CHAPTER - II

CENTRE-STATE FINANCIAL RELATIONS
CENTRE-STATE FINANCIAL RELATIONS

So fundamental is money to government that one might redefine the orthodox constituents of the State by saying that it consists of territory, people, sovereignty, organisation and financial resources\(^1\)-said S.P. Aiyer. Finance is an essential prerequisite of government irrespective of the form of government. Though the problems such as maintenance of proper balance between resources and responsibilities, maximum economic welfare, currency control, balance between direct and indirect taxation etc. are common in unitary as well as federal governments, there are certain special problems of finance in a federal type of government.

The most important problem of federalism is that of finances, of the raising of revenues where with to pay for the various functions of the various levels of government.\(^2\) According to K.C. Whee, the general and regional governments in a federation should be independent of each other in their

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\(^2\)Quoted by Raman Bombay, Federal Financial Relations in India, Meerut, Meenakshi Prakashan, p. 2.
respective spheres. They should be co-ordinate and not subordinate to each other. Each must be financially co-ordinate with the other. Fiscal independence is the backbone of the autonomy of regional governments in a federation. According to Alexander Hamilton, one of the fathers of the American constitution, it is as necessary that the state governments should be able to command the means of supplying their wants as that the national governments possess the like faculty in respect of the wants of the Union. The main problem is that of securing balance between division of functions and the division of resources.

Federation refers to the union of two or more states. The main features of federal system are the existence of a written constitution, division of powers and functions between federal and state governments and an independent judiciary. A.H. Birch defined federal system of government as one 'in which there is division of powers between one general and several regional authorities each of which in its own sphere is co-ordinate with each other.' Royal Commission on the

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Australian Constitution, also expressed a similar view when it defined federation as a form of government in which sovereignty or political power is divided between the central and local governments, so that each of them in its own sphere is independent of the other.\(^6\)

In a federal system, the division of powers and functions between centre and states are defined in the constitution itself. A part of the authority and power is vested in the local areas while another part is vested in an association of local areas.\(^7\) The functions which are of national importance are generally placed under the control of central government and those which are of regional importance are assigned to the State governments. Defence, currency and coinage, international relations, tariff and international treaties, postal services, telephone and telegraph belong to the centre. Education, health, agriculture, public works, internal law and order are allocated to the states. The essence of federalism therefore is that the general and regional governments should be more or less independent of each other in their respective, constitutionally demarcated, spheres of action.\(^8\) For this,

\(^6\) Quoted by S.A.H. Haqq\(i\), Union-State Relations in India, Meerut: Neenakshi Prakashan, 1967, p. 54.

\(^7\) Ibid., p. 54.

the division of financial resources between centre and the state governments along with the allocation of functions is necessary. Thus in a federalism, fiscal structure is decentralised. As A.R. Prest, rightly remarked while earlier constituent governments were essentially independent of one another both financially and otherwise, this is no longer true of the modern federations. Today it is much more common to find unit governments partially dependent financially on the central government, and the latter frequently shaping its financial policy in order to promote development in matters which are, constitutionally, prerogative of the regions. It would, therefore, seem appropriate to define federalism not unite so tightly as was done formerly so as to admit a greater degree of administrative cooperation and smaller degree of independence between the federal and unit governments.9

Finance which is an essential pre-requisite of governments (both centre and the states) should be properly allocated between the functions and resources. The integrity of financial system in any federation may be tested by a double criterion. On one hand it must ensure independence, on the other hand it must be adequate.10

Unlike in the older federations, which had the objective of a 'minimal' state, extension of social welfare programmes in the present day world increased the expenditure of the regional government, which has added a new dimension to the problem of fiscal federalism. This resulted in the imbalance between functions and resources and created additional financial problem in a federal system. The chronic gap between the own resources and expenditure potential of the states seem to have become an inherent feature of all established federations\textsuperscript{11} characterised by a non-relationship between the national and state governments. New style federalism refers to a multifaceted positive relationship of shared action. The meaning of federalism today lies in a process of joint action, not in a matter of legal status. It lies not in what governments are but in what they do. It is a matter of action rather than structure.\textsuperscript{12}

The constitutional relations between centre and state governments however differ from federation to federation - United States of America, Canada and Australia have a varying pattern of relations between central government and the state.


governments. Therefore before we proceed to a detailed
discussion of the trends in federal finance of India, a
brief examination of the working of some of the federations
in the world vis. U.S.A., the oldest federation in the world,
Canada and Australia would be instructive.

