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INTRODUCTION

1.1. Introduction

Federalism is essentially a system of voluntary self-rule and shared rule. This is implied in the derivation of the word ‘federal’ which comes from the Latin word foedus, meaning covenant. Federalism provides a technique of constitutional setup that permits action by a shared government for particular common purposes. Federalism has been defined in several ways, depending upon the interests of those who make them. The modern concept of federalism was evolved in U.S.A between the years 1776 to 1789. As such federation is often associated to an American invention. Federalism is usually classified by the function, whether it is political or economical. It is important to note that federalism is about nature and form of association among interacting states. It is therefore more appropriate to categorize the concept by the way that it can evolve. Here we can identify two major modes of federalism. The first mode is dual federalism. In this case, the Constitution allows two independent layers of government with their own responsibility. The second is the co-operative federalism which refers to making federalism work through co-operation between different levels of government.

'It is interesting to note that federalism exists even in a unitary system of government. It is important to note that the basic responsibility of any government
is to identify and evolve an appropriate framework for the satisfaction of the needs and preferences of the society. This can be achieved through effective mobilization, optimal allocation and efficient utilization of national resources. Federalism revolves around three major functions of the state for promoting the welfare of the society. These are, allocation, distribution, and stabilization' (Ademola Ariyo, 2003).

An attempt is made interesting here to understand the term ‘Fiscal Federalism’. As a subfield of public economics, fiscal federalism is directly concerned with understanding the functions and instruments which are best centralized and best placed in the sphere of federalism. In other words, it is the study of how competencies (expenditure side) and fiscal instruments (revenue side) are allocated across different (vertical) layers of the government. Fiscal federalism is considered to be an optimal institutional arrangement for the provision of public services. It combines the advantages of decentralization with the benefits from economics of scale. The basic issues of fiscal federalism are assignment of functions and sources of finance between different layers of government and evolving mechanisms and policy instruments to resolve fiscal balances.

The traditional theory of fiscal federalism lays out a general normative framework for the assignment of functions to different levels of government and the suitable fiscal instruments for carrying out these functions. This Theory
contends that the central government should have the basic responsibility for the macroeconomic stabilization function and for income distribution in the form of helping the poor. Decentralized levels of government have their responsibility in the provisions of goods and services whose consumption is limited to their own areas. At the outset, it is important to stress that basic issue in federalism is not only of centralization verses decentralization. But, the layers of government playing important roles in the provision of public services.

1.2. Fiscal Federalism in India

Federalism in India is characterized by constitutional demarcation of revenue and expenditure powers among the three levels of government. More than 1.20 billion people in the country are spread over twenty-nine (including Telangana) states and seven union territories.

The constitution of the Indian Republic, like the 1935 Act, provided the three fold distribution of powers (Article 246). It transferred a few minor items from the Central list to the State list and allotted greater powers to the central government such as national highways, inter-state trade and commerce. The matters of national importance were assigned to the Union list (list-I) and those of regional importance were assigned to State list (list-II). Those matters relevant to both the parliament and legislatives were listed in the Concurrent list (list-III). The attempt, like the 1935 Act was to assign the functions to the two levels of
government based on their comparative advantages. However, functions in which both the levels of government had a stake were placed in the concurrent list. The residuary powers were reserved for the union government.

In the Indian Constitution the constituent units neither have neither political sovereignty nor are they co-ordinate and independent of one another. In the Indian context, the Constitution is described as a ‘quasi-federal’. In fact, in its final report to the constituent Assembly (August 20, 1941), the union powers committee stated: “We are unanimously of the view that it would be injurious to the interests of the country to provide for a weak central authority which would be incapable of ensuring peace, of co-coordinating viable matters of common concern and of speaking effectively for the whole country in the international sphere” (Sarkaria Commission Report).

