CHAPTER I

INTRODUCTION
India, that is Bharat, is a Union of States. It consists of the Union government, twenty-two state governments and nine union territories. The constitution of India which is federal in character came into operation from 26th January 1950.

In a federal system of government, there is division of powers between one general and several regional authorities - each of them in its own sphere is coordinate with others. In a federal set up, of all types of relationships, financial relations are the most important. Finance - an essential prerequisite to any government - plays an important role in establishing harmonious centre-state relations. The aggregate of fiscal activities of the centre and state governments and the relationship between them go by the name of federal finances. An analysis of the division of taxing and spending functions among different levels of government is called fiscal federalism. Fiscal cooperation is the essence of modern federations. A federation will stand or fall by the adequacy of its economic constitution.


3. L. Robbins, Economic Aspects of Federalism, 1941, p. 3.
More allocation of functions and resources between centre and state governments is not sufficient to build sound financial relationship between different units in a federation. If the division of resources between different units in conformity with the financial requirements is difficult, that of keeping the division in step with the growing needs of different layers of government is more difficult. Inter-governmental cooperation, reduction of regional inequalities and levelling up of the levels of economic and social development in different states are some of the principal objectives of a modern federation. It is this economic aspect of federation which has assumed importance over the coordinate and independent aspects of the two sets of government.

The importance of economic aspects of federation for a developing country like India is too well known to require elaboration. Fiscal adequacy and fiscal discipline, efficiency and economy, administrative convenience and suitability have been some of the principal guiding principles in the demarcation of the economic powers between Union (centre) and the states in India. The inclusion of an additional list of concurrent powers in the Indian constitution emphasises the need for this coordination and cooperation particularly in the economic spheres between centre and the states. The objective of planned economic
development of the country by launching five year plans and
the goal of socialistic pattern of society with a dominant
public sector wedded not to the realisation of narrow commer-
cial gain but to provide the base for development, have their
own influence on the federal character of the constitution and
emphasise the need for close economic cooperation between
different units. The constitution that has been in operation
for the last thirty-six years has been subjected to several (46)
amendments. The flow of resources from the centre to states
increased manifold. At the aggregative level the total of taxes
and grants transferred from the centre to the states increased
to ₹14003.0 crores in 1963-64 (Accounts) as against the average
annual transfer of ₹286.2 crores during the first plan period.
In addition, the loans advanced by the centre to the states
amounted to ₹4902.6 crores in 1963-64. For 1985-86 the budget
estimates of Shared taxes and grants are ₹12470.6 crores and
loans given to states are ₹5980.6 crores.

In spite of the massive transfer of resources from the
centre to the states there does not appear to be all round
satisfaction. Individual states complain about the resource
transfers as - too little, delayed and discriminatory and
demand greater financial autonomy to states.

Just before the fourth general election (1967) the central
government appointed an Administrative Reforms Commission (ARC)
whose terms of reference included examination of centre-state relations also. A study team, constituted by the Administrative Reforms Commission, examined this problem and submitted its report in 1969. Making it as the basis, the ARC finalised its own report on the subject in 1969. The central action in setting up a commission to examine inter-governmental relations however did not completely satisfy the states. Therefore, in 1969, the government of Tamil Nadu, (which was then ruled by a party other than the one at the centre) appointed a committee headed by P.V. Rajanmanan to study the centre-state relations and to forward the suggestions necessary for securing greater autonomy to the states. Rajanmanan Committee traced the growth of unitary trends in India and strongly favoured states' autonomy in all spheres.

Sri Balwant Singh, Finance Minister of Punjab, complained that the states had to go to the Union with a begging bowl to seek financial aid for their development programmes. This practice, if continued, would lead to servitude of the states. Drawing attention to the constitutional provisions, Sri Balwant Singh

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pointed out that all elastic sources of revenue like corporation tax, excise duty were with the union, while inelastic sources like water, passenger tax, which caused public resentment, if raised, were with the states.  