FISCAL FEDERALISM IN AMERICA, CANADA AND AUSTRALIA—INTER
GOVERNMENTAL FISCAL RELATIONS—AMERICA:

The U.S. federation was formed in 1787. The U.S.
federation consists of central (federal) government, fifty
States and District of Columbia. Each state in its turn
shares its fiscal tasks with local governments of various
types, including cities, townships, countries, school dis-
tricts and other special service districts — 80,000 in all.13
The U.S.A., the oldest of all modern federations, has been
regarded as pure and true federation. The constitution
favoured strong government at the centre and strengthened the
fiscal position of the federal government.

The fiscal framework of the United States is deeply
embedded in a federalist spirit of its constitution.14 The

13 R.A. Musgrave and P.B. Musgrave, Public Finance in
Theory and Practice, Mr.Graw-Hill Book Company, 1963, p. 540-
541.

14 Ibid., p. 29.
major fiscal provisions of the federal government of the U.S. constitution include taxing powers and uniformity rule. The federal government has power to levy and collect taxes, duties, imposts and excises, to pay debts and provide for the common defence and general welfare of the United States. The general welfare is understood to cover not only general objectives such as national defence or the administration of justice, but also highly selective programmes aimed at particular regions or population groups. Taxing powers of the federation are subject to the uniformity rule. The rule requires that 'all duties, imposts and excises shall be uniform throughout the United States.' In U.S.A., both the federal government and the state governments impose income tax, gasoline, tobacco and liquor taxes and death duties. The state governments impose corporate income tax whereas the federal government imposes both corporate and personal income tax. For the U.S.A. Shirras calculates over-lapping for more than 90 per cent of the combined tax proceeds. Larger portion of the total federal revenue is from direct taxes i.e. personal and corporate income tax.

15 Ibid., p. 30.
16 Ibid.,
17 Ibid.,
The constitution of the United States laid down certain limitations on the taxing powers of the states. In addition to these restrictions, the state constitutions impose certain limitations on the state taxation. The constitutional provisions of some states deal with the tax structure in detail, while the provisions of other states deal with specific matters. The fiscal powers of local government are granted by the states, since local government has no sovereign powers of its own. By the same token, the federal limitations on the taxing powers of the states also apply to the derived powers of the local governments.\(^{19}\)

**Expenditure by Origin of Funds:**

The distribution of expenditure by level of government may be viewed in two ways, (1) according to the origin of funds, where grants are included at the level of the grant or (2) according to where expenditures to the public are made, in which case grants are included at the recipient's level.\(^{20}\)

As shown in table No. 2.1, the share of local governments in public expenditures was 52 per cent during 1902.


\(^{20}\) Ibid., p. 541-542.
## Table 2.1

### Expenditure by Levels of Government in the United States

(As percentage of total)

<table>
<thead>
<tr>
<th>Year</th>
<th>Federal</th>
<th>State</th>
<th>Local</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962</td>
<td>36.4</td>
<td>11.3</td>
<td>52.4</td>
<td>100.0</td>
</tr>
<tr>
<td>1967</td>
<td>33.0</td>
<td>17.7</td>
<td>49.3</td>
<td>100.0</td>
</tr>
<tr>
<td>1940</td>
<td>33.0</td>
<td>22.5</td>
<td>44.5</td>
<td>100.0</td>
</tr>
<tr>
<td>1950</td>
<td>66.5</td>
<td>17.8</td>
<td>15.6</td>
<td>100.0</td>
</tr>
<tr>
<td>1960</td>
<td>64.6</td>
<td>16.4</td>
<td>19.0</td>
<td>100.0</td>
</tr>
<tr>
<td>1975</td>
<td>62.0</td>
<td>22.3</td>
<td>15.7</td>
<td>100.0</td>
</tr>
</tbody>
</table>