Thus, India evolved as a two-tier fiscal federalism until the 73rd and 74th amendments to the Constitution recognized the third tier of government below the state level in rural and urban areas. The seventh schedule to the Constitution assigned the legislative matters including the fiscal functions and instruments to carry the functions for the Center and State governments. The Constitution recognizes that there would be imbalance between the revenue powers and expenditure responsibilities at central and state levels and provides the solution for vertical fiscal imbalance. The Constitution also provides for the setting up of the Finance Commission every five years or earlier. Commissions make
recommendations on the proportion and the principles for the distribution of Central taxes to be shared with the States. In addition to the tax devolution, the Finance Commissions are required to make recommendations on the grants-in-aid to be given to each and every state. With the passing of the 73rd and 74th constitutional amendments, two separate schedules were inserted into the constitution listing the functions to be assigned to rural and urban local bodies. The State governments are also supposed to appoint a State Finance Commission (SFC) for every five years to assess the requirements of the rural and urban local bodies and recommend transfers to them.

1.3. Inherent Centralization

The centralization inherent in the constitutional assignments was incorporated by the working of the fiscal federalism over the years. As noted by Chellaiah (1991) “Centralized planning negation of federalism and the planning process enormously curtailed the powers of the sub national governments”.

The Indian states are different in terms of size of population, area, resources, geographical features and cost constraints. This heterogeneity affects the size of government, the quantity and quality of public goods and their needs for fiscal transfers. Fiscal transfers in India are overseen by two major institutions, viz., Finance Commission and Planning Commission. The Finance Commission looks after the current account needs of the states while the Planning Commission is primarily concerned with the developmental needs of the states, which comprise
both current and capital needs. Recently, the Policy Commission is going to be replaced with Planning Commission which has considered as very traditional setup. Following the 80th Amendment of the Constitution, all central taxes have been brought into a divisible pool and it is mandatory to assign a share from each central tax to the states.

'Concentration of powers in the hands of the central government did not create serious conflicts in the early years of the functioning of the Constitution since, the same political party i.e., the Indian National Congress, ruled at the centre and states. Any potential interstate or centre-state conflict was resolved within the party. With the congress party losing power in some of the states, the conflict became open. Periodic attempts at re-examining centre-state relations have not led to any fundamental changes in the constitution. One may need to rethink in a fundamental way the unitary features of our constitution' (Singh and Srinivasan, 2006).

In this context, it would be useful to undertake a comparative study of issues and problems of fiscal federalism in other countries which have been successful in minimizing horizontal and vertical fiscal imbalances in their own federations. The present study is an attempt in this direction. The study has examined the federal fiscal relation in India and Canada. Further, the study has highlighted the best practices of Canadian federation which could be replicated in Indian federation.
1.4. Fiscal Federalism in Canada

Canada is a constitutional monarchy with a federal system and a parliamentary government, with strong democratic traditions. Through fiscal federation, Canada has many dimensions regarding the centre-state financial relations. Among them, core issue is the division of revenue and expenditure responsibility between federal and provincial governments which shows the share of tax room for various revenue sources occupied by the federal and provincial governments. In Canada the size and structure of federal transfers to the provinces are made through the big three transfers programs; they are Equalization, the Canada Health Transfer (CHT) and Canada Social Transfer (CST).

Canada, over its 138 years of existence evolved from a relatively centralized to a more decentralized federal system, and a key element in that trend has been the evolution of its fiscal arrangements. In Canada, the constitution has not established any formal institutions for co-ordination between federal and provincial governments in fiscal matters but during the latter half of the twentieth century there developed an elaborate system of federal- provincial consultations and meeting between their executive branches relating especially to financial relations.

These processes have come to be known by the label ‘Executive Federalism’. In Canada, these direct inter governmental relations have been
confined to the federal and provincial governments, with all the financial transfers to local governments coming under the single control of provincial governments. The main areas in which the involvement of the federal government in Canada has focused in intergovernmental financial relations of spending power in provincial programs such as health, education and social welfare. The conversion of the transfers for shared cost programs into unconditional transfers and the unconditional nature of the equalization grants have limited federal control over provincial programs. 'Federalism requires a pragmatic approach and represents a dynamic political technique for accommodating the circumstances and needs of the particular society in question. The most interesting feature is the institutional arrangements for conducting the fiscal relations. There are no constitutional solutions to the fiscal transfers. They depend on political solutions' (Boad Way and Watts, 2004).

