertical equity refers to the conflict-ridden issue of equality between unequal’s which necessitates unequal treatment of unequal. Horizontal equity is feasible in a unitary form of country in a federal setup it may be difficult to achieve. Though, persons may bear the same federal tax burden and receive the same federal bundle of goods and services, individuals may be discriminated due to differential state tax burden and differential size of the state bundle of goods and services. Horizontal fiscal equity in federal design requites person equally well-off before a change be just the same after the change. The federal fiscal transfer of resource should result in higher benefits to

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the poorer States so as to enable them to levy comparable level of taxes and provide comparable level of services.

The net fiscal burden (taxes less benefits) on individuals is likely to be less in states having comparatively higher concentration of higher income of population. The reason is that the higher income state can provide a comparable level of services on tax rates lower than those in other states or a higher level of services on tax rate comparable to those in other states. This deviation from horizontal fiscal equity can be corrected if the central government so adjusts the distribution of its own taxes and benefits that differentials caused by the activities of the statistics are neutralized. This can be done through central grants to lower income states. The grants are relieving fiscal pressure on state citizens will bring about fiscal equity.

Thus, the horizontal fiscal imbalances are the result of disparities that exists among the federating units in resources mobilized. The actual amount of resources mobilized, infact depends upon three factors e.g. revenue capacity, revenue efforts and administrative efficiency. Revenue raising capacity depends upon the per-capita income, levels of socio-economic developments distribution of income, sectoral composition of state domestic product and so on. Level of development and per capita income provide the tax and revenue base. Prominent primary sector with limited capacity to contribute to the exchequer reduces revenue capacity of the state. If the large states happen to be the rich and small states happen to be the poor states inter-governmental transfers from rich to the poor on the one hand will be capable of satisfying the revenue requirement of poorer states without putting undue strain on the rich states. At the same time the smaller states may find it profitable to remain in the federation. If large states happen to be poor and backward while small states happen to be rich adequate fiscal adjustments cannot take place. The small rich states will not have enough surpluses to finance the large deficits of large poor states. Any amount of resources transferred from the small state would be inadequate to meet the
growing needs of the large poor states. Thus, the federal fiscal transfer mechanism may fail to satisfy the small rich states as well as the large poor state.

**Equal Assistance to needy States:** Equalization means helping the states with below normal service levels to attain the normal level. The possibility of achieving national norms is enhanced if funds are given exclusively to the poorer state for raising the levels of services. Once the objective of fiscal equalization is accepted in principle and is considered necessary condition for meaningful and lasting devolution, it is important to guide the design of national policy. “As a first step it is useful to state in concrete term what exactly the objective of fiscal equalization is to be one, such objective suggests itself. For those public goods and service considered appropriately provided by state governments. It should be possible for all states to provide a minimum level of services without exceeding a maximum tax burden level.”

Equalization objective can be achieved when each federating unit is enabled to provide a minimal level of selected services without imposing a tax burden on its citizens in excess if some nationally agreed upon maximum. “More appropriate interpretation of the term equalization would be in terms of equalization of fiscal need” The states which occupies the lowest place in terms of physical indicators of development representing productive sector, social infrastructure, economic infrastructure and financial infrastructure land at the same time has very low fiscal potential to mobilize the resources however measured, is considered to be the most needy state and vice-versa.” If the federal transfers help to reduce regional disparities in development and fiscal potential (i.e. the needy states getting relatively more) the objective of equalization would be considered as attained. The effective pursuit of the economic developmental objective in federal finance calls for adequate amount of control and chicks on the past of the federal government. This to ensure that

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each state executes its post of the plan, exercises diligent economy is expenditure and meets the tax effort required for it.

A Unitary state has combination of autonomous governing units which work with Centre. Union has over look on the state. The States are financial autonomous. In practice it is the strength of financial resources that paves the way to success of a government. In a federation, the sharing of financial resources has to be effected in such a way so that the balance is kept steady between the two units. Each layer of government had access to sufficient financial resources so that all obligations are fulfilled. However, of all federal problems, the financial relations between the centre and the units are most difficult. The troubled history of federal finance in the older federations and frequent adjustments in relatively new federations amply probe the crucial position of federal finance. When the constituent’s assembly examined the financial relations between the centre and constituent unit it was apparent that the problems had to be considered anew. “For one thing, the partition of India by altering the boundaries brought in its wake demands on the centre for vast expenditure. On rehabilitation of displaced people, for another, the divided provinces of West Bengal, Punjab and Assam had to face the issue of keeping their economy on an even keel.” At the time of debate on provision relating to Centre-State financial relations. Some members were in favor of state autonomy in financial matters. “The provinces should not be beggars at the doors of the centre.”

As finance is the back bone of administration and development financial dimensions of centre-state relations acquire greater significance than the political an administration. K. Sansthanam the former chairman of second finance commission describes financial relations as the “Achilles’ Heel” of every federation. No system of federation can be successful unless both the union and

185 K. Sasthanam, Union State Relations in India, Bombay, Asia Publishing House, 1960, p.29.
the state have at their disposal adequate financial resources to enable them to discharge their respective responsibilities. To achieve this object these are provisions in the constitution relating to the distribution of the taxes as well as non-tax revenues and the power of borrowing, supplemented by provisions for grants-in-aid by union to the states. The aim was an equitable distribution of the financial resources between the two units of the federation, instead of dividing the resources into two water-tight compartment as under the usual federal system. A fitting introduction to this assignment has been given by the Supreme Court in these words, “sources of revenue which have been allocated to the union are not meant entirely for purpose of the union but have to be distributed according to principles laid down by parliamentary legislation. Thus, all the taxes and duties levied by the union do not form part of the Consolidated Fund of India but many of the taxes and duties are distributed amongst the states and form part of the consolidated fund of the states. Even those taxes and duties which constitute the Consolidated Fund of India may be used for purposes of supplementing the revenue of the states in accordance with their needs. The question of distribution of the aforesaid taxes and duties amongst the states and the principles governing them as also the principles governing grant-in-aid are matters which have to be decided by a high power finance commission which is a responsible body designated to determining in those matters in an objective way. The constitution makers realized that fact that those sources of revenue allocated to the states may not be sufficient for their purposes and that the government of India would have to subsidize their welfare activities. Realizing the limitations on the financial resources of the states and the growing needs of the community in welfare state, the constitution has made specific provisions empowering parliament to set aside a portion of its revenue for the benefit of states, not in states proportions but according to their needs… The resources of the union government are not meant exclusively for the benefit of the union activities, In other words the union and the state together form an organic whole
for purposes of utilization of the resources of the territories of India as a whole. The constitution reflects a different picture, an overwhelming concern of its framers in favor of a strong centre. The framers thought that only a strong centre could pressure the unity of the nation in face of regionalism and strong disruptive forces that could weaken the nation. So, they have deliberately distributed the functions and sources of revenue between the union and states in such a manner that union has relatively more elastic sources of revenue and the states have expending and expensive functions, but relatively less elastic sources of revenue. “The centre has been given more resources than it can digest.”

Such an allocation would lead to both vertical and horizontal federal fiscal imbalances but at this stage there was no clear view of the kind of planning that might evolve in the future. For this reason economic and social planning was placed in the concurrent list. Under the scheme of the constitution, it was apparent that there would be a growing gap between the resources ordinarily available to the states and the task they were expected to carry out. This gap could be reduced by periodic transfers of resources from centre to the states.

