CHAPTER-II
2.1 FINANCIAL AUTONOMY

It is a fact that the degree of financial autonomy of states is a complicated issue. There is no literature which can be said to be sufficient and clear in the matter. The question is whether to measure the financial autonomy on the basis of percentage of the state’s own resources to their financial needs or whether the measurement should be on the individual states on the basis of tax revenue and the expenditure in the total control of the states. The basis, today among the division of function and revenue resources amount different level of government of federation lead the centre to superiority for the financial matters (Thimmi 1981). For the centralised planning approach, the growth and idea of welfare in today’s world, the centralisation of revenue has become necessary. Therefore in the federal set-up, the complete financial autonomy is neither acceptable nor it can be justified from any end. Many experts (Chelliah 1981 and Rao Hemlata 1981) in their studies have revealed that there should be financial autonomy to the states but they do not come to any consensus. The Sixth Finance Commission took up states autonomy matter in respect to growth of tax rates which has grown by nine times at the state level and eleven times at the central level, during the period 1950-51 to 1972-73. However, it may be argued that the state’s revenue resource is inelastic.

The other study (Lakadawala D.T. 1967, P.74) which was for the period 1960-61 to 1976-77 shows that there has been higher degree of centralisation in the Indian economy. George K.K. and Gulati I.S. (1988,
125) have taken the same outlook regarding the question of the finance.

2.2 REVENUE TRANSFERS FROM CENTRE TO STATES

The study further states that the aggregate transfer from the centre to the state never exceeded 1/3 of the aggregate central receipts during the First to Fourth Plans. Even though the centre had been transferring its 1/3 of its total receipts, they have emerged as a substantial proportion of the state's aggregate expenditure (Patel Madhukant 1984). During the Sixth plan, 41.6% of the total state's expenditure is financed by the central transfers. This shows that the study proves the increasing dependency of the states on the centre. In the financial matters, state's dependency has increased particularly, from the commencement of the planning period.

The study by a group headed by Chelliah (1981), was undertaken in the matter of the states heavily depending upon the centre. The dependency is shown the share of revenue collection and the share they get from collection to devolution. The findings of the National Institute of Public Finance and policy, headed by Chelliah revealed that the divergence between the said parameters during 1955-56 was 18.6% and it was 21% during 1975-76, showing the degree of increasing dependency of the states on the centre, for revenue.

Thimmiah and Rao Hemlata, in their study (1981, P 74) have examined the issue of fiscal autonomy of the state's in terms of vertical federal fiscal imbalance in India. The study reveals that there has been growing centralisation tendency, which is supported by the fact in 1979-80, the state's shared less than 30% of the total revenue
CENTRE - STATE FINANCIAL RELATIONS,

raised by both the centre & the states and less than 17% of the total capital receipts, while the centre shared about 70% of the aggregate revenue receipts and about 83% of the capital receipts.

Financial autonomy can be explained by the degree of centralisation. Higher the decentralisation, higher will be the fiscal centrality, similarly lower will be the fiscal autonomy of this states, lower is the centralisation and more shall be the state's autonomy. The centralisation or decentralisation can be measured by either the revenue side or by the expenditure side. If revenues are considered then the distinction of the total and own revenues within governmental transfers should be taken into account (Gulati 1987, P 112).

The needs of the states are many and the capacity of tax collection is low. Due to this difference the continuous dependence of the states on the centre shall not make the states self-reliant. This position is found in federal system in which the centre dictates terms in financial matters and states just remain as powers.

2.3 DIVISION OF REVENUE RESOURCES UNDER CONSTITUTION

Financial powers are distributed under the Article 246 of the Constitution. Legislative and financial matters of the centre and the states are mentioned in the Seventh Schedule. It contains three lists: List (I) is the union list which shows the powers of the Central Government. List (II) shows the powers of the states and the List (III) shows the powers where the states and the centre can legislate but do not include any tax powers. All the residuary powers are vested in the Centre and to legislate in any matter for any part of the
2.4 **TAX RECEIPTS AND EXPENDITURE OF THE STATES**