### Civilian Expenditure

<table>
<thead>
<tr>
<th>Year</th>
<th>Federal</th>
<th>State</th>
<th>Local</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962</td>
<td>21.2</td>
<td>13.9</td>
<td>64.9</td>
<td>100.0</td>
</tr>
<tr>
<td>1967</td>
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<td>55.4</td>
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<td>1940</td>
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<td>1950</td>
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<td>27.5</td>
<td>24.1</td>
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<tr>
<td>1960</td>
<td>48.3</td>
<td>23.9</td>
<td>27.7</td>
<td>100.0</td>
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<tr>
<td>1975</td>
<td>54.5</td>
<td>26.7</td>
<td>18.8</td>
<td>100.0</td>
</tr>
</tbody>
</table>

### Total Expenditure

<table>
<thead>
<tr>
<th>Year</th>
<th>Federal</th>
<th>State</th>
<th>Local</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962</td>
<td>35.9</td>
<td>13.8</td>
<td>55.8</td>
<td>100.0</td>
</tr>
<tr>
<td>1940</td>
<td>48.0</td>
<td>17.8</td>
<td>34.4</td>
<td>100.0</td>
</tr>
<tr>
<td>1950</td>
<td>62.8</td>
<td>15.2</td>
<td>22.0</td>
<td>100.0</td>
</tr>
<tr>
<td>1960</td>
<td>59.6</td>
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<tr>
<td>1975</td>
<td>53.2</td>
<td>26.7</td>
<td>18.8</td>
<td>100.0</td>
</tr>
</tbody>
</table>

### Civilian Expenditure

<table>
<thead>
<tr>
<th>Year</th>
<th>Federal</th>
<th>State</th>
<th>Local</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962</td>
<td>20.6</td>
<td>10.2</td>
<td>69.2</td>
<td>100.0</td>
</tr>
<tr>
<td>1940</td>
<td>23.5</td>
<td>15.2</td>
<td>61.2</td>
<td>100.0</td>
</tr>
<tr>
<td>1950</td>
<td>41.7</td>
<td>19.7</td>
<td>38.6</td>
<td>100.0</td>
</tr>
<tr>
<td>1960</td>
<td>42.7</td>
<td>23.4</td>
<td>33.9</td>
<td>100.0</td>
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<tr>
<td>1975</td>
<td>41.2</td>
<td>21.5</td>
<td>37.3</td>
<td>100.0</td>
</tr>
</tbody>
</table>

### Source

Corresponding share of the states was 11 per cent and that of federal government 36 per cent. With the great depression in 1930's, the share of federal government increased to 53 per cent in 1940 and the share of local governments declined to 24 per cent.

As 'responsibility for defence' lies in the hands of federal government, expenditure on defence and other items led to steep rise in the share of federal government to 66 per cent in 1950, in total expenditure whereas the share of states and that of local governments decreased to 18 per cent and 16 per cent respectively in the same year. In 1975, the share of expenditure of the federal government was 62 per cent, the corresponding share of the states was 22 per cent and that of local government was 15 per cent. The federal share in civilian expenditure shows a raising tendency but only a little change from 47 per cent in 1940 to 48 per cent during 1960. It was 54 per cent in 1975. The percentage share of local governments in civilian expenditure decreased from 65 in 1902 to 19 during 1975. Increasing expenditure centralisation is arrived at by including grants at the level of donor.