The tax structure of government of India is highly complicated and highly centralized. Under the head, social and economic planning and national interest the central and government is given a predominant position. The productive and elastic resources are maintained by the central government more than anything else grants-in-aid is one of the main instruments where by the union government can play cat and mouse with state autonomy. The RBI is also another means of influencing the states policy in financial matters, for influencing the states policy in financial matters, for instance when there were over drafts by states from the RBI, Morarji Desai the then union finance minister replying to debate on general budget in Rajya Sabha on March 28, 1963 said government is taking steps to prevent the states from resorting to overdrafts on their grants with Reserve Bank.

189 Coffee Board vs. CTO, AIR, 1971, Sc.870
The revenues of states governments in India are derived from three distinct sources: state taxes, non tax revenue and transfer of funds from the centre to the states. It appears that there is a problem of inelasticity of state revenues. The UP chief minister Kalyan Singh (1991) had called for redefining of centre-state relations so as to give more financial powers and resources to the states. He said that “at present the states were like municipalities earning revenue from just three sources excise, sale tax and stamp duty.”191 This he said, “led to the state becoming entirely dependent on centre for funds for development, the centre uses this fiscal power to dictate terms to the chief minister resulting in a situation where all powers get centered with the central government much against the ethic of democratic functioning of the states.”192

STATES FISCAL AUTONOMY: DEMANDS

In the Union State financial relations most controversial problem between union and states is the financial relations and Indian federal system is no exception in this regard. The Union State fiscal relations in Indian federal polity are much more complex than in any of the three federations of the world e.g. USA, Canada, Australia. Actually, the federal financial relations reflect the equations of power and influence between the centre and the states and among the states. “Federalism has its own special and particular problems in this area like the problems of multiplicity of taxing and spending authorities, the imbalance as regards financial resources between centre and states and the imbalance between different regions of federation.”193 It is also a true fact if the legislative and administrative authority of the constituent units is to be maintained they must be financially autonomous. However, this principle of a

191 The Hindu, New Delhi, May 1, 1992.
192 Ibid.
federations have not been fully implemented even in any of the existing federations of the United States, Canada and Australia.\textsuperscript{194}

The demand of the states for greater fiscal autonomy has now become one of the most controversial issues of the Indian federation. There has been much talk for and against autonomy with different parties at the centre and in the states in power autonomy is asserted and is necessary. In either case autonomy should be real, but in present practice this fact is being completely forgotten. State legislative parties are subjected to log rolling and almost all state ministers are nominated by the centre. This in itself detracts from autonomy and discourages it. The compulsions of planning have also made the states more dependent than they are required to be under the Constitution. Unless the states are given more sources of revenue instead of being allocated shares in divisible or indivisible pools, they would be left to the mercies of Finance Commissions, Planning Commissions and the vagaries of the party politics. As in the federal structure, the financial relations between the Union and States governments present difficult problems. The problems however, would not be solved by any formula. But we must necessarily look to constitutional provisions as the back-ground for examination of this question. But it is to be kept in mind before entering into these elaborate provisions setting up a complicated arrangement for the distribution of the financial resources of the country, that the subject of this complicated machinery is an equitable distribution of the financial resources between two units of federation, instead of dividing the resources into two water-tight compartments that is the usual case under federation.\textsuperscript{195} The Supreme Court has provided an introduction to such an arrangement in the following words, “sources of revenue which have been allocated to the union are not meant entirely for the purpose of the union but have to be distributed according to the principles laid down by parliamentary legislation. Thus, all the taxes and duties levied by union...Do not form part of the consolidated fund of India but many of these taxes and duties form part of the consolidated fund of


the states. Even those taxes an duties which constitute the consolidated fund of India may be used for the purpose of supplementing the revenues of the states in accordance with their needs. The question of distribution of the aforesaid taxes duties amongst the states and the principles government grants-in-aid are matters which have to be decided by high powered finance commission, which is a responsible body designed to determine those matters in an objective way. The constitution makers realized the fact that those sources of revenue allocated to the states may not be sufficient for their purpose and that the government of India would have to subsidize their welfare activities…Realizing the limitations on financial resources of the states and the growing needs of the community in welfare-state, the constitution has made specific provisions empowering parliament to set-aside a position of its revenues, for the benefits of the states not in stated proportions but according to their needs….. The resources of union government are not meant exclusively for the states together form one organic whole for the purpose of the utilization of resources of the territories of India as a whole. ¹⁹⁶

Allocation of Resources to the States: Union taxes are of several types there are some taxes such as stamp duties are imposed by the union but are collect ed and taken by the states. Secondly taxes such as succession and estate duties (except on agriculture) taxes on railway fares and freights etc. are imposed and collected by the union, but the entire proceeds are distributed among the states. Thirdly, there are some taxes such as taxes on non-agricultural income (and the union excise duties which may be shared with states) which are levied and collected by the union, but the proceeds thereof are shared between union and states. Fourthly, there are certain taxes such as corporation tax custom duties are levied collected and appropriated by the union. Besides the union parliament is authorized by the constitution to increase any of duties or taxes, mentioned in Article 269 and 270 by surcharge for exclusive union purposes. ¹⁹⁷

¹⁹⁶ Coffee Board v/s C.T.O. AIR, Sc-870
¹⁹⁷ Art. 270 (1) and 272 of Indian Constitution.
With in the jurisdiction of the states are more taxes concerned with land such as land revenue, agriculture income and land succession taxes, estate duties in respect of a agricultural land and also the excise duties on alcoholic liquors and narcotics. Also, among state taxes heads are sales taxes, taxes on professions and callings and taxes on vehicles on passengers traveling by roads or inland waterways and on luxurious and amusement. It we critically examine the distribution of taxes between the centre and states as provided in the union and state lists then it will be found that most of the flexible sources of revenue have been assigned to the centre and the most of the rigid sources of revenue have been provided to the states. Demands of the States:

➢ The States criticized the policy of the union, to keep out divisible pool certain resources, which according to them, should have been shared with them. An important instance of this as pointed out by them was the exclusion of corporation. Tax from the divisible pool by an amendment of income tax act 1959. Several state governments suggested that the proceeds of corporation tax should be mad sharable with states.

➢ The state complained that long continuance of surcharge on income tax deprived them of considerable revenue which would have been sharable with states if the government of India had instead adjusted basic rates of income tax. It was therefore, suggested that proceeds from surcharge on income tax should be shared with the states.

➢ Revenue from union excise duties (basic duties) levied under Art. 272 of the constitution of India are distributed between the union and the states on the basis of recommendations of finance commission. It was alleged that the centre had levied separate excise duties on commodities (e.g. special regulatory and auxiliary excise duties on some commodities) thus keeping revenue outside the purview of sharing.

➢ Many states complained against the increases in administered prices of petroleum, and coal unilaterally made by the union instead of increasing excise duties which should have been sharable with them.
Some of the state governments alleged that the central government had not been showing sufficient interest in rising revenue from income tax 85% of which is now sharable with the states on the other hand, through the special bearer bond scheme (which became effective since February 2, 1981) the centre mobilized resources for the exclusive use which would have been otherwise shared by the states, if better compliance of the income tax act had been enforced.

It had also been complained that replacement of sales tax by additional duties of excise (goods of special importance) Act 1957 which covered sugar, tobacco and textiles, resulted in loss of revenue to them. Although, the yield from the additional excise duties to assigned to the states. The revenue raised from them was allegedly not as high as what could have been realized had the sales tax on them continued. A few state governments suggested withdrawal of this scheme to enable the states to levy sale tax on these commodities.