The tax collection in the advanced states is relatively higher as compared to the national standard. The resource received by developed states and centre diverted to less developed states. In the less developed states, though the investment is made in some fields, the most preferred expenditures are not made with. This can be seen from the research studies on the expenditure patterns. The richer states spend more on the social and economic services. The poor states spend more on social wants in conception of modern state and are also of the view to be equal to the advanced states (Nanjundappa and Basvana 1968). The big institutions, the regulation of company operations, the development of Railways and Ports, subsidies, tariffs, freight rates, food subsidies control and location of industries and price regulation methods are conceived and operated on the broad national interest. All these things are in favour of the states like Maharashtra and Gujarat, where the central investment is huge as compared to the poor states like Rajasthan, Madhya Pradesh etc. This can be known from the number of licences the states get from the centre. Which in Maharashtra alone in 1969 received 3084, whereas, Rajasthan received 203, Madhya Pradesh with 275, Assam with 105 etc. Those matters give enough evidence to show that the efforts of the state and the centre are framed in the national interest. The Union Government is in a position to initiate policies, which can increase or reduce incomes in some states at the cost of other states. This can be done by regulating the prices of the food, raw material or finished goods by determining the location of industries. The expenditure of centre is more than all the and enhancing taxes. The surplus should be transferred to the less developed states.
METHODOLOGICAL ASPECTS OF THE STUDY

1. While analyzing the data concerning the financial as well as non-financial variables, we assume a linear trend which can be measured by means of the moving average method, considering the appropriate period as the periodicity for computing such a moving average.

2. Growth rate for the relevant data can be estimated on the basis of annual growth rate (AGR). However, it would be more appropriate to consider the well-known semi-log trend equation on the basis of which the percentage growth rate of the series can be computed, interpreted, and projections can be made on its basis for inter-regional as well as for inter-period comparisons.

3. We assume linearity (or non-linearity, as the case may be) as an appropriate relation to examine the effect of a set of explanatory variables upon the endogenous variable.

4. The per capita total expenditure incurred by the group of states is related to the corresponding population density, literacy ratio, per capita non-developmental expenditure, per capita total revenue, per capita loan payment and total labour force.

5. The per capita developmental expenditure incurred by the group of states is also assumed to be related with the corresponding population density, literacy ratio, per capita expenditure on social and communication services, per capita expenditure on economic services and per capita total revenue.

6. The variation in per capita total revenue of the group of states is found to be due to the corresponding change in the population density, literacy ratio, per capita total tax revenue, per capita grant received, per capita loan received and total labour force.
7. Per capita total tax revenue of the group of the states is dependent upon the corresponding population density, literacy ratio, per capita state's share from the central taxes and per capita total revenue.

8. Per capita total GDP of the group of the states is related with the corresponding population density, literacy ratio, per capita GDP from agriculture sector, and labour force of agriculture sector.

9. The variation in per capita GDP for the group of the states is due to the corresponding population density, literacy ratio, per capita GDP from non-agriculture sector and labour force of non-agriculture sector.

3.4 DATA BASE

Today in India there are 25 states. It would be worthwhile to consider only the major states representing the development status as well as their actual financial position, which is measured in terms of their per capita income or per capita GDP. We may regard such a criterion as a criterion for potential growth representing economy viability as well as financial position for the relevant states for the economy as a whole. Thus, we have listed sixteen states (out of the republic of India) as the major states and we regard the group of all the sixteen states as the group of major states or group of all the states, so far as our study is concerned and it reflects the financial behaviour of the major states in India.

3.4.1 GROUP DIVISION OF THE STATES

With the above criterion for the major states, now we shall consider the method of grouping as applied to the financial and non-financial data collected from the different states. The grouping of states
This would lead to increased budget expenditure and reduction in the tax collection in the under-developed states. This process shall continue till the federal equilibrium is attained. In the economy where the disparity is noticed, tax sharing and resource transfers based upon equity consideration should be applied in higher dose. Shall this be criterion of distribution help to achieve the stated results? Developed state with the virtue of its developed position and higher receipts of the taxes as contribution and poor states with their resources and receipts shall be lower. From the general experience, it can be said that the states who have more expenditure have less resource. The states who have less expenditure have more resource. The states which are developed and have a well set social and economic infrastructure and industrial complexes find their resource more expensive.