The Chief Ministers of Southern States established a Council which held its first meeting at Bangalore on March 24, 1983 to discuss the problems of mutual interest affecting Centre-State relations. They wanted a fiscal Commission to examine and to ensure more funds for the States. The Chief Minister of Andhra Pradesh objected to the tendency towards concentration of excessive powers in the hands of the Centre - more strikingly evident in financial field. He also objected to the erosion of States' autonomy and demanded the reallocation of resources to meet the requirements of the States. The States felt that the Centre has been deliberately abridging the resources to keep its preeminence in the financial field. According to a report, the Chief Ministers of Andhra Pradesh & West Bengal  


8Speech of Sri N.T.Rama Rao, Chief Minister of Andhra Pradesh, in discussions with the eighth Finance Commission during their visit to Hyderabad on May 5 and 6, 1983, p. 2.  

9Ibid., p. 2,3 and 6.
expressed their resolve to resist the union government’s move to ‘centralise everything.’

The Chief Minister of Karnataka blamed the over-centralisation of resources that is responsible for the poor rate of growth and finds fault with the centre for making inroads into the legitimate areas of the states in the distribution of finances. He pleads for centre-state governance through partnership and consensus. According to him, strong states are imperative for a powerful centre. Basic harmony among different levels of government lies in proper balance between responsibilities and powers at each level without which federal principle will be reduced to mere mockery.

Another factor in centre-state relations in India is the role of Planning Commission. Planning Commission, which was set up under an executive resolution, is said to have emerged as a powerful body and restricted the scope and functions of Finance Commission. Finance Commission, a statutory body merely determines the revenue gap of the states and provides for filling up the gaps through devolution – sharing of taxes and duties and

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grants-in-aid. This is said to be contrary to the intention of the constitution makers, for, as visualized by them, the Finance Commission was to be the most active and powerful body in regulating centre-state financial relations in India.\textsuperscript{12}

Besides, political factors also have their impact on centre-state financial relations. States with ruling parties different from the one at the Centre, affected the harmonious relationship between Centre and the States. Problems of Centre-State relationship became prominent with changes in the political scene of the country. Sri Jalagam Vengal Rao, President of the Andhra Pradesh Congress Committee, who belongs to the ruling party at the Centre stated that the cut in outlay of Andhra Pradesh's seventh plan is mostly due to clash with Centre.\textsuperscript{13}

This is an example of the prevailing attitude, to say the least. Healthy relationship between the Centre and the States is essential for steady growth irrespective of the parties in power (both at the Centre and States). Political conflicts increased the disparities in the development levels of different states.

It is suggested, that for better relations between the Centre and the States and for proper utilisation of limited re-


\textsuperscript{13} The Hindu, Friday, January 31, 1986, p. 1.
sources, States should be given more financial powers by the Centre so that they may not wait for orders from Union government to discharge their duties and responsibilities towards the people of their respective states.\textsuperscript{14} It is also suggested that to establish good relations between centre and the States the present consititutional provisions should be amended.\textsuperscript{15}

It is proposed that a permanent autonomous institution should be constituted and planning commission and Finance Commission should be merged with this institutions or these institutions should work as subsidiary departments with the newly constituted institution. The Constitution of such a permanent body will be in national interests, and ensures impartial treatment of all states, not influenced by the political parties in power.\textsuperscript{16}

In view of these changing circumstances, a fresh look at the Centre-State relations became, therefore, necessary and in 1983 Sarkaria Commission was set up by the Centre to examine all facts of Centre-State relations in India. The Commission is expected to submit its report by the end of June 1986.

In the context of changing Centre-State relations and the allegations of some experts that the states have been reduced to


\textsuperscript{15}Ibid.