In view of the provisions of Art. 285(2) of the Constitution of India read along with section 154 of the Government of India Act 1935 the municipal in the states cannot levy tax on properties of the union government which came into being after April 1, 1937 nor are the states local bodies allowed to enhance the old rates. Similarly, the railway properties are protected by section. 135 of the Indian Railways Act 1890 read with section 4 of the railways (Local authority’s taxation) act 1941, which permit only such taxation as is allowed by the government of India. It had been pointed out that because of these provisions the local bodies of the states were losing revenue whereas they were required to provide services to the union government and railway establishments.

Several state governments had drawn attention to changes introduced by the constitution (6th amendment act 1956) in Art. 269 and Art. 286(by the enactment of the central sale tax act 1956). They alleged that these
amendments had adversely affected the yield from states, sale tax, and the most important source of revenue to them.

➢ Almost all the state governments were of the view that resources transfers outside the channel of the finance commission had increased year after year and now overshadowed the statutory transfers.

➢ Most of the state governments had drawn attention to the fact that grant in lieu of the taxes on railway passenger fares, which was abolished in 1961, had been for less than what they would have realized had the tax measure been continued owing to the growth in revenue from railway fares. Demand had been made for re-imposition of the tax on the railway passenger fares.

➢ The central government’s decision on pay revision, terminal benefits granting installments of dearness allowances etc. are said to cost a corresponding burden on the states. This is cited as an instance where actions of the centre to the states. A few state governments stated that this additional burden should be shared by the government of India.

➢ It had also been alleged that the failure of the union government to mobilize sufficient revenue under Art. 268 and Art. 269 of the constitution had adversely affected their interests. A number of states proposed that the powers to levy some taxes and duties included in these articles might be transferred to the states. It had further been suggested that through a constitutional amendment levying of taxes and duties included in Art. 269 should be made compulsory.

➢ A number of states complained that in determining the composition of the finance commission and laying down its terms of reference, the state governments had never been taken into confidence. It was also suggested that the recommendations of the finance commission ought to be implemented in to-to. The non-implementation of the final recommendations of 8th Finance Commission in full as submitted by
several states before the Sarkaria Commission, had added yet another dimension to the problems in financial relations between the Union and the States.

- Among the important sources of funds for development are market borrowings and capital transfers from the union of the total market borrowings of the union and states it may be noted the share of the states has declined over the years. Further, as proportion of the total capital receipts of the union loans, to the states have also gone down. The limitations imposed on the states in this regard under Article 293 of the Constitution were also objected to by many state governments are restricting their freedom to borrow.

- Some states pointed out that their capital receipts ere meager in relation to their large and growing requirements of capital funds for investment in development activities. They had to be heavily dependent on the discretion of the centre for their capital receipts. A suggestion was mad by some that the states should have access to the capital resources as a matter of right.

- It was pointed out that the states share of two-third (since raised to three-fourth from April 1987) in additional small saving s collection should be enhanced and that such loans should be treated as loans in perpetuity. A specific suggestion mad by some states was that the repayment period and moratorium allowed on small saving loans should be doubled. It had also been alleged that through the special deposits scheme the centre had acquired access to substantial invertible funds of the provident fund organizations and had thus reinforced its budgetary position at the expense of the states.

- There had also been complaints of delay, inadequacy and discrimination in providing relief for major calamities which needed to be dealt with as a matter of national concern.
A number of state governments complained that the present pattern of the union transfers with preponderance of loans was completely out of line with their pattern of expenditure and repayment capacity and had demanded a review.

Another grievance of the states was that the union government obtained external assistance on concessional terms, but the benefit of the same was not correspondingly passed on the states.

It was also pointed out by some of the states that the union government had incurred substantial expenditure on several subjects belonging to the sphere of the states. (e.g. agriculture, rural development, cooperation, health and irrigation) through the centrally sponsored schemes and by maintaining large establishments. These had on the one hand, allegedly deprived the states of substantial transferable revenues and on the other distorted their priorities by requiring them to find matching funds for the schemes sponsored by the union governments.

Government of India’s exclusive control over the policies and resources of the banks and public sector financial institutions is considered to be one of the irritants in the union-state financial relations, although these are union subjects. In this context, some states suggested the setting up of a national credit council having representatives of the state governments on its panel.

**Twelfth Finance Commission: A Review**

The report of the Twelfth Finance Commission (TFC) headed by C. Rangarajan has been remarkably free from controversy of the type that accompanied the reports of some of its predecessors. Most of its major recommendations have found ready acceptance at the centre and in the states. The union budget has already incorporated some of its broad provisions. All this reflects sobriety of the TFC and its chairman in consciously working for a consensus on some potentially contentious issues. Adopting principles of
distribution of central revenues very similar to those of its predecessor commission, the TFC has recommended a total devolution of central taxes at 30.5 percent one percentage point higher than last time. Past experience suggested that arriving at an acceptable devolution pattern of central revenues is relatively easy part. The more difficult task is to arrive at a satisfactory method of distributing taxes on an inter-section basis among states.

The Twelfth Finance Commission has followed the method of assigning weights to parameters such as area, population, tax discipline, infrastructure, and inter-state variations in income levels. It has assigned less weight to the income variations, which are an index of backwardness, than the Eleventh Finance Commission did. The objective seems to be to blunt criticism from better off states which stood to lose if the distance criterion were given more weightage. While disregarding the weight for infra-structure, the Twelfth Finance Commission has enhanced the importance of population area and tax efforts.

- The Twelfth Finance Commission’s recommendations on Centre-State fiscal relations their core subjects are considered a watershed by many experts. While being liberal in its approach to debt relief it has made the grant of relief conditional on states reducing their fiscal and revenue deficits according to stipulated parameters. More than half of all state borrowings are used to meet their current expenditure. Any attempt at reining in revenue deficits is therefore welcome. Another key recommendation has to do with the central funding of states plans. The Twelfth Finance Commission has recommended that henceforth the centre should release only grant portion of its assistance letting states raise the loan component from market. There will be a number of mutual benefits, because state will borrow directly the centre’s fiscal deficit will come down.

- The Twelfth Finance Commission has also recommended a substantial increase in grants-in-aid to the states. This should ensure an element of certainty in the magnitude of resources transferred by the centre.
However, the overall effect of the report is likely to be a reduction in the
dependence of the states on the central transfers. Looking beyond
numbers the Twelfth Finance Commission seems to have contributed to a
healthier fiscal federalism.

➢ The Twelfth Finance Commission recommendations have been accepted
by the centre and finance minister P. Chidambaram has estimated the total
impact on the Union Budget for 2005-06 at approximately Rs.26000 crore
or an addition of three-quarters of percentage point as a proportion of
GDP. He has expressed concern that such a large allocation in the first
year of implementation may even affect the capacity of the centre to abide
by the fiscal responsibility and budget management act.

➢ In the overall picture the states shares in central resources has been
marginally increase from 29.5% to 30.5%, whereas states such as Tamil
Nadu sought a whopping 50% of the divisible pool.

➢ The horizontal distribution between states has now been spelt out in a
new formula by TFC. It will be distributed on following basis: 50% based
on per capita income on a distance basis, 25% based on population, 10%
on geographical area, 7.5% on tax efforts and 7.5% on fiscal discipline.