The Canadian political culture has been characterized by linguistic and regional diversities and the process of intergovernmental relations and fiscal arrangements have reflected and reinforced these characteristics. The linguistic and regional differences and the inadequate representation of the provinces within the Canadian senate have resulted in the provincial premier becoming the primary advocates of provincial and regional interests on the federal scene. This explains why intergovernmental meeting and the process of 'executive federalism' have in practice come to dominate intergovernmental fiscal relations in Canada.
Nevertheless, despite the existence of regional and linguistic cleavages, there is a high degree of consensus among Canadians on many social values. The largely unconditional or only semi-conditional character of these transfers has at the same time allowed considerable discretion in how the provinces deliver these programs. ‘The intergovernmental financial set-up has thus reflected the diverse regional and political culture of Canada while permitting the federal government to develop broad social programs and policies. This indicates that, the Federation has developed its particular form of fiscal federation reflecting the distinctive character of its society and political culture’ (Boad Way, Wealth, 2004).

1.5. Fiscal imbalances in Federal system

Although a federal system provides for divided governmental functions and powers in India, imbalances always arise between responsibilities and financial resources of different layers of the government. Even in older federations (like the United States) financial conflicts exist between the national and sub-national governments and their once-for-all solutions are impossible.

Fiscal imbalances refers to the mismatch between own revenue collecting capacity and expenditure responsibilities among the different layers of government. Usually, these are two types of Fiscal Imbalances. The imbalances at different levels of the government (inter governmental) are known as vertical fiscal imbalances while those at different units of the same level of government
(inter-jurisdictional) are known as horizontal fiscal imbalances. Vertical fiscal imbalance is usually given primary importance in the discussions of fiscal imbalances because it focuses mismatch in the assignment of taxing powers and expenditure responsibilities. In India, there is fairly high degree of vertical imbalance. A high degree of centralization of revenue power is a common condition for high vertical imbalances. In India, there is low centralization of expenditure but high degree of vertical imbalance due to high degree of centralization of financial revenues. It demonstrates the lack of any direct link between centralization and vertical imbalance and the major reason for this vertical imbalance. The constitutional assignment of high expenditure responsibility to the states which have less financial resources coupled with the relative advantage that the federal government has in collecting taxes. Again, the central government in India control monetary policy and deficit financing which has also given rise to vertical imbalance.

In Canada, the trend of the dominion assuming financial powers, which started with tax sharing in 1957, was reversed on the demand made by richer states, resources transfers have been affected there for equalization purpose.

In India, horizontal fiscal imbalance also exists. This has arisen mainly from interstate disparities in revenue capacity and effort as well as in expenditure needs. Most of the states are relatively homogeneous in nature and only a few (north-eastern states) are hilly states which are generally grouped together as
special category states. Special category states are characterized by small industrial sectors and largely unorganized economics and the unit cost of providing various public goods and merit goods is relatively high in these states. As a result, their revenue capacity is low compared to their per capita public expenditure. All these are leading to fairly high degrees of fiscal imbalance.

Inter-governmental transfers have been employed as an instrument to resolve fiscal imbalances, both vertical and horizontal. The design of transfer system therefore plays a key role in federal fiscal systems. Since many countries have “strong centre and weak states”, there is an imperative need to reallocate the resources and responsibilities between the centre and the states.

The existing pattern of financial devolution in India consists of these channels mainly Finance Commission, Planning Commission and Central Ministries. The most notable feature in the existing centre- state arrangement is setting up of a Finance Commission; Finance commission is a constitutional body having quasi- judicial character. It gets appointed every five years by the order of the president.

1.5. Review of Literature

M. Govinda Rao (1998) reviewed the federal fiscal arrangements in India with a view to identify the areas for reform in the economic environment. The starting point for such a review is the assignment of taxes and expenditures
between the centre and individual states should not only be in accordance with the principle of comparative advantage but also should ensure a clear linkage between revenue raising and expenditure decision. When the fiscal powers of different government units overlap, free riding behavior among them causes centre state and interstate fiscal disharmonies.

M. Govinda Rao and Raja. J. Chellaiah (1991) observed that an inherent problem faced in all federations is the inadequacy of revenue resources to perform the constitutionally assigned functions at sub-national levels of government. Given that the primary responsibility for stabilization and redistribution is vested with the central government, the taxes with nationwide bases are assigned to it. Besides, the economic consideration of having less distortionary taxes narrate the uniformity in the levy of taxes nationwide. The existence of inter-state disparities indicates greater centralization in revenues so that central government can undertake appropriate tax-transfer programmes to prevent the inequalities and to promote balanced regional development.