2.6 NEEDS OF THE STATES

There are different meanings of the word needs to which the Finance Commissions have also made certain references. The absolute needs are those for which the revenue is required for the existing social services. For these services the excess of fund is required to speed up the growth of economic and social services, to reach the national standards, so that the states may attain higher standard of growth path. Wherein the disparities are reduced. Finance Commission has observed that "Having regard to broader consideration of equity and the main purpose of devolution which is to secure more balanced correspondence between the need and the resource of the states is widely different due to their circumstances. We feel the present weightage to contribution which result in marked disparaties
between more or less states should be reduced. (Report of Finance Commission 1969, p.23). To meet with the existing as well as growing needs, the modes of distribution among the states should be changed. It was necessary to keep in mind that the main purpose of devolution is to augment the resources of the states in the equitable manner to come up with increasing needs. The earlier commissions started with the notion of the relevant needs. Though various meanings were given to the word need but this was confined to the distribution of the excise duties. The existing level of social service standard and the finance provided for meeting these needs result in structural transformation of the economy and the improvement of the existing services. This has added a new dimension to the problem. In the advanced states the population growth necessitates only expansion. The less developed states have to initiate them in vast rural areas where the unit cost would be high. The need of education, health and housing programmes, roads & their expenditure would be more and the return as revenue in the short run would be nil, thus it becomes a thicker problem. There is a great difficulty in implementing it on the educated people. To make them use such amenities and preparing themselves to adjust with such changes for their own benefits put a lot of pressure in this situation. It forces the capital and the trained people to move to advanced states. The problem of less advanced states is not to expand but to make "Critical Minimum Efforts" to meet with the advanced states. For this the resource transfer should become a very important factor. The main question which arises is that does the population represent the complexity? Or can the relative of absolute needs without reference to costs or standard of services are being
supplied to create a sense of National equality? Is it that the state with higher population needs less resources? Do the states provide higher standard of social services to more people? It has been found that the population is the inefficient source of showing the resource transfer. It was the distribution of Excise duty that was to be the main indicator. How much of the share a state gets the backwardness and standard of social services should lead to estimate for relative needs of the states. Therefore, it is necessary to take the measure of the need that the scale of population. For population reflects the need as the simple measurement.

2.7 PER CAPITA INCOME AND POPULATION CRITERION

Consumption for the resource transfer can be used, if it is a satisfactory criterion. Population might be the right criterion if all the states are placed at an equal economic development level. Population basis for distribution can be said to be good if it gives a flat rate grant, but when there are disparities in the per capita income and the development among the states this criterion is against the poor states. It can also be said that the person in the poor state is not identical as that in the richer state in terms of income. The true neutrality can be gained when poor states are given more share and the rich states less. For the relative need, population is not only the right measure, but it is highly discriminating and this measurement works against the fiscal equity and the development strata. Therefore the distribution of the resources should be made on the criterion of backwardness and the sharing of all the tax resources should be done and paid to the states. The distribution made by the IVth and the Vth Finance Commission shows that the income tax and Union excise pay-
merits are higher to the developed states. It is clear that the inequality in devolution recommended by the Fifth Finance Commission was reduced but again the share percentage was reduced, the change in the weightage resulted in reducing the inequalities in the distribution of the resources. Income tax was given the weightage by 20% to the index of backwardness. The Fifth Finance Commission in the broad spectrum levels brought some equality among states of each spectrum. Still the higher spectrum state received more on the basis of population and its higher per capita income and the poor states received less because of the low per capita income.

This process created a barrier to the growth of the less developed states. The average state moved towards a progressive trend by reducing the disparities among all the states. From the above discussion, one thing is clear that neither contribution nor the population reflects the varying needs of the states clearly. So it is not logical to use population as the measure for need, giving the dis-appropriate weight to 80% to 90% on the population. As it is the unnatural criteria and is highly indiscriminatory in terms of regional imbalances in the level of economic and social services. The criterion of distribution by population is a traditional approach, but due to change in time and in the present context, it would be necessary to follow the criterion which is more logical, which would lead to fiscal equity and national equilibrium, which can direct to federal integrity.