**EXPENDITURES TO THE PUBLIC:**

As shown in lines 7 to 12 of table No. 2.1 the picture differs, if inter governmental grants are included at the
level of the recipient. Distribution between levels is then in line with outlays to the public. As a result, the importance of the higher-level shares is reduced. In 1975 federal share in total expenditures dropped from 62 to 53 per cent and showed a substantial decline since 1950. The drop in civilian expenditures is to 45 per cent, i.e. slightly above the 1950 level.\textsuperscript{21}

Both ways of looking at the matter are of interest. If concern is with revenue requirements, inclusion of grants at the level of origin is appropriate. If interest lies with what levels control expenditures to the public, inclusion at the recipient level may be preferable. This is clearly the case if control over grants rests with the recipient, but must be qualified for categorical grants, the use of which is at least partly controlled by the donor. Nevertheless, assessment of fiscal centralization differs, depending on whether concern is with the tax or the expenditure side of the picture. Revenue centralization as indicated by lines 1 to 3, has been more marked than has expenditure centralization, as measured by lines 7 to 9.\textsuperscript{22}

\textsuperscript{21}Ibid., p. 543

\textsuperscript{22}Ibid.,
### TABLE 2.1c

**Federal Grants to State Governments in the U.S.**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>11.0</td>
<td>21.9</td>
<td>55.6</td>
<td>85.0</td>
</tr>
<tr>
<td>2. Aid to State Governments</td>
<td>9.8</td>
<td>19.3</td>
<td>42.0</td>
<td>57.0</td>
</tr>
<tr>
<td>3. Direct federal aid to local governments</td>
<td>1.2</td>
<td>2.6</td>
<td>13.6</td>
<td>22.0</td>
</tr>
<tr>
<td>4. Direct federal aid to city governments</td>
<td>4</td>
<td>1.2</td>
<td>5.8</td>
<td>n.a</td>
</tr>
</tbody>
</table>

**Ratios**

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>5. (3) as percentage of (1)</td>
<td>10.5</td>
<td>11.9</td>
<td>24.4</td>
<td>35.0</td>
</tr>
<tr>
<td>6. (4) as percentage of (1)</td>
<td>3.7</td>
<td>5.5</td>
<td>13.4</td>
<td>n.a</td>
</tr>
<tr>
<td>7. (4) as percentage of (3)</td>
<td>35.2</td>
<td>44.4</td>
<td>42.6</td>
<td>n.a</td>
</tr>
</tbody>
</table>

The role of grants differ from federation to federation. In the U.S.A conditional grants play a vital role. These grants are to assist the states in implementing welfare programmes and in maintaining minimum national standard. Grants for the construction of inter-state highway, grants for health, education and welfare are most significant. Most grants are given in the form of 'matching' requirements but these matching requirements differ. Matching grants are uniform for some programmes and vary for other purposes in relation to the fiscal capacity of the lower levels of government.

The federal grants which were $11 billion in 1965 doubled during 1970. It was $55.6 in 1976 and $85 billion in 1979. The increase was nearly 8 times over a period of 14 years. Direct federal aid to local governments also increased from $1.2 billion in 1965 to $2.6 billion in 1970 and further increased to $28 billion in 1979. Direct federal aid to local governments during the period of 14 years has become almost 23 fold. Substantial growth of federal grants strengthened the fiscal capacity or ability of the states and local governments to operate their functions. But these grants increased the reliance of regional governments on federal government.
Canada was given its Constitution by the British Parliament through its enactment, British North America Act, 1867. In 1867 the four colonies formed into a federation and other colonies joined later. Canada consists of ten provinces and two territories. These colonies joined together to meet the external aggression and for accelerating economic development. The colonies of Canada differ in size, population, natural resources and financial capacities.

The division of powers between Dominion government and provincial governments were enumerated in the British North America Act, 1867. Postal services, currency and coinage, defence, trade and commerce etc are assigned to the Dominion. Municipal institutions, local works and undertakings, hospitals etc are allocated to the provinces. The constitution allotted education to the provinces. Matters relating to civil items and property belong to the Dominion. The constitution restricted the powers of provinces 'to direct taxation' in order to raise revenue for provincial purposes. It favoured strong government at the centre and provided customs, excises, income and corporation taxes and estate duties to the Dominion and sales tax, motor vehicles tax, entertainment tax to the provincial governments.
Extension of developmental measures, such as education, highways, health and welfare and unemployment relief fell within the sphere of provincial governments. But the sources of revenue of the provinces remained unchanged. The provincial governments had the constitutional right but not the financial capacity to deal with the social and economic crisis. The Dominion government had the financial ability, but not the legal right to undertake responsibility. In 1874, the total expenditure incurred on education by all provincial governments amounted to 4 million dollars. In 1937, the expenditure rose to 250 million dollars, that is, sixty times in almost as many years. This affected the financial position of the provincial governments. Inadequate financial resources compelled the provincial governments to depend on the Dominion government for grants and subsidies.

