CHAPTER - 1. THE PROBLEM.

The eternal problem of fiscal federalism - of imbalances in Revenue powers and Outlay needs - has to be subjected to an 'inspection' process, if not periodically at least as and when the need is felt and more so in the context of an over-all national endeavour for optimising savings ratio for planned economic development, so that 'displacements' in either powers or functions can be made. Since any set pattern of distribution of Revenue powers and transfer mechanism are bound to be out-moded very soon, the inspection process explores the possibilities for concentration or decentralisation of Revenue powers - in the context of planned development, for optimum resource mobilisation and efficient utilisation of these additional savings by public authority - and improvement of both organisation and techniques of resource transfers in achieving resource equilibrium to lower units. This inspection process is an essential aid to fiscal adjustments. The totality of the outcome of changes in tax powers or expenditure functions from one level to the other and the institutional arrangements for achieving resource equilibrium may be termed as "Fiscal Adjustments". Since fiscal adjustments, thus defined, encompass changes not only in allocation of powers and functions between different levels of Governments but also in the institutional arrangements for financial transfers, in the pages that follow not only the techniques of fiscal (Revenue and Outlay) adjustments but also of financial adjustments (organisations responsible for transfers, changes in divisible pool, tax rental agreements, grants, loans and their related problems) are given equal emphasis both at Central-State and State-Local levels. Obviously since an integrated approach should be preferred to an adhoc, tentative and piecemeal, though pragmatic, ones, Union-State and State-Local aspects are subjected to
that fiscal adjustment process. That the necessity for such an inspection process into the Indian fiscal federalism has arisen can be seen from the operation of concentration process in the fiscal landscape as well as from the suggestions for both centralisation and decentralisation.¹

While the very Indian Federal organisation and the over-all economic planning initiated since 1951 justify the work undertaken, certain developments have lent further support to this enquiry. For instance, in raising savings ratio, internal mobilisation of savings by Government plays dominant role; even there shares allotted to States is significant, which is evident from the fact that Rs. 898 crores, Rs. 2,100 crores, Rs. 1,462 crores out of total investment of Rs. 2,013 crores, Rs. 4,600 crores and Rs. 7,500 crores during 1st, 2nd and 3rd Plan periods respectively as against the Union's share of

¹. Union Govt. levied new taxes (Wealth, Gift, Expenditure tax and Super-profit tax) for augmenting its revenues; action taken by Union Govt., in certain other cases directly touched the revenues of either State Govts., or some important Local Govts.. Those in the former category are (1) Extension of number of articles liable for the Union Excise duty (2) Levy of additional Excise duties in replacement of Sales tax (3) Centralisation of tax on Railway passenger fares and (4) the suggestion of the Transport Fannnel (1966) for the levy of uniform taxation of Motor Vehicles in all States..... tended to strengthen the Union's finances at the cost of the States. In the later category is the levy by Union Govt. on properties worth over Rs. 2 lakhs in Cities with population over 2 lakhs which also strengthened central purse at the cost of some of the Local Govts., finances. Union Govt., has undertaken some other measures that affect the quantum of transfers to States. Exclusion of Income tax on the profits of Companies from the divisible pool is an example. In the State-Local sphere financial impact of Panchayat Raj Bodies on States' finances is immense such that it was felt that these are affecting the State's autonomy from local end. On the other hand gradual abolition of Octroi, as recommended by T.B.C. from the Local taxation has not been made good by Local fiscal process. Besides these it was suggested that the "Profession Tax" be handed over to Income Tax Department in Cities. In Central sphere replacement of periodical Finance Commissions by a permanent Grants and Loans Council on the Australian pattern was suggested, while in the State-Local sphere suggestions for a Commission similar to F.C. or Grants Commission are made. Further suggestions and counter suggestions for centralisation and decentralisation of Land Revenue and Agricultural Income Tax are made. Suggestions for rate uniformity in case of power generated in different grids of Electricity Boards and transfer of Motor Vehicle Taxation to concurrent list were made. All these are aspects which generate centrifugal and centripetal tendencies in fiscal federalism of India.
Rs. 507 crores, Rs. 426 crores and Rs. 3,238 crores during same periods. While such substantial sums are allotted to States, the economic basis for such an allotment has not been made explicit. State's performance in mobilising those allotted shares has been a dismal failure which has been acknowledged as such, while on the contrary, Union's performance was praised. While State's failure, in contrast to Union's success, has cast aspersions on the genuineness of State's efforts, consequential increase in dependence on transfers by States from Finance Commissions (F.C.) or Planning Commission (P.C.) or Union Govt., has been exaggerated. While conflicting views are held on such a development necessity for this type of work are nevertheless clearly stated. Therefore an inspection into the financial mobilisation by States - both individually as well as collectively - under various techniques was undertaken to assess, pragmatically, the case and scope for transfer of tax functions through centralisation or rate uniformity. This is taken up in Chapter 2.