Two of the criteria laid down in TFC formula together accounting for
15% tax efforts and fiscal discipline provide a new dimension to concerted
efforts in improving the state of finances of all states. Keeping the broad index
of fiscal discipline in mind, the commission’s recommendations may have far
reaching effect for the period 2005-20. In particular the plan for restructuring
debt has been linked to fiscal reforms, doing away with present system of central
assistance to state plans in the form of grants and loans and transfer if external
assistance and conditions as attached to such assistance by the agencies. Besides,
focusing on fiscal discipline and even transfer of resources to the local bodies,
the TFC has provided a healing touch with regard to the spheres of calamity
relief, grants-in-aid and debt management. The scheme of calamity relief funds
will continue in its present form in a 75:25 ratio between centre and states, with
the fund estimated at Rs. 21,333 Crore for five-year period 2005-10. But the present system of grants-in-aid as central assistance for state plans is being done away with. None plan deficit grant of Rs. 56,856 crore has been recommended to 15 states for these five years. In addition, grants for Rs. 10,172 for education sector to eight states and Rs. 5,887 crores to seven states for the health sector. But this has also sparked some problems because health and education are key sectors in which all states want help and singling out a few of them may only complicate the issue. An equally important aspect planners point out is to ensure that allocated funds are properly utilized for the projects they are meant for that the states are made accountable. In the area of debt relief and course correction, the Twelfth Finance Commission has done a lot of homework and come up with useful package. Central loans to States contracted till March, 2004 and outstanding on March 31, 2005 amounting to Rs. 1,28,795 Crore are to be consolidated and rescheduled for a fresh term of 20 years at an interest rate of 7.5%. But, this will be subject to their adopting the fiscal responsibility act. Similarly, a debt write under this scheme, repayments due from 2005-06 to 2009-10 on central loans contracted up to March, 31 2004 will be eligible for write-off.

The Twelfth Finance Commission has recommended that the total transfer to the states be limited to 38% of the gross tax revenue of the centre against Eleventh Finance Commission’s overall ceiling of 37.5%. No rationale has been provided for increasing this overall ceiling by only .5%. The Government of India has accepted this recommendation. The share of states in the net proceeds of sharable centre taxes has been increased from 29.5% to 30.5% by Twelfth Finance. So far as the divisible pool is concerned, the state governments had proposed a minimum of 33% and maximum of 50% but Twelfth Finance Commission has recommended only one percentage point increase from 29.5% by the Eleventh Finance Commission to 30.5%. “If the share of states is increased, the redistributive content in the inter se distribution will have to be increased significantly by altering the weights among the distribution criteria so
as to be consistent with equalization objective.”

Hence, as per commission’s observations, the tax share portion has been increased very little and while the grants portion has been substantially increased.

The tax share grant ration has undergone a drastic change over the year. Table 1 show that the Tenth Finance Commission award consisted of 91% of share in central taxes and 9% as grants-in-aid. In the Eleventh Finance Commission period this ratio changed to 87% and 13% respectively. But the twelfth finance commission period the tax share portion has further gone down to 81% with the grant portion rising to 19%.

<table>
<thead>
<tr>
<th>Items</th>
<th>Tenth Finance Commission</th>
<th>Eleventh Finance Commission</th>
<th>Twelfth Finance Commission</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share in Central taxes and duties</td>
<td>206345.00 (91.04%)</td>
<td>376318.01 (86.53%)</td>
<td>613112.02 (81.13%)</td>
</tr>
<tr>
<td>Total grants-in aid</td>
<td>20300.30 (8.96%)</td>
<td>58587.39 (13.47%)</td>
<td>142639.60 (18.87%)</td>
</tr>
<tr>
<td>Total transfer to all states</td>
<td>226643.30</td>
<td>434905.40</td>
<td>7557751.62</td>
</tr>
</tbody>
</table>

Sources-Twelfth Finance Commission’s Report

This change in the composition of transfers has implications for state finances. As per the constitution, the share in central taxes is the legitimate right of the states and it comes to the states on a regular basis without any strings attached to it. This is a substantial portion of states’ total revenue receipts. Hence, it is with certain degree of certainty that the states are able to prepare their cash flows, whereas the grants recommended by the Twelfth Finance Commission (excluding revenue deficit grant) have some conditionality attached to the releases. There is therefore, some uncertainty attached to flow of grant funds and in such a situation there arises difficulty in cash flow management at the state level.

The share of different states in the divisible pool has been determined on the basis of formula which is slightly different form Eleventh Finance Commission formula in terms of weightage given by Twelfth Finance Commission. The

change in the formula as suggested by Eleventh Finance Commission and Twelfth Finance Commission is presented in the following table:

<table>
<thead>
<tr>
<th>Items</th>
<th>11th Finance Commission</th>
<th>12th Finance Commission</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>10.0</td>
<td>25.0</td>
<td>+15.0</td>
</tr>
<tr>
<td>Income Distance</td>
<td>62.5</td>
<td>50.0</td>
<td>-12.5</td>
</tr>
<tr>
<td>Area</td>
<td>7.5</td>
<td>10.0</td>
<td>+2.5</td>
</tr>
<tr>
<td>Tax Efforts</td>
<td>5.0</td>
<td>7.5</td>
<td>+2.5</td>
</tr>
<tr>
<td>Fiscal Discipline</td>
<td>7.5</td>
<td>7.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Index of Infrastructure</td>
<td>7.5</td>
<td>0.0</td>
<td>-7.5</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>-</td>
</tr>
</tbody>
</table>

Sources-Twelfth Finance Commission’s Report

By raising the weight of population, Twelfth Finance Commission has reduced the weightage of Income distance thereby neutralizing the effect of population factor increase. In tax effort, weight is in line with the restructuring scheme of Twelfth Finance Commission. The impact of change in the formula inter-state shares of the states can be seen from

<table>
<thead>
<tr>
<th>States</th>
<th>Eleventh Finance Commission</th>
<th>Twelfth Finance Commission</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Pradesh</td>
<td>00.701</td>
<td>07.56</td>
<td>04.4</td>
</tr>
<tr>
<td>Bihar</td>
<td>14.597</td>
<td>11.028*</td>
<td>-24.5</td>
</tr>
<tr>
<td>Gujarat</td>
<td>02.821</td>
<td>03.569</td>
<td>+26.5</td>
</tr>
<tr>
<td>Haryana</td>
<td>00.944</td>
<td>01.075</td>
<td>+13.8</td>
</tr>
<tr>
<td>Karnataka</td>
<td>04.930</td>
<td>04.459</td>
<td>-09.6</td>
</tr>
<tr>
<td>Kerala</td>
<td>03.057</td>
<td>02.665</td>
<td>-12.9</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>08.838</td>
<td>06.711*</td>
<td>-24.1</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>04.632</td>
<td>04.997</td>
<td>+07.8</td>
</tr>
<tr>
<td>Orissa</td>
<td>05.056</td>
<td>05.161</td>
<td>+02.1</td>
</tr>
<tr>
<td>Punjab</td>
<td>01.147</td>
<td>01.299</td>
<td>+13.2</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>05.473</td>
<td>05.609</td>
<td>+02.5</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>05.385</td>
<td>05.305</td>
<td>-01.5</td>
</tr>
<tr>
<td>Uttar Pradesh</td>
<td>19.140</td>
<td>19.264*</td>
<td>+00.6</td>
</tr>
<tr>
<td>West Bengal</td>
<td>08.116</td>
<td>07.057</td>
<td>-13.1</td>
</tr>
</tbody>
</table>

*Percentage share of successor state only.