**GRANTS:**

The gap between constitutional responsibilities and financial resources is bound to result in disparities in the standards of social services and administrative efficiency among the units. In all federations, devices are developed for reducing these disparities as far as possible. Usually these devices take the form of federal grants-in-aid to the

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units, grants being varied in accordance with fiscal need of the units.

In Canada, unconditional grants are given on a large scale and these include compensation for federal assumption of tax powers. Conditional grants are considered as a part of the central expenditure. The Rowell-Sirois Commission suggested two forms of grants vis. (i) fiscal need or, as the commission called them, rational adjustment grants to enable the provinces to provide services at a national standard which it recommended as irreducible, and (ii) emergency grants to be made only in the event of financial stringency.

Tax Rental agreement between provincial governments and Dominion government gave the Dominion the power over income tax, corporation tax and succession duties. In 1952, 1957 and 1961 the agreements were renewed. In 1962 the legislation gave the provinces the jurisdiction over three taxes, i.e., income tax, corporation tax and succession duties and changes were made in the federal tax rules also. The provinces with less revenue per capita (less than that in Canada as a whole)

### TABLE - 2.A.

**REVENUE OF DOMINION AND PROVINCIAL GOVERNMENTS IN CANADA**

(Millions of Dollars)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Direct taxes</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Dominion</td>
<td>3443 (84)</td>
<td>4651 (69)</td>
<td>5202 (68)</td>
</tr>
<tr>
<td>b) Provincial</td>
<td>654 (16)</td>
<td>2053 (31)</td>
<td>2469 (32)</td>
</tr>
<tr>
<td>c) Total</td>
<td>4097</td>
<td>6704</td>
<td>7671</td>
</tr>
<tr>
<td><strong>Indirect taxes</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Dominion</td>
<td>2190 (64)</td>
<td>3575 (59)</td>
<td>3707 (56)</td>
</tr>
<tr>
<td>b) Provincial</td>
<td>1233 (36)</td>
<td>2535 (41)</td>
<td>2905 (44)</td>
</tr>
<tr>
<td>c) Total</td>
<td>3423</td>
<td>6110</td>
<td>6612</td>
</tr>
<tr>
<td><strong>Total Tax Revenue</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Dominion</td>
<td>5633 (72)</td>
<td>8226 (64)</td>
<td>8909 (62)</td>
</tr>
<tr>
<td>b) Provincial</td>
<td>1887 (28)</td>
<td>4588 (36)</td>
<td>5374 (38)</td>
</tr>
<tr>
<td>c) Total</td>
<td>7520</td>
<td>12814</td>
<td>14283</td>
</tr>
<tr>
<td><strong>Total Revenue</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Dominion</td>
<td>6668 (64)</td>
<td>9809 (57)</td>
<td>10631 (55)</td>
</tr>
<tr>
<td>b) Provincial</td>
<td>3709 (26)</td>
<td>7312 (43)</td>
<td>8661 (45)</td>
</tr>
<tr>
<td>c) Total</td>
<td>10377</td>
<td>17121</td>
<td>19292</td>
</tr>
</tbody>
</table>

**Note:** Figures in brackets are percentages

**Source:** J.M. Shams, *The Union and the States*, p. 60.
are given equalization grants. Revenue equalization grants vary with states on the basis of their fiscal capacity. Unconditional grants occupy the major part of state expenditure.

