INTRODUCTION

In recent past, the fiscal thinking in multi-unit terms has been stimulated in public finance mainly for two reasons: First, all well established federations like USA, Canada and Australia etc. have been facing the serious and perennial problem of fiscal imbalances, viz. vertical fiscal imbalance and horizontal fiscal imbalance. These imbalances lead to maleficient working of the federal fiscal system. Hence, the need for correcting these imbalances have attracted the attention of the fiscal economists. Secondly, the experience of European Economic Community (EEC) has necessitated the reorganisation as well as harmonisation of fiscal institutions and co-ordination in fiscal activities of all member countries.¹ These hard realities with which the above said multi-unit fiscal systems are confronted have stimulated fiscal thinking in multi-unit terms. Hence, we have good deal of theoretical as well as empirical literature on the issues of fiscal federalism.²


² The relevant contributions are listed in bibliography.
During the first decade of economic planning in India, i.e. 1951-60, the working of the federal polity gave the impression that the federal fiscal framework provided by our Constitution functions smoothly. But, since then the "known tensions" of fiscal federalism have brought forth the fiscal issues of vertical and horizontal fiscal imbalances in India. As a consequence, there is demand for more fiscal autonomy for the sub-national units of our federalism. This has also led to the suggestion that the federal fiscal arrangements require critical evaluation and reorganisation of the present federal fiscal framework.

This leads us to a very important question - why since 1960-61, the very perspective of our federal fiscal arrangement has altered remarkably? Actually, in late fifties and sixties several crucial changes took place in India and these changes were mainly responsible for highlighting the difficulties of the present federal fiscal arrangements as well as for altering the perspective of the present fiscal system. The following are the crucial changes:


The process of economic planning as well as the centralisation tendencies got intensified in India during late fifties. Because of these forces, the States which are primarily responsible for crucial developmental and distributional programs were failing in bridging the gaps between their available revenue resources and the public expenditure commitments. The financing through increasing debt burden, i.e. through overdrafts from Reserve Bank of India and loans from Centre, became common practice among the number of States.

By this time, the Planning Commission, also emerged as powerful agency for recommending transfer of funds from Centre to the States. In fact, this development has altered the whole profile of the federal transfer mechanism provided by the Constitution as well as the Union State-financial relations. In past, the distribution of Central Plan Assistance and Loans through the recommendations of Planning Commission have raised suspicions and it was alleged that Planning Commission's recommendations with respect to federal transfer to the States are arbitrary and discretionary. This function of the Planning Commission has, also substantially reduced the scope and effectiveness of the Constitutionally provided statutory quinquennial body - the Finance Commission.

For the brief account of these tendencies and their implications, see Government of India: Report of the (Sixth) Finance Commission, 1973, Chapter:2, para:6.
(3) One of the reasons for relatively smooth functioning of the federal fiscal system till mid-sixties was that in majority of states in India, only one political party, i.e. Congress Party, was in power at both the layers of government. But as a result of Fourth General Election in India, in 1967, this milieu changed remarkably because in many states other political parties came in power.

It should be clear from the above discussion for the critical evaluation of working of federal fiscal system in India, the period after 1960-61 becomes more meaningful. Moreover, in any such study, the main focus should be on the developmental, distributional and stabilizational objectives of the fiscal policy. Keeping these objectives in view while evaluating the working of the system, also suggests that along with the examination of budgetary operations of Central Government we should examine the fiscal operations of the States. Because, the States carry the major burden of the developmental and distributional functions and their budgetary operations do influence the stabilizational measures adopted by the Centre fisc. This will help us to come to some broad conclusions about the efficiency of the Indian federal fiscal system in achieving the accepted objectives.

Our studies of finances of Government of Gujarat have impressed us about the need to study the working of federal
In our studies, we found that even the financially well administered State like Gujarat was subject to stresses and strains as a result of working of federal fiscal system. It is obvious that such stresses and strains would be greater in the case of relatively poor States in India. As a consequence, the problem of vertical and horizontal fiscal imbalances has aggregated in India over time. Hence, it is important to study in depth the impact of the working of our multi-unit fiscal system on the finances of the States in our country and its implications on the realisation of goals of the fiscal policy in India.