Performance of certain functions allotted to States by the constitution has come under fire pointing out necessity for their transfer to Union. For instance performance of Agricultural sector - a State's subject - was quite unsatisfactory as can be evidenced from two facts, viz. continued import of 6 million tons of food grains during 2nd Plan and food riots in Kerala and West Bengal in 1966. Similar case is the demand for centralisation of University education. Whether financing these functions pose any special problems to States has been

1. Review of 1st Plan, p. 24, 26-27; progress Report for 1958-59, p.23; Mid-term appraisal of 3rd Plan, p. 32 and 34,
2. (a) R.N. Bhargava thinks it as undesirable, vide p. 41 of his 'Indian Public Finances! (b) M.H. Gopal supports this trend vide, p. 32 of his "Studies in Indian Public Finance".
3. (a) F.C. (1952) p. 110, (b) F.C. (1957) p. 29 & 39, (c) Report of Local Finance enquiry Committee (1948) p. 358 and 463 for such a review at State-Local level.
given some thought in Chapter, 3. Financing development in a federation takes the shape of allocations for various projects and programmes by Union Govt., and other organisations. Therefore system of transfers through F.C. and P.C., are examined, with an emphasis on the role and working of F.C., which has constitutional Status, in Chapter, 3. Here resource transfers other than through grants are considered.

Not only has the failure of the State's revenue performance led them to lean heavily on transfers through grants and loans from centre but also the introduction of Panchayat Raj at State-Local level has led to enormous transfer of funds from State to Local Bodies, through grants and loans. In this context the system of grants and the techniques applied by the respective organisations together with the possibility of exploiting grants and loans system in making recipient units to raise part of the necessary funds for themselves are examined since both at Union and State levels transfers through grants and loans are assuming greater quantitative significance. This was dealt in Chapter, 9 to facilitate the consideration of these problems both at Centre and State levels simultaneously.

Fiscal adjustments between Union and States cannot be made on the basis of study of any single State for the simple reason that "Representative" state does not exist at all and each State has got its own peculiar economic features. Nevertheless techniques evolved can be conveniently applied to every individual State to examine the scope for such adjustments. While decisions on such fiscal adjustments have to be based on collective experience of all States, this technique can be applied to them individually. Moreover conclusions obtained by Macrotechniques can be verified by the conclusions from the application of Micro-techniques. The need for a closer examination of performance of each source of revenue of State Govt. of Andhra Pradesh arises in the context of planned development. While the demand for larger quantum of planned outlays was there as was evinced by the Revised Estimates of
plan outlays of Rs. 185 crores and 313 crores in 2nd and 3rd Plans as well as Rs. 650 crores (Original Estimates) for the 4th Plan, the resources that A.P. Government could muster have been very low at Rs. 84.13 crores, Rs. 78 crores and Rs. 140.26 crores respectively during 2nd, 3rd and 4th Plan periods. This brings out the increasing gap in State's own resources to finance economic development within the State and hence greater reliance upon resources transferred by Union Govt., either independently or on the recommendations of F.C. or P.C. Nevertheless fiscal performance of the State, from the viewpoint of fiscal adjustments at Micro Level, with reference to revenue and outlay aspects of Andhra Pradesh has to be considered which has been done in Chapters 4 and 5. In Chapter 6 resource requirements of State mainly through the grants of Finance Commission for the 4th Plan period, the scope for additional revenues that may be mobilised by A.P. Government and the financial transfers required by the State are examined.

Application of techniques of fiscal adjustment and suggestions based on it between State and Local Governments has no such methodological limitations, as noted above, since Local Governments in each State derive their powers and functions through the Acts passed by the State Legislatures. Therefore methodologically valid fiscal adjustments can be suggested in the State-Local spheres in any particular State. While the sheer largeness of the number of Local Governments themselves warrant an examination of their fiscal effort, slackness in their fiscal efforts and uncoordinated actions by them are bound to result in loss of finances; hence the consequential and the combined impact on the State's finances for grants and loans are significant. Since the failure in fiscal performance by level in a
federation influences the other two levels initially and international level ultimately, we cannot ignore fiscal performance of Local Govts. The scope for fiscal adjustments in accordance with the techniques applicable to them, together with the scope for additional local revenues are considered with reference to Andhra Pradesh alone in Chapter, 7 and 8. In the 8th Chapter individual Local Govts., namely Hyderabad and Secunderabad Municipal Corporations and Guntur Municipality are taken up for detailed study.