Twelfth Finance Commission Report, Government of India,

It is clear from above table that the share of Gujarat, Haryana, Maharashtra and Punjab has increased in percentage terms while share of Karnataka, Kerala,
Tamilnadu and West Bengal has gone down. This is due to deliberate policy of Twelfth Finance Commission as enunciated in Para 2.23 of the report. The report says that a continuous fall in the share of richer states is not desirable. To some extent this could be redressed by increasing the share of these states. This has been done by realignment of weights governing the sharing of taxes. Thus, there has been no progress in tax sharing formula. The finance commission has sought to correct the regressively by increasing the equalization content of grants. So far as the grant portion is concerned the share of each state after applying the equalization factor by Twelfth Finance Commission is presented in Table

<table>
<thead>
<tr>
<th>States</th>
<th>11th Commission</th>
<th>Finance 12th Commission</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Pradesh</td>
<td>03.47</td>
<td>03.66</td>
<td>+5.4</td>
</tr>
<tr>
<td>Bihar</td>
<td>03.06</td>
<td>05.59</td>
<td>+82.7</td>
</tr>
<tr>
<td>Gujarat</td>
<td>02.36</td>
<td>02.60</td>
<td>+10.2</td>
</tr>
<tr>
<td>Haryana</td>
<td>01.12</td>
<td>01.01</td>
<td>-10.6</td>
</tr>
<tr>
<td>Karnataka</td>
<td>01.94</td>
<td>02.84</td>
<td>+46.4</td>
</tr>
<tr>
<td>Kerala</td>
<td>01.39</td>
<td>02.28</td>
<td>+64.0</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>02.97</td>
<td>03.60</td>
<td>+21.2</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>03.34</td>
<td>03.88</td>
<td>+16.1</td>
</tr>
<tr>
<td>Orissa</td>
<td>02.95</td>
<td>03.70</td>
<td>+25.4</td>
</tr>
<tr>
<td>Punjab</td>
<td>01.90</td>
<td>03.44</td>
<td>+81.0</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>05.11</td>
<td>03.26</td>
<td>-36.2</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>02.28</td>
<td>02.90</td>
<td>+27.2</td>
</tr>
<tr>
<td>Uttar Pradesh</td>
<td>06.06</td>
<td>10.70</td>
<td>76.5</td>
</tr>
<tr>
<td>West Bengal</td>
<td>07.99</td>
<td>05.31</td>
<td>-33.6</td>
</tr>
</tbody>
</table>

It is evident from the table that Gujarat, Maharashtra and Punjab except Haryana have gained in the grants distribution of grants also. Thus, the Eleventh Finance Commission’s objectives of equalization has not been fulfilled in this case also. There are two states, Rajasthan & West Bengal whose share in grants-
in-aid has also gone down. If the combined effect of these changes in the shares of states in the total transfer from the centre is examined, it tells altogether a different story as is evident from the table given below

Transfer to State under Eleventh and Twelfth Finance Commissions (% Share of Taxes)

<table>
<thead>
<tr>
<th>States</th>
<th>Eleventh Commission</th>
<th>Twelfth Finance Commission</th>
<th>Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Share of Taxes</td>
<td>Total Transfers</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total Grants</td>
<td>Share of Taxes</td>
<td>Total Transfers</td>
</tr>
<tr>
<td>Andhra Pradesh</td>
<td>0.70</td>
<td>0.13</td>
<td>0.76</td>
</tr>
<tr>
<td>Bihar</td>
<td>1.46</td>
<td>1.04</td>
<td>1.10</td>
</tr>
<tr>
<td>Gujarat</td>
<td>0.28</td>
<td>0.26</td>
<td>0.35</td>
</tr>
<tr>
<td>Haryana</td>
<td>0.09</td>
<td>0.09</td>
<td>0.01</td>
</tr>
<tr>
<td>Karnataka</td>
<td>0.49</td>
<td>0.43</td>
<td>0.43</td>
</tr>
<tr>
<td>Kerala</td>
<td>0.36</td>
<td>0.39</td>
<td>0.26</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>0.84</td>
<td>0.95</td>
<td>0.67</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>0.46</td>
<td>0.44</td>
<td>0.50</td>
</tr>
<tr>
<td>Orissa</td>
<td>0.06</td>
<td>0.37</td>
<td>0.51</td>
</tr>
<tr>
<td>Punjab</td>
<td>0.12</td>
<td>0.12</td>
<td>0.13</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>0.54</td>
<td>0.42</td>
<td>0.56</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>0.38</td>
<td>0.49</td>
<td>0.51</td>
</tr>
<tr>
<td>Uttar Pradesh</td>
<td>0.19</td>
<td>0.60</td>
<td>0.19</td>
</tr>
<tr>
<td>West Bengal</td>
<td>0.12</td>
<td>0.10</td>
<td>0.07</td>
</tr>
</tbody>
</table>

Source: *Eleventh and Twelfth Finance Commissions reports*

The table shows that the overall share of eight states out of fourteen non-special category states has, in fact, gone down from Eleventh Finance Commission award. The share of other five states has marginally gone up. Thus, in overall terms the recommendations of Twelfth Finance Commission have not made any substantial change in the shares of different states and in fact, the overall shares of most of states have gone down.
Grants-in aid to Panchayati Raj Institution (PRI) and Urban Local Bodies (ULB): The commission has also recommended grants for Panchayati Raj Institutions (PRIs) and Urban Local Bodies (ULBs) to the tune of Rs. 20,000 Crore and Rs. 5,000 Crore respectively for the next five years. Commission has specified certain conditions which need to be fulfilled by the PRIs and ULBs in order to ensure the release of the above mentioned grants. Further, the grants will have to be utilized for certain specified purposes. But the major change from the EFC is that the condition of matching contribution by these institutions has been done away with. This has been done by the Twelfth Finance Commission based on the experience of Eleventh Commission award period where in the matching contribution was negligible and as a result, the grant could not be fully utilized.

Calamity Relief Grant: The scheme of Calamity Relief Fund (CRF) will be continued in its present form with contribution of centre and states in the ration of 75:25. The size of the CRF has been worked out at Rs. 21,333.30 Crore. Some, new items of expenditure like landslides, cloud bursts, snow, rain etc. have been added in the list of works in which the fund can be utilized.

State Finance Commission: Under the provision of Art. 243(I) and 243(Y) and the provisions made under their respective PR-Acts most of the states had constituted the first generation SFCs. The State Finance commissions worked with in the stipulated terms of reference and submitted the reports to the state governments. The relevant recommendations (from states point of view) of these reports were accepted by the state governments. Some of the states recommended for global sharing of total revenue (tax and non-tax together) and a few of them recommended for sharing of revenue from taxes only. Like the national finance commissions SFCs recommendations are recommendatory and not mandatory in nature, but unlike national finance commission, SFCs recommendations are being given cold shoulders. Infact many states are making a mockery of the constitutional provision. On the one hand, they constitute a body with people of little expertise and on the other they do not even consider
the report. If the report is considered very few recommendations are accepted. In the process the crucial ones are rejected without assigning reasons. In the action taken report, only numbers are mentioned such as this many recommendations are accepted with modifications and this many are rejected. In this number game sometimes the most crucial recommendations can also be rejected.

In every federation states are depended on union of various grants for several purposes. In India the union gives grants in aid to the states for following purposes:

- To compensate the loss of shares of some items of revenue which they once had.
- To compensate for additional expenditure imposed on certain states on account of new obligations arising under the constitution.
- To induce the states to undertake scheme for welfare of scheduled tribe and for raising the level of administration; and
- To help the poor and necessitous state to come on at par with states which are more fortunate?

The first two viz. (1) & (2) are statutorily compulsory on central government while (3) & (4) are within the discretionary powers of the union.\(^{199}\) Statutory grants are made on the basis of the recommendations of the finance-commission, while discretionary grants are given on the basis of the recommendations of the planning commission. Discretionary grants involved state dependence on the centre, while obligatory central grants to the states promote cooperative tendency. Thus the states have questioned the need for centre to wield heavy financial clout in the shape of discretionary grants. There are justified misgiving about the inherent danger of their being used as a political weapon against a state that happens to be out of favor with the centre.