The total tax revenue of the Dominion (in table No.3.1) government in 1960-61 was $5633 million and increased to $8226 million in 1965-66 and further rose to $8909 million during 1966-67. The corresponding values of the provincial governments were $1887 million in 1960-61, $4586 million in 1965-66 and $5347 million in 1966-67. In the total tax revenue, the share of the provinces during 1960-61 was 28 per cent whereas the share of Dominion was 72 per cent. In 1965-66 the share of provinces was 36 per cent and further increased to 38 per cent during 1966-67.

The percentage share of Dominion in the total revenue was 64 in 1960-61 and that of provincial government 36 per cent. The share of Dominion in the total revenue during 1965-66 was 57 per cent and in the case of provincial governments 43 per cent. During 1966-67 the share of total revenue of provinces increased to 45 per cent while the share of Dominion was 55 per cent. On the whole, large part of total tax revenue was allocated to the Dominion government and the provinces depend on the Dominion for financial assistance.
AUSTRALIA

Australia, one of the federations of the modern world, was given its constitution by the British Parliament through enactment. The units of Australian federation differ in size, population, economic development and natural resources. Australia, which consists of six states - Tasmania, Western Australia, New-South Wales, Victoria, Queensland and South Australia - is an example of economic inequality between the units.

The constitution of Australia (1900) does not consist of any well worked out financial provisions. The constitution provided more financial powers to the commonwealth government. Customs and excise duties are levied by the commonwealth government. States have the power of taxation in other fields. Under section 96 of the constitution Commonwealth Parliament was empowered to grant financial assistance to the states during the first ten years and thereafter until parliament otherwise provided. 28

The growing responsibilities of the states in respect of social services have forced them to rely on the commonwealth government for financial assistance. The federation

must, therefore, run to the rescue of the poorer states for creating a common service standard, and the best way of ensuring this would be through grants. To meet the fiscal need of the units grants are given to them by the Commonwealth government. The main purpose of these grants is to lessen economic inequalities among the states. The Australian grants covering more than 40 per cent of state revenue are both conditional and unconditional. The unconditional grants are most predominant. After 1928 conditional grants also have worked fairly smoothly. These grants are distributed in such a manner that the weaker states get more per capita amount than richer states.

GRANTS:

The Common Wealth Grants Commission (CGC) was established in 1931 to determine the grants to be given to States. In Australia grants are given (through Common Wealth Grants Commission) to the claimant states - the poor states. These grants are given to the poor states to improve their standards to the level of other rich states. In the beginning there were three claimant states viz., South Australia, Western Australia

30 Ibid., p. 19.
and Tasmania. From 1969-70 Tasmania remained the lone claimant to get these special grants. The Commonwealth Grants Commission bases its recommendations on the principles of fiscal need of the state. Commonwealth Grants Commission attempts to measure this by three elements, viz., a budget element, a revenue element and an expenditure element. The budget component is to see that the deficit of the poor states does not exceed the deficit of the standard states. The revenue component is a matter of estimating what the poor states could raise without too much difficulty. It is recognised that this will depend on the population, on the per capita incomes, on the distribution of state incomes and on the distribution of age among the population. It is a very sophisticated estimate. The third component in the estimate is based on three categories. First they should be able to spend the same, if they want to, as the standard states, on first of all education, secondly, health, hospitals and charities, thirdly, law, order and safety and so on. The Grants Commission estimates are based on fundamental comparisons of this nature and they are extremely sophisticated. They are forward looking taking into

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account the projected needs for the next five years although they will be considering them every year. This commission submits its yearly reports and recommendations to the Commonwealth Parliament. Besides financial assistance grants and specific purpose grants, special grants are also given to the states by the Commonwealth government.

General revenue grants in Table 2.4 include special grants paid to the states on the recommendations of the Commonwealth Grants Commission. It is clear from the table that the general revenue grants and specific purpose grants increased substantially. Loans are also given to the state governments for specific purposes.

