Chapter – 6

FINDINGS AND CONCLUSIONS

6.1. Findings

6.2. Conclusion
Chapter – 6

FINDINGS AND CONCLUSIONS

6.1. Findings

The design and Implementation of inter-governmental transfer schemes suffer from a number of weaknesses in India. Transferring central resources with overlapping roles result in wasteful duplication in functioning. The absence of a clear and co-ordinated approach is a major weakness in the Indian federation.

A number of models have been applied to achieve optimal degree of decentralization assuming either geographical fixity of population or foot loose mobility, but it is found that it is not possible to arrive at a self-policing system. The degrees of optimal decentralization are necessarily different for revenue raising powers and for expenditure functions. The imbalances exist not only vertically between different layers of government, but also horizontally among various sub-central provinces mainly due to the differences in their capacities to raise revenues and variations in the unit cost of providing public services.

6.1a. Indian Federalism

➢ The states own revenues financed 50 percent of their revenue expenditure and about half of their total expenditure.

➢ Revenue Deficit of all the states has registered a satisfactory figure which shows surplus (-0.2) in 2011-12
The 13th Finance Commission (13th FC) in its revised road map for fiscal consolidation recommended each state to amend/enact FRBM acts and made it clear that the release of State-Specific Grants, be based upon compliance of this recommendation.

- Share in Central Tax (SCT) has shown constant trend whereas Grants from the Centre (GFC) has shown upward trend.

- Share in Central Tax (SCT) in total revenue receipts of central government, Tax revenue has major share of 82 percent in 2012-13.

- Revenue receipts of states also depict the same trend that the share of non-tax revenue in total revenue was very low. i.e. 30 percent in 2011-12.

- The states' tax collection was an average 35-37 percent and after devolution it has raised to 55percent.

- States Own Tax Revenue (SOTR) to revenue expenditure varies from as low as 3.8 percent to as much as 71.2 percent in Karnataka in the year 2010-11. States own non-tax revenue (SONTR) to revenue expenditure was as low as 2.6 percent in Bihar and was as high as 47.4 percent in Goa.

- The fiscal consolidation process of the states was somewhat affected by a slowdown in economic activities in 2011-12.

- During 2008-10, the average Revenue Receipts – GDP ratio further increased, with the increase in central transfers and decline in states own revenues.
During the crisis years (2008-10), the average aggregate expenditure – GDP ratio remained unchanged as the increase in revenue expenditure was offset by a decline in capital expenditure.

Despite an improvement in the revenues from states own taxes and tax devolution from the centre, revenue receipts in 2010-11 were lower, reflecting the impact of reduced receipts from states own non-tax revenues.

FC-XIII had chalked out a fiscal consolidation path for states, stipulating that states achieve revenue balance and a fiscal deficit – GSDP ratio of 3.0 percent by 2014-15.

The centre’s share in the combined revenue expenditure varied from 40-46 percent from FC – I to FC – XIII.

6.1b. Federalism in Canada

In Canada, tax collection agreement between the federal and provincial governments provide for joint use of the same income tax base.

The smaller vertical gap in Canada can be attributed to the fact that the provinces of Canada have access to all the major broad – based taxes and there is no constitutional ruler on tax base.

The federal revenue as a percent of GDP is higher than the program expenses. Budgetary deficit has come down (‘-‘indicates deficit) from −5.0 percent in 1990-91 to −1.5 percent in 2011-12.
Federal tax revenue was 6 to 10 times higher than the other revenue over the study period, and it has covered up to 80 percent in the total revenue.

Major transfers to other levels of government were constant during the study period.

The large provinces have higher tax points since their tax bases are very large.

Canada Health and social Transfers (CHST) was introduced in 1996-97 to replace the Canada Assistance Plan, education support, insurance and medical care. CHST constitutes three-fourth of the total transfers in 2011-12.

Budgetary deficit of provinces has come down from –7.9 percent in 1990-91 to -6.0 percent in 2011-12.

There is no such considerable imbalance after transfer for either of the two tiers.

The budgetary balance is projected to improve over the forecast period from a deficit of -1.0 percent in 2012-13 to a surplus of 0.4 percent in 2018-19.

Own source revenue as a percent of total revenue was unequal among the provinces. They stand between 58 percent and 87 percent except territories in the study period.
Among provinces, own source revenue as percent of total expenditure was very high as 87.9 percent in Alberta. The per capita expenditure of Nunavut was as high as 43624 CAD.

The average of the revenue before transfers of all provinces and territories was above three fourth of their revenue after transfers.

6.1c. Federalism in India and Canada

States Own Current Revenue (SOCR) as percent of total revenue is high in Canada Compared to India. SOCR in Canada, was stable at 77-79 percent whereas India stands at 31-40 percent during Study period.

India’s transfers constitute 68-98 percent in their own revenue whereas Canada’s transfers lie between 17-30 percent of their own.

With their own revenue, Indian states were able to meet nearly 50-55 percent. Canadian provinces would meet 70-90 percent of the total expenditure.

In Canada, budgetary deficit has overcome from -5 percent (1990-91) to -1.5 (2011-12) percent. In India, budgetary deficit overcame from – 7.6 percent (‘_’ indicates deficit) in 1990-91 to – 5.8 percent in 2011-12.

Compared to India, revenue of Canadian provinces was large over the study period due to large federal transfers.
In India, total transfers as percent to total expenditure was 25 percent in 2011-12. In Canada, total transfers as percent to total program expenses was stable at 66-67 percent.

CHST as percent of total transfers was 68 percent in 2011-12. Share of fiscal transfers in total transfers was 33 percent in 2011-12 in Canada.