The states want more resources to be earmarked for statutory devolution so that the trends of increasing allocations through discretionary grants can be curbed. Certainly the funds distributed among the states through discretionary

\(^{199}\) Article. 282 of Indian Constitution
grants have greatly increased over the years for examples, “only 38% of the total transfer of resources is regulated by the finance commission. The remainder according to Art. 282 are at the discretion of the centre, which is transferred through planning commission and ministry of finance.” The finance commission is required to make recommendations on the principle which should determine the grant-in-aid to these states out of the consolidated fund of India and sum to be paid to the states which are in need of assistance by way of grant-in-aid of their revenue under Art. 275 (1) of the constitution. The grants-in-aid is provided to the states to cover the assessed deficit on non-plan revenue account after devolution of taxes and duties. The finance commission is also required to recommend grant-in-aid for the up gradation of standards of administration of the states with the objective correcting disparities in the availability of administrative and social service between the developed and the developed states and thereby achieving regional balance in economic development. Grants-in-aid may also be recommended by the finance commission to provide assistance to a state to meet expenditure on account of any special problems peculiar to that state.

The grant-in-aid is also provided to a state to meet expenditure arising out of special problems particularly to the state concerned. The finance commission makes recommendations on grants-in-aid to cover the revenue component of non-plan expenditure and not essentially plan expenditure. The Ninth Finance 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 grants-in-aid, keeping view the need for generating surplus for investment and reducing the deficit.

200 For the period from 1969-79; the FC provided 38% of total transfers, the planning commission 40% and the present status of debates”, The Economic Times, February 4, 1984, p.7
The federal grants are intended to corrective for differences in relative fiscal capacities and expenditure need of the states. It is necessary for a proper system of fiscal need grants that favorable adjustments be made for states spending less on social services than the standard set and an unfavorable adjustment be made against those states which do not make a comparable tax do not make a comparable tax effort proportionate to their taxing capacity. Only this can ensure that there will be uniform development of all states in India and backward state a prospect shall be conductive to the co-operative federalism in the country. Along with the tax-sharing and fiscal needs grants, central aid also flows to the states through grants under Art. 282. These grants lie outside the purview of the finance commission. The grants under Art. 282 are conditional as there are tied to specific purpose and are discretionary with the central government. In making these grants, the union government acts on the recommendations of planning commission which is a non-constitutional and non-statutory body. Grants under Art. 282 are much larger in dimension than the fiscal need grants made to the state and therefore, this article has emerged as most significant constitutional provision for the transfer of funds from union to the states.

Thus, it is clear that like some other federations, the doctrine of co-operative federalism has been well operated in India through grants-in-aid from the union to the states. Financial assistance (grants-in-aid) is a prolific source of central control and direction. They are made subject to conditions and are followed by the regulatory authority of the union government. It is a matter of common experience that one who pays the piper has a loud voice in calling the tune.

Sharing of Income tax between rich states and poor states: The most controversial issue in sharing of income-tax revenue relates to the principles on

201 Art. 282, provides that the union or state may make any grants for any public purpose. Notwithstanding that the purpose is not one with respect to which parliament or legislature of state as the case may make a law.
which income tax pool is to be distributed among the states. There have been put forward two criteria for this purpose viz. population and collection. The populous states, like Bihar, and UP, prefer more weightage to the population and the states like Gujarat, West Bengal, Maharashtra and Tamilnadu were about 60% of the income-tax is collected, prefer more weightage to collection. But the finance commissions have failed to maintain a steady practice and have altered the relative weightage to both these factors.

The Finance Commission gave relative weightage to population and collection as 80% and 20% respectively. The second Finance Commission expressed the view of collection is not proper index to distribution and it should completely be abandoned in favor of population. The commission however, could not go radical and therefore it reduced the weightage assigned to the factor of collection from 20% to 10%. The third Finance Commission endorsed the recommendations of the first finance commission and increased the share assigned to the factor of collection and industrial peace. Even a matter of policy the advanced states should not be penalized for their prudent, fiscal managements. When the population is given higher weightage then the non-Industrial populous states are benefited and they also became reluctant in mobilizing additional resources of their own. Thus, giving more weightage to the population criteria means it results in punishing the states which have observed the line of fiscal prudence. This had been termed by one of the chief ministers of prudent states as “reward for indiscipline” while submitted memorandum to the seventh finance commission.203 Equally important is the argument that higher weightage to population would affect adversely the states which are seriously planning for population control and thus it may also hinder the national policy of population control. The fourth finance commission did not enter into the dispute and made no change. The fifth finance commission again reverted to the position of the second finance commission, reducing the shared of factor of collection

again from 20% to 10%. The Sixth and Seventh Finance Commissions did not make any change. Thus, a dispute is going on even between the experts in this field.

As the Finance Commissions have been using criteria which lay a much greater emphasis on considerations of need and equity that a performance in terms of both mobilization and efficient deployment of resources on the part of the states. In our view the demands made by some states like Gujarat that the sharing formula also take into account performance is quite justified. To give some weightage to the factor of collection seems to be quite justified, because relatively advanced state have to spend more on law and order problems of the states have sharply reacted to the favor given to populous states and according to them, the criteria is against the policy of population control. Furthermore, the backward states not only get premium for their backwardness but are also encouraged to indulge in financial indiscipline. This is because the centre comes to the rescue of the deficit state having large non-plan revenue gaps, for example MP, MH, Tamilnadu, Gujarat, Haryana, Karnataka and Punjab did not receive any grant-in-aid because of small non plan deficit from 1974-75 to 1978-79. While the other fourteen states got about Rs. 2509.61 Crores as grant-in-aid. These states included West Bengal (Rs. 23.86 Crore), Andhra Pradesh (Rs. 205.93 Crore), Assam (Rs. 284.53 Crore), Kerala (Rs. 208.93 Crore), Orissa (Rs.304.73 Crore), U.P. (Rs. 198.83 Crore) and Rajasthan (Rs. 230.53 Crore). Hence, the devolution formula should be evolved in such a way that the transfer of resources should not only help backward states but also provide advanced states with adequate resources so that their progress was not impeded. Rather, advanced states should be given incentives for their fiscal prudence.

**88th Constitutional Amendment Act 2003 and Centre-State Fiscal Relations:** Indian parliament has enacted 88th Amendment Act (2003) which has far reaching impact on centre-state relations. The main provisions of this act are:

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204 Assam reacted sharply because it expected to lose Rs. 2 crore on this account.
1. Entry of new article 268 A: After article 268 of the constitution the following articles have been inserted namely-

(A) 268 A service tax levied by the union and collected and appropriated by the union and the states.

(I) Taxes on services shall be levied by the Government of India and such tax shall be collected and appropriated by the Government of India and the states in the manner provided in clause 2. 205 (II) The proceeds in any financial year of any such taxes levied in accordance with the provisions of clause 1 shall be:

(a) Collected by the Government of India and the states.

(b) Appropriated by the Government of India and states. In accordance with such principles of collection and appropriation as may be formulated by the parliament.

(B) Amendment of Article 270: In Art.270 of the constitution of Clause 1 of the words and figures Art. 268 and 269 the words and figures Articles 268, 268 A and 269 has been substituted.