Thus, the findings of our earlier studies on finances of the government of Gujarat as well as the preceding exposition of our federal fiscal system has led us to take up this problem for the present study, "State Finances in Indian Multi-unit Fiscal System".

The survey of Indian literature in this area reveals that we do not have studies which can provide the analytical framework for handling this problem. For, the official as
well as non-official studies in this area are either discrip-tive and/or based on casual imperialism.\(^2\)

Moreover, most of these studies mainly deal with one of the positive fiscal issues of our multi-unit fiscal system and, hence, provide only a partial view of the working of our system. Therefore, their prescriptions remain less meaningful in terms of restructuring the present system. As against this, the studies done abroad, and particularly in USA, view the system as a whole and evaluate the working of the system. Therefore, they offer the suitable approach to this type of problem. As an example, the recent study of working of American Federal Fiscal System by Dick Netzer provides appropriate analytical framework for evaluating the given multi-unit fiscal system.\(^2\) His study starts with the quantitative analysis of positive issues of American fiscal federalism and on the basis of this analysis he sorts out the major deficiencies of the existing federal fiscal arrangements. In light of these deficiencies of the system, he evaluates the given Constitutional arrangements and suggests suitable changes therein to make the system conducive to attain the


\(^2\) Netzer, Dick; "State Local Finances and Intergovernmental Fiscal Relations" in Blinder, Solov, Break, Steiner and Netzer: The Economics of Public Finance, 1974, pp. 353-421.
desired goals. As the present study aims at evaluating the working of our multi-unit fiscal system and at prescribing appropriate changes therein, the analytical framework provided by Netzer's study seems to be appropriate. Therefore, the present study broadly adopts the analytical framework or the procedure provided by Netzer's study.

It is obvious that the present study cannot proceed without the quantitative analysis of comparative fiscal behaviour of Union and State Governments and various aspects or fiscal issues of our federal fiscal system. The main aspects or issues which deserve quantitative analysis are as under: (1) The comparative analysis of growth rates, stability indices and other behavioural measures of the revenue and expenditure programs of Union and State Governments, (2) The differentials in States' per capita expenditure on various developmental and distributional budgetary heads as well as in the per capita expenditure on administrative services, (3) The inter-state variations in tax-capacity, tax-state income ratio and tax efforts of the states, (4) The determinants of differentials in tax-income ratio and public expenditure performance of the states, (5) The impact of federal transfer on states' budgetary operations and (6) The implications of working of the federal fiscal system in general and federal transfer mechanism in particular on the efforts we are putting in realising the goals of fiscal policy in India.
Unfortunately, very few studies in India have attempted the quantitative analysis of some of these aspects, viz. the inter-state variations in states' tax efforts or in public expenditure programs and their determinants by using appropriate statistical techniques such as regression analysis. The quantitative analysis of one of these issues is far more inadequate in evaluating the working of the whole system and in prescribing appropriate changes therein. Only one research project which is in process analyse two crucial aspects of states' finances - their fiscal capacities and fiscal needs - with widely used statistical techniques for quantifying the genuine fiscal gaps in their budgets and aims at eliciting the implications for federal transfer in India. Hence, for quantitative techniques the present study relied on the techniques which are widely tried in such type of studies undertaken in India and abroad.

The chapter scheme for the present work is as under: Chapter ONE surveys the literature related with the theoretical as well as operational issues of fiscal federalism.

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Chapter TWO gives exposure to the problem which we are handling in this study and discusses the methodological issues which are relevant in analyzing the working of the present federal fiscal system in India. Chapter THREE deals with the trends and nature of horizontal and vertical fiscal imbalances in India since 1960-61 and shows the ineffectiveness of the federal transfer mechanism, especially, the Finance Commissions in correcting these imbalances. The States' public expenditures are quantitatively analyzed in Chapter FOUR and States' resource mobilization efforts through their own tax resources are appraised in Chapter FIVE.

In the final Chapter, i.e. Chapter SIX, on the basis of our analysis, we have stated our conclusions and suggested the changes in the present arrangements which according to our opinion make the system conducive to the objectives of our fiscal policy and fiscal federalism. We are aware that the comprehensive evaluation of the working of the whole federal fiscal system is beyond the ability and resources of individual researcher. In this context, the chapter also discusses the limitation of the present study and shows the area where there is scope of quantitative analysis.