6.2. Conclusion

The theory of fiscal decentralization clearly indicates the superiority of the central government in undertaking redistributive and stabilization functions and the welfare gains that can accrue by decentralizing the allocative decisions. The more diverse the preferences of people across jurisdictions, the greater are the welfare gains from decentralization. Also, it is demonstrated that welfare gains from decentralization are inversely related to the price elasticity of demand for public services.

A number of models have been applied to achieve optimal degree of decentralization assuming either geographical fixity of population or foot loose mobility, but it is found that it is not possible to arrive at a self policing system; for, the degrees of optimal decentralization are necessarily different for revenue raising powers and for expenditure functions. The imbalances exist not only vertically between different layers of government, but also horizontally among various sub-central jurisdictions mainly due to the differences in their capacities.
to raise revenues and variations in the unit cost of providing public services. Besides, the existence of externalities results in non optimal provision of public services calling for Pigovian transfers.

In India transfer routed through the Finance Commission pertain to sharing of certain central taxes, and grants-in-aid of revenues of the states. Revenue from certain taxes and duties are levied by the centre are totally assigned to or shared with the states to meet their needs. The states always complaint that resources allocated to them are inadequate to enable them to discharge their responsibilities. They complain against widening gap between their own resources and needs, similarly, the centre also feels constrained at the widening gap between its resources and needs, as reflected in the budgetary deficits. The government of India took initiative to issue guidelines to the states to prepare Medium Term Fiscal Reform Programmes (MTFRPs). The purpose of MTFRPs was to reduce wasteful expenditure and improving efficiency of the tax administration. The MTFRPs did not succeed in improving the fiscal situation to the desired level.

It is important to recognize that for successive fiscal consolidation, the key lies in maintaining the growth dynamism of our economy. Except some variable and some years, as on day, vertical and horizontal fiscal imbalances are widening. There needs to be change in governments’ policies and practices which may be drawn as a lesson from any federation in the world.
In Canada, majority of the resource intensive expenditure responsibilities rest with the provinces, but their access to financial resources was quite difficult. Federal revenue was higher than its expenses over the time. Budgetary deficit of federal has come down from – 5.0 percent in 1990-91 to – 1.5 percent in 2011-12. It indicates federal supremacy over the revenue power. Federal tax revenue was higher than the other revenue throughout the study period.

Most of the major taxes are typically assigned to the central government while substantial and growing expenditure responsibilities are devolved to regional and local government. Sizeable vertical imbalances frequently emerge at the sub national government level. Central government’s share of tax revenue in the total revenue has been increased during the study period.

The CHST is the largest federal transfer to the provincial and territorial governments. The CHST transfers are meant to finance health, education and other social services. The extent of tax points are determined by negotiations between the individual provincial or territorial governments and the federal government. The large provinces have higher tax points since their tax bases are very large. The CHST constitutes almost three-fourth of the total intergovernmental transfers in Canada. Total transfers as percent of total program expenses constitute nearly 60-70 percent.
In Canada, federal transfers make provinces enrich to meet their responsibilities. Total expenditure was higher than the revenue in all the years. In the recent years provincial expenditures have been met almost fully by own revenues and transfers, implying that the vertical imbalance in the assignment of functions and resources is almost eliminated after transfers.

Equalization is adjusted to ensure fairness among provinces while continuing to provide a net fiscal benefit to half of their per capita resource revenues, fiscal capacity and natural resources. Own source revenue as percent of total revenue is unequal among the provinces.

Federal cash transfers in terms of equalization grants have played a vital role in minimizing revenue gap between different provinces, by getting federal transfers, are in a position to face their expenditure needs and have minimized budgetary deficit. Equalization grants enabled provinces to reach all the public services and welfare activities.

An important feature of any federation is the high degree of imbalances between the revenue power and expenditure responsibilities and differences in fiscal capacities across the states. Canada has an equalizing and liberal system of federal transfers under the Federal – provincial Fiscal Arrangements and established Programmes Financing Act, 1977.
India has the system of inter governmental transfers which is constitutionally entitled and made through Finance Commission, Planning Commission and National Development Council.

In Canada, the primary goal of inter-governmental fiscal transfer is to maintain minimum national standards in provincial local public services.

Canadian provinces could get maximum transfers in terms of ‘transfers to persons’ and ‘federal transfers’, so that they are very close to their expenditure track. In Canada total transfers as percent of total expenditure was stable at 66-67 percent over the period of time while India stands for 25 percent which is less than 40 percent of Canada’s one.

Canada Health and Social Transfers had a lion’s share in total transfers. CHST as percent of total transfers could stand for 68 percent in 2011-12. Share of fiscal transfers in total transfers was 34 percent in 2011-12.

In case of Revenue position after transfers, the differences between India and Canada depicts 6-9 percent of GDP. Canada’s fiscal condition is better than India. So that all provinces in Canada were self-sufficient to reach their expenditure needs.

The present study has brought out the features and trends of Indian as well as Canadian Fiscal Federalism. CHST is the revolutionary step taken by the Government of Canada to overcome vertical fiscal imbalances. The reforms made
to equalization grants to achieve minimization of horizontal fiscal imbalance is also the centre of attention for any federation. There are many successful practices in Canada which are worthy of consideration to be adopted by the Indian Government. India may look forward to the model of transfers such as CHST. There has to be change in discretionary grants and unconditional grants in India. There is an urgent need for reformulating inter-governmental transfer mechanism for every nation in the globalised era. Since, India is suffering from many obstacles regarding decentralization and providing public services to each and every individual in the country, practices taken up by the Canadian fiscal federalism may be the guide lines for a successful fiscal federation.