2.8 RATIONAL DISTRIBUTION

The modern approach is to have resource distribution from a divisible pool on the rational and national criterion which accepts the impact
on state budgets. The progress achieved through planned developments and gaps therein are to be filled. The Finance Commission puts it as the relative needs that emerge to be the only basis for efficient and equitable allocation. The question would arise—what is the satisfactory indicator of fiscal needs of the states? The first aspect is to work out the levels of economic development of the individual state. Monetary investments shall not give the correct idea of their development as the cost and price structures vary when the growth is measured. Therefore the physical growth levels show the economic development attainment of the individual state. This gives us the relative needs through the under-development of the state. Thus the development sectors can be grouped to formulate the index for integration. The following sectors should include Agriculture, Irrigation, Power, Transportation, Communications, Education and Health, Industrial structure and employment, credit and banking, backwardness and development (Divatia V. V. 1983). These are the main components of economy and can state the quantitative measurement. From this formulation and weights given to these sectors, priorities can be adopted in the national planning and the contribution to growth should be taken into account as the research studies have suggested. There might be some difference between the per capita income and the development of the states. Thus states may have registered growth and might have higher per capita income, but their development index might be lower. Entrepreneurial capacities and abilities, skill and services can not be shown reflected to indicators. This criterion can be based upon upliftment of guidance and bring them development stream for distribution to the poor states. The other important factor of per
capita transfers should be the transfer of resources between the poorest and richest. By this method, the richest state shall be receiving more on per capita basis, which shall be an alternative criterion of population. The special matter of this proposal shall be the resource transfer to the poorest states as it shall rise and it will be progressive with the degree of under-development. The less-developed states shall become lathargic in the matter of raising resources by their tax effort.

2.9 DISTRIBUTION AND TAX EFFORT

In the case of resource transfer for reducing backwardness, it would work as the premium on under-development. The check on the States can be by the Centre by distribution based on the tax efforts by the states. Target for the collection should be fixed in advance. Any agency in revenue collection by the states or Centre should be reduced into a grant as penalty by the revenue as their efforts for collection tax had been less to such States and instructing them for the incoming grants cut. The tax effort should be assessed by the tax potential measured by the development levels. This scheme does not discriminate against the poor states. The other way to come out this discrepancy is the contribution criterion. Whatever inequity is caused by the distribution it can be rectified by the full weight assigned to the population. This matter has already been argued by the states. Population causes the utility loss to the country. Prof. Ursula Hicks (1969, P. 24) has also pointed at the recommendation of the Finance Commission, by stating that this approach shall take to the disequilibrium, as the rich states and the poor states remain backward in receiving the share. The prevailing distribution is based upon the weightage given.
If the attention is paid to per capita income, result would be different.

2.10 **RECENT DEVELOPMENT IN DISTRIBUTION**

One procedure which can be expected as valid criterion is that population by development which is just the opposite to policy adopted by Australia. It is development population mix of different proportions, as population leads to the poor stage and with the development index, rich states go on receiving less by which qualification can be made through the criterion of population leads the poor states to more poorer stage and with the development index, the rich states go on receiving less by which qualification can be made through the criterion of population and development or 50:50, whichever is useful according to the circumstances.

If the development as base is not accepted by any reason, then there can be the alternative way of per capita income at its place. The distribution can be made on population per capita on equal portion of 50:50. There are also other mix which can show the distribution base (i) 90% of population and 10% development (ii) 50% development and 50% per capita income (iii) 10% population and 90% development (iv) 100% per capita income (v) 100% population adjusted to development (vi) 100% development adjusted to the population (vii) 100% development adjusted to population.

From the above discussion, distribution criterion whatever is the development and population taken together, per capita source transfer to the richer states shall be progressively more as compared to the poor states. The equal concept shall only be acceptable if the development criterion is adjusted to the population criterion or reverse of
it, even if the two are applied with different proportions, then also there can be equalisation force in the system. The development criterion can be substituted and the per capita income can be accepted. There will be a limit when the state has reached at the level of development, the per capita may not be generated by the growth process and some social service and economic infrastructure may not increase or generate income, but it can serve social needs and wants thereafter. Under such conditions, if the per capita and development are adjusted, the poorer states will benefit which is based on equity consideration. The result does not differ as compared to distribution with the development base. The poorer state compared to richer state shall get more. Similarly giving weightage to the population per capita income would not differ. There will not be any difference in weightage of population and the development base. The study attributes financial resources and expenditure of various States. Every year budget is prepared for individual States by their respective governments to meet with the expenditure. The State depends upon its internal resources as well as share of central taxes, grant and loans from the centre. State can manage partial capital receipts by their own internal resources as well as revenue receipts, viz tax revenue and non-tax revenue. The focus in this study is mainly on revenue and expenditure side. These are derived from different heads and spent on various functioning. However every year the revenue and expenditure of each state are increasing but the increasing rate of expenditure head is higher as compared to the increasing rate of revenue heads. Thus, there is a deficit in the state budget grown up and increased year by year, this