(C) Seventh Schedule’s Amendment: In the seventh schedule, the constitution, in List 1, union list after entry 92 B206 the following entry has been inserted namely 92 C taxes on services.207 At present the item relating to taxes on services in not specifically mentioned in any entry either in the union list or in the state list of the seventh schedule of the constitution. Parliament has the exclusive power to make laws with respect to entry 97 of the union list for any other matters not enumerated in List 2 or List 3 including tax not mentioned in either of those lists. In exercise of this power, the central government has periodically taxes certain services at the rate of five percent, ad valorem with a view to widening their tax base, the states have suggested that they should be enabled to collect and appropriate tax on services. The services sector accounted for 48.5% of the country’s Gross Domestic Product (GDP) in financial year 2000-01.

205 Indian Constitution, Article 268 (A)
206 Indian Constitution Union list entry 92 B
207 Ibid. Union list entry 92 C
The role of service sector in the economy is quite significant, and expert committees set up by the central government have repeatedly recommended taxation of services on the basis of the deliberations between the state governments and the central government. In view of the recommendations of various expert committees, it was proposed to suitably amend the constitution to provide tax on services as a specific entry in the union list (II) insertion of a new article namely Article 268 A and III consequential amendment to Article 270 to enable parliament to formulate by law principles for determining the modalities of levying the laid tax by the central government and collection of the proceeds thereof by the central government and the states.

The 88th Amendment would also help in the significant augmentation of revenue of the states in accordance with the law and pave the way for eventual inclusion of services within the purview of state level VAT. In case of state governments of reluctance to raise greater resources through taxation has been noticed. The state tax SDP wide variations across states and remained static in most cases. The state governments have to show greater initiative to raise more resources and reform in their tax system.

The rationalization of rates, broadening of the tax base, ensuring more effective compliance, revamping of tax administration machinery are some important areas where effective actions are required. There is a good scope for raising sector particularly through reform of the land revenue system introduction of national level VAT on goods and services is another area of fiscal challenges which has to be adequately addressed in the coming years. The past decade we can find out the vast development in the field of centre-state relations.

The change-over to the global revenue sharing system following the recommendations of the 11th Finance Commission, by which 29.5% revenue of the centre will be shared with the states, is expected to increase buoyancy of revenue transfers to states through dispute about the adequacy of the present ratio of sharing continues. Nevertheless the fact remains that the level of financial transfers from the centre to the states as percent of GDP has gone down
over the previous decade putting further strains on state finances. The need for tax harmonization between states has also reduced their ability to raise more resources by changing the tax rates.

The introduction of uniform rates of VAT across states is also expected to constrict the ability of states to raise more resources. Sharing of revenue from taxes on service is also a ticklish issue to be addressed in future. Similarly the system of plan transfers based on 30% grants and 70% loan formula has also remained a matter of dispute, and also introduced an element of built increase in the indebtedness of states. Another area with important long term implications for state finances is that of newly introduced system of incentive based transfers which is likely to benefit the richer and better performing states more and thus lead to increase in inter-state disparities over the long run. These changes have reduced the fiscal changes have reduced the fiscal autonomy of the state governments to a considerable extent and have important implications for centre-state financial relations and working of the federal system of country.

**Working of Fiscal Federalism:** At the working of fiscal arrangements and federal transfer of resources in India have not only led to conflicts between union and states but also resulted in uneven economic development of states. It has contributed to regional imbalances and erosion of state autonomy. In this section some of the major problems and criticisms concerning the working of fiscal arrangement have been presented in synoptic manner as:

Most notable factor in operation against decentralization is the unsatisfactory status of fiscal tiers below the state level. Constitutionally local bodies (PRI) and municipal bodies set up recently under the 73rd and 74th amendments of the constitution are not autonomous. They derive their powers and resources from state governments. Also, the virtual absence of a reasonably structure to provide public services at local levels is truly glaring.

The working 12 Finance Commissions and the approach and methodology adopted by them in formulating their recommendation have been criticized by economist experts. It has been pointed out that through the
presidential order detailing the terms of reference, restrictions were sought to be placed on Finance Commission’s role. More importantly, with emphasis on developmental planning gaining ground the terms of reference restricted their revenue budgets of the states, particularly since the third finance commission. The observation of chairman of fourth finance commission that as the language of Article 275 stands that there is nothing to exclude from its purview neither grants for meeting revenue expenditures on plan schemes not is there any explicit bar against grant for capital purposes. Yet, the Planning Commission did not do so as it would blur the entire division of functions between Finance Commission and Planning Commission and therefore chose a narrower role than the broader one assigned constitution. Most of the time, it is felt that the design and implementation of inter-governmental transfer scheme suffer from a number of important weaknesses which render the achievement of their objectives extremely difficult. Multiple agencies Finance Commission, Planning Commission and National Development Commission transferring federal resources with overlapping roles results in wasteful duplication in their function. The compartmentalized role of Planning Commission and Finance Commission to assess what essentially is an interdependent and many a times artificially distinguished plan and non-plan needs of the states have posed severe difficulties in the clear pursuance of the objectives of these transfer.

Over the years the states have complained about the inadequacy of central assistance in meeting their respective social obligations and varied developmental requirements. They are neither satisfied with the quantum of resources transferred, nor their distribution. They are also not satisfied with the controls that go with such transfers. Through a 73rd Constitutional Amendment (1992) the setting up of the state finance commission is provided for under Article 243 (I) to help the local bodies a more secure financial foundation. Though it is an innovation many states had appointed Panchayati Raj Finance Committees in the past. However, there is a little experience of the effective working of state finance commission anywhere in India. Due to centralized bias
in fiscal arrangements, the issued of regional economic imbalances have not been addressed. It is in fact for these reasons that we see now more and more demands for creation of new/smaller states in most parts of India.

Union States financial relations during the Janta Party Period:

If the states suffer from inadequacy of financial resources and powers, the autonomy of the states faces constraints and the federal character of the constitution is also jeopardized. “In the views of this background the centre-state relations on financial matters acquire greater significance. In the matters of resources allocation the states there should not be a rigid demarcation between the plan and the non-plan developmental revenue and the capital accounts. The problems of resources allocation to the states must be viewed in a wider and a more comprehensive perspective.208 The fiscal structure of India has not received the attention what for it deserves. In true sense, financial part of the constitution (Part-XII) has affected considerably the constitution as well as the political aspects of India’s federal system. “The framers of the constitution designed a truly federal financial structure and expressly enumerated the sources of revenue, which are levied by the union government but either assigned entirely to the states under Article 268 & 269 or shared with them under Article 270 & 272. What is more, the constitution set-up an independent finance commission under Article 280 to act as an umpire to review the situation periodically in order to safeguard the federal character of the financial system while recommending financial transfers from union to the states, in the accordance with the scheme of the constitution. The framers of the constitution made India’s fiscal system truly federal in character.209 Against this background, Janta party has given its views on financial relations between union and states. The party has suggested that these should be rigid demarcation between plan and non-plan, developmental and the non-developmental revenue and capital accounts. The resources should

be distributed to the states on wider and perspective manner. The party’s general trend is that the constitutional aspect of the country’s fiscal structure has not received the attention it deserves.

The states should get a share in the income tax and also the tax on companies should be shared between the union and states. The surcharge levied for general revenue purposes on duties and taxes including income tax should be treated as part of the divisible pool. The auxiliary and special duties should be merged with the basic excise duties. Janta Party has suggested that at least 60% of the net proceeds should be made available for divisible pool. While the centre sanctions the grants to the states under Article 275 of the constitution, it should not draw the revenue from the state’s share of divisible pool. “Janta Party had also suggested to setting up of a national expenditure commission which should go into the expenditure of both the centre and the states very thoroughly. The commission should also rationalize the basis for the assessment of revenue surpluses for its own guidance. “To deal with the other aspects of the revenue, the party has suggested that the centre should establish a national credit council, which should deal with the acute problems of the institutional finance. It (NCC) should consist of the representatives of the central and the state government at ministerial level, the governor of the RBI, the chairman of NABARD, IDBI, export –import bank and the LIC. This council should be established under the aegis of the national development council.”