\textsuperscript{16}Ibid. p. 13.
the status of beggars during the course of the last thirty-six years, it is necessary that there should be a thorough study of Centre-State relations. Even the seventh Finance Commission deplored that there has not been much of competent research work in the field of public finance for quite some years now. While there are quite a few studies at the aggregate level studying in depth the transfer of resources from the Centre to States as a whole, there does not appear to be many studies dealing with individual states. Studies relating to financial relations of the individual states with the Centre are as important as studies at the macro level. So, it is proposed to study the financial relations of the Centre (Union government) with Andhra Pradesh which was formed on 1st November 1956. Andhra Pradesh is one of the twenty-two states in the Indian Unions and is the fifth largest state in the country both from the point of view of population and area. It is one of the first few states to be reorganised in independent India largely on the basis of language. Andhra Pradesh has 7.8 per cent of the population of India according to 1981 census and 8.37 per cent of the area of India.

**Objectives of the Study:** The principal objectives are:

1. To review the financial relations of Andhra Pradesh with

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\(^{17}\text{Report of the Finance Commission, 1978, p. 91.}\)
the Union government for the last twenty-eight years (1957-58 to 1984-85).

2. To study the inter-governmental fiscal relations in Indian Union in general and in comparison with other federations - United States of America, Canada and Australia.

3. To undertake comparative study of the financial relations of Andhra Pradesh with the Union government in comparison with all other states in India.

4. To make a detailed study of fiscal transfers from the union government - shared taxes, assigned taxes, grants-in-aid and loans - to the state of Andhra Pradesh and to assess their relative importance.

Data-base and methodology of the study:

The study has been made mainly on the basis of secondary sources such as the Reports of the Finance Commissions, Memoranda submitted to the Finance Commissions by Andhra Pradesh Government, and budget documents of Andhra Pradesh government. The annual review of the Finances of State governments published in the Bulletin of Reserve Bank of India is another principal source of information particularly for inter-state comparisons on a uniform basis. The following are the main bases for comparison -
1. Share of Andhra Pradesh in the Central taxes as a percentage of total revenue and total tax revenue of Andhra Pradesh, in comparison with the corresponding percentage for all the states in India put together.

2. Shared taxes of Andhra Pradesh as a percentage of shared taxes to all the States in India in the aggregate.

3. Percentage share of grants-in-aid in the total revenue of Andhra Pradesh in comparison with the corresponding figures in respect of all states in India (Revenue from shared taxes, assigned taxes, grants-in-aid etc. received by Andhra Pradesh has been calculated as a percentage of total transfers under different categories to all model.

In short, Andhra Pradesh model has been compared with the All States model (all the states put together constitute the All States' model). This percentage will help us in drawing meaningful comparisons in relation to the share of Andhra Pradesh in the total population and area of India.

Scope of the study:

This study examines the problems of Centre-State financial relations in Indian Union and also in a few mature or developed federations – U.S.A., Canada and Australia. Further, a detailed study of the financial relations between the Centre
and the government of Andhra Pradesh is furnished. This study is confined only to federal financial relations.

**Data Analysis**:

The collected data in this study are statistically analysed with the help of tools like averages, percentages and index numbers. Figures relating to estimates of elasticity and buoyancy of important taxes have been adopted from the studies of the Reserve Bank of India.

**Limitations**:

Given the nature of the subject, the study is based on secondary data. Because of financial constraint it was not possible to have detailed interviews and discussion with all the persons connected with the Centre-State relations.

**Chapter lay-out**:

The study is divided into six chapters.

Chapter one deals with the purpose of the study, objectives, of the study, methodology of the study and the like.

Second chapter is concerned with the inter-governmental financial relations in the federations of United States of America, Canada and Australia.

Evolution of Union-State relations in India and the financial provisions of the Indian Constitution are discussed
Chapter four highlights the transfer of tax revenue from the Union government to all States in general and to the State of Andhra Pradesh in particular. The Andhra Pradesh model has been compared with the all States' model.

Fifth chapter concentrates on grants-in-aid to Andhra Pradesh as well as to all states in the Indian Union. Union loans to states are also discussed in this chapter.

Summary of the study and the conclusions derived from the study of 'Centre-State financial relations in India with special reference to Andhra Pradesh' are presented in the last chapter.

Note: Central, Federal, Dominion and Union governments are used as synonymous terms—States, units and regional provincial governments are used as synonymous terms in this thesis.