<table>
<thead>
<tr>
<th align="left">TABLE 2.4.</th>
<th align="left">COMMONWEALTH GRANTS TO THE STATE GOVERNMENTS ($ 000)</th>
</tr>
</thead>
<tbody>
<tr>
<td align="left">General Revenue Grants</td>
<td align="left">799,121</td>
</tr>
<tr>
<td align="left">Specific purpose Grants (capital &amp; Revenue)</td>
<td align="left">330,593</td>
</tr>
<tr>
<td align="left">TOTAL:</td>
<td align="left">1,129,715</td>
</tr>
</tbody>
</table>

Source: J.M. Sharma, The Union and States, p. 66.
Australian Loans Commission was established to manage the external borrowing of the Commonwealth government as well as state governments. The total external borrowings for the whole of Australia, Federal and State is determined once a year through the deliberations of the Commonwealth government and State Governments. Then the States put their claims for what they hope to get and they are allocated according to what is conceived in the national interest, i.e., their share of the total which the Loans Commission thinks is wise to borrow abroad. At one time this was immensely important. In fact, the Loans Commission had its origin because of very great borrowing on the market by some of the states. But the States that are trying to develop fast, find the Loans Commission a bit of a restriction.

**Distribution of Revenue:**

In short the commonwealth revenue is obtained in the form of taxes from the people of the commonwealth and then distributed among the states in the form of grants in lieu of taxes surrendered by them to the commonwealth. In fact, as

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12 J.N. Sharma, *The Union and the States*, p. 65.
taxation is collected in greater degree from the wealthier sections of Australia and distributed mainly on the basis of population, the distribution is favourable to the less fortunate states. 34

**BROAD TRENDS IN FEDERAL-STATE RELATIONS**

An examination of the working of some of the federations of the world leads us to the following broad conclusions. All the federations we have examined - U.S.A., Canada and Australia - seem to now favour strong government at the centre. For example in the U.S.A while the federal share in total expenditure of the nation was about (36%) one third during 1902 it increased to nearly two-thirds during 1975 (62%). Over the same period the share of the state governments rose from 11 to 22 per cent while the share of the local governments declined from 52 per cent to 16 per cent. In short the share of the state governments and the federal government increased at the expense of the local governments. In Canada, the share of the Dominion government in total revenue during 1960-61 was 64 per cent, and that of provincial government was 36 per cent. During 1966-67, there

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34 Quoted by J.N. Sharma, op. cit., p. 65.
was a decline in the share of Dominion (35 per cent) while
the share of provinces rose to 45 per cent. Though the fiscal
data indicate faster growth in the budgets of the state govern-
ments, there has been relative decline in their revenue raising
capacity. While expenditure of the state governments has grown
faster than that of the federal government, the revenue raising
capacity has come to be concentrated in the hands of the latter.
Similar is the position in Australia.

SHARE IN TAX RESOURCES:

In recent years, there has been a greater centralisation
of revenue in the federal government of U.S.A. While the share
of the centre during 1975-76 was 56 per cent, that of state was
24 per cent and the corresponding share of the local government
was 19 per cent. In Canada, the revenue resources of the pro-
vincial government were restricted to direct taxation. The
Dominion government has more powers to exploit any source of
taxation. The share of the Dominion in direct taxes was more
than two-thirds while that of provinces was nearly one-third.

GRANTS:

To reduce the disparities in the level of social servi-
ces as far as possible certain devices are developed in all
these federations. These devices take the form of grants to the regional governments conditional and unconditional. The main purpose of these grants has been to cover the gap between functions and resources of the regional governments, to lessen the economic inequalities and for implementing welfare programmes in the unit governments. Conditional grants play a vital role in U.S. A federal grants to lower levels of government have increased from $11 billion in 1965 to $85 billion in 1979. Direct federal aid to local governments during the period of 14 years (1965-79) has become almost 23 fold. In Canada, unconditional grants are given to the states on a large scale. Conditional grants given by the Dominion are considered as a part of the central expenditure and they account for 30-40 per cent of all transfers. In Australia, grants (both conditional and unconditional) cover more than 40 per cent of the revenue of the states.

Substantial growth of the federal grants to the states in all these federations examined above shows the inadequacy of revenue resources at the disposal of the regional governments and their increasing dependence on the centre.