Janta Party had also suggested that the national debt commission should be set-up to decide the general principles in regard to the relative shares of the central and the state governments in market borrowings and the interest differentials. This National Debt Commission should work in consultation with the planning commission and Reserve Bank of India. There should not be any discrimination among the various state on political grounds in permitting the over drafts. “The very concept of devolution of powers and the decentralization is rendered meaningless, if in the planning process right from the formulation of plans up to

the stage of implementation, there is no effective participation of the states as well as lower local bodies; at present in effect, the planning has remained a highly centralized process at the apex."²¹¹ The party has expressed its views about the role of the national development council in the national planning process. This council is essential as national forum for discussion not only of national planning but also of decentralized planning, the planning commission should not scrutinize all the details of the proposals made by the states. The union list permits parliament to legislate in respect of industries. The parliament exercises control over these subjects in the public interest. But the basic scheme of the constitution is that the industries and commerce should remain with states. When the people of a state are keen to take-up major industrial projects and are ready to make the necessary sacrifices, why should the ruler in Delhi object is all this in national interest.²¹²

The national commitment is to have social and economic development through the planning process. The union and states both have had heavy planning responsibilities. Some division of these responsibilities between centre and the states already exists. But according to the party, this has to be streamlined and rationalized according to the clear principles to avoid ugly and socially disruptive controversies. Subjects like health, education, water-supply and sanitation naturally come under the control of the states. The centre should not interfere and involve directly in such subjects. The responsibility for planning in these areas should be vested in the centre. The centre should not sponsor the plan schemes in more areas of the states concerned that required the centrally sponsored anti-poverty schemes are total irrational. There is no meaning in centralizing such schemes. "By eroding the autonomy of the states in this fashion have the people of this country been benefited in any way."²¹³ Economic and social planning is an entry (item no. 20) in concurrent list of VII Schedule.

For this purpose, there should be consultation between centre and states. The states have to approach the planning commission to finalize their annual plans. Even for the scrutiny of minute details, the states have to approach the planning commission, though the planning commission may not have correct knowledge in the field the states are not free to decide the size of their plans. It is difficult to make planning commission a joint endeavor. As the subject “economic and social planning is in the concurrent list the centre should consult the states in the planning process. Such tension and distortion will not contribute to national well-being and national integration. Therefore, the party has viewed that the planning process should be a joint endeavor i.e. the centre should not force the states to approach the planning commission for the scrutiny of minute details.

Thus, we see that centre has been increasing its expenditure over the years even on the state subjects. It has caused distortion in development and non-development expenditures. All these tendencies have combined to create an acute imbalance between the resources and responsibilities at the state level. Without adequate resources to the states, there is no meaning to the responsibility alone. The recommendations of finance commissions on the division of resources from time to time have not been commensurate with changing federal relations. The Gadgil formula also has created new tensions in the distribution of central assistance to the states especially the less developed states.”

**Lok Dal:** The Lok Dal came into being as a direct result of the split in the Janta Party, which brought an end to the Janta Party rule at the centre. This party was also known as Janta Party (Secular). It was one of the constituent parties in the Janta Party government between 1977-1979. The Janta Party which came into existence in 1977 was unable to work with a real sense of unity. All the allies of the party worked together up to 1979, while retaining their separate identities. So was the case with Lok Dal. Formerly, this party was also known as Bhartiya Kranti Dal. After some time, this party came to be known as Bhartiya Lok Dal. The Lok Dal has had its own views on Indian federation. The party has
said that the Indian constitution is not unitary but is a federal one. Lok Dal has strongly given its clear views on the issue that the federation is must for efficient administration of India. The party’s opinion in this regard is that the principle of federalism has to be adopted in such a manner to suit the ideas of the people. It is true that the centre should be strong but it should not be at the cost of the constituent states. If the states are strong, no doubt the centre will be strong. It is like a biological process that the centre can be strong only when the states are strong. The states have been demanding for more financial powers. The present tug-of-war between the centre and the states is due to lack of finances to the states. The constitution has given the powers to both centre and states to share the revenues. The Lok Dal has given the view that the Government of India can play havoc with the state governments by utilizing the discretion grants. Therefore, the Lok Dal has stressed the role of the national development council. This council should formulate every year the general principles for distribution of grants-in-aid. “The resources for raising the funds available to the states are practically inelastic and comparatively very inadequate.”214 In the context of development plans the states are in need of increasing resources. The central government has the provision to get the revenue from foreign aid and the resources to deficit financing. The states have not been getting these revenues. “If the states have to depend totally on the central government for financial resources, the federal structure would end up as unitary state. This is the danger inherent in the situation.”215

Lok Dal also suggested that according to Articles 272 of constitution taxes which are levied and collected by the centre may be distributed between the centre and the states. The sharing of these duties, the excise duties be compulsorily shared between the centre and the states. For this purpose Article. 272 should be amended to make the division compulsory. The party has also suggested that the statutory devolution of resources should be transferred to the

states. The centre should transfer 50% of tax revenues to the states and at the same time the centre should share the surcharge on excise duties with the states.

There are two types of grants viz. statutory and non-statutory grants. Statutory grants are also called as the grants –in-aid and non-statutory grants are known as discretionary grants. Articles 273 and 275 of the constitution deal with statutory grants. “All these discretionary grants have overwhelmingly outstripped the statutory grant recommended by the finance commission and they have reduced the position of the states to that of supplicants for the central assistance.” The discretionary grants are fully controlled by the centre. These grants range between 71.3% to 88%. “These discretionary grants naturally fluctuate depending upon the centre’s financial position. Therefore, the position of the states becomes nebulous and since dependence on the centre becomes more pronounced in a federal structure while the different parties may come to power in different states.

Through a critical study of centre-state fiscal relationship, the conclusion emerges that the Indian Constitution demarcates the taxing powers of the centre and the states, taxes of local nature have been given to the states while taxes with a tax base extending over more than one state or which would be levied on a uniform basis throughout the country or which can be collected more efficiently and more conveniently by the centre rather than the states have been provided for the centre. This scheme has been found beneficial to eliminate all problems of multiple and overlapping taxation which has arisen in an acute form in the older federations of the USA, Canada and Australia due to concurrent taxing powers creating manifold complications both for the tax payer as well as tax collector. Although, the scheme of separation of centre-state tax resources has also as discussed above, created problem of imbalance between resources and functions at the state level. Most of the expansive functions, under the constitution have been allotted to the states, such as agriculture, education, roads, irrigation etc. While the taxes allotted to the states are not very expansive and are not sufficient by themselves to enable the states of discharge their growing social welfare obligations. Hence, further conclusion emerges that
founding fathers themselves realized this and sought to augment resources of the states by providing for transfer of funds to the states from the centre through the technique of tax-sharing grants. We find that a huge amount of central aid is given to the states every year through the grants, loans, the states hardly find themselves in a position of being able to meet their own commitments. Although, to some extent such a situation arises because of the fact that the states are not utilizing fully the taxing powers available to them under the constitution. Although, the constitution devises an elaborate and flexible scheme of centre-state financial relationship, yet the fact remains that the demands for greater financial allocation by the centre to the states seems to be justified demands of the states. Thus, review of centre-state relations becomes inevitable.