M. Govinda Rao and Tapas K. Sen (1996) analyzed fiscal imbalances in the light of Economic Reforms. The economic reforms programme initiated in 1991 has many facets, some of which has not yet been unveiled. But even the major reforms that have already come about, and the ones that are expected in the near future are likely to change the character of fiscal federalism in India in general, and the vertical as well as horizontal imbalances in particular. These are supposed
to follow directly from some part of the reform programme as well as indirectly from the shifts in policy stance.

The major impact of the reforms is likely through the indirect and much long term effort of the shift in policy from widespread government intervention in the economy to a market-oriented one. The reduced importance on planning is likely to increase the responsibilities of the states by itself. According to the new policy, the initial duty of the government is to ensure provision of sufficient social and economic infrastructure. These include education, water supply, health, agricultural research and extension, poverty alleviation programs, telecommunications, social security, transport, irrigation and power for the successive fiscal reforms at its ground level, the central government must carry its deficits under control. This cannot be done by working on only the receipts side of the budget, the centre has to decrease the expenditure. The burden of the fiscal adjustment has to be linked by current expenditures.

According to Amaresh Bagchi (2000), it is time to take a fresh look at the core issues of federalism in the light of expenditure and academic work in the area. His paper “Rethinking Federalism” seeks to provide an overview of current debates focusing on the basic issues that arise in translating the ideals of federalism into practice and the dilemma or tradeoffs involved in order that any reforms sought to be undertaken are guided by informed judgment.
G. Thimmaiah (2002) pointed out that the framers of the Indian constitution have made an original contribution by providing for appointment of Finance Commission to review the centre-state financial relations. He made a thorough study to find out whether the successive Finance Commissions were able to achieve the objectives originally envisaged by the framers of the constitution. The appointment of a Finance Commission used to generate a lot of interest in academic and state government circles in the past. But in recent such genuine interest has faded.

Amaresh Bagchi (2003) examined the importance of economic virtues of federalism, as recently exemplified by coming together of so many independent nations under the European Union. He analyzed the performance of the Indian economy over last fifty years in terms of Musgrave’s Triology of government functions. He tried to identify the weaknesses of federal operations and suggested the lines of reform. He suggested a few reforms for curing the weaknesses that impair the efficiency in performance of fiscal tasks. While the federal system should go whole hog for decentralization, the author suggested, the centre should assert its authority to ensure free flow of trade and commerce throughout the country by removing all barriers.

K. Gayithri (2001) in her monograph, emphasized on spending central measures in Canada, the rapid growth of spending and the gradual determination in the revenue yield since the mid 1970’s had created an unsustainable fiscal
position by the mid-80's and spending exceeded revenues by over 50 per cent. The Canadian federal government adopted a medium term fiscal strategy introducing a range of measures to control the fast growing fiscal deficits since 1984. This was attempted by reducing the government expenditure rather than mobilizing tax revenue.

C. Rangarajan and D.K. Srivastava (2004) examined the relevance and applicability of the Canadian system of inter-governmental transfers in the Indian case. Equalization grants are meant to ensure that provinces have sufficient revenues to provide reasonably comparable levels of services at reasonably comparable levels of taxation. An elaborate ‘representative tax system’ approach using individual revenue bases is used in Canada for determining the equalization grants, although there has been a debate to use a macro approach. The source-by-source approach is less practical in the Indian case for want of comparable and reliable information required for applying the method. A more practical alternative is the macro approach, which is adopted in Indian, but better indicators of fiscal capacity than those based on GSDP need to be used. In addition, the concept of ensuring that resources are available for maintaining the per capita expenditure of selected basic services, as attempted in Canada through the Canadian Health and Social services Transfers (CHST), is worth exploring.

Kumudini S Hajra, Rakhe P.B, and Dhirendra Gajbhiye (2008) have discussed about Equalization Transfers. In Indian, states are large in number and
also differ in various aspects such as location, area, size of the population, income, and tax base. Resource gap may arise because states have inadequate fiscal capacities and also because the revenue effort is deficient in relative terms, while the former may need to be taken into account for correcting the horizontal imbalance, the latter should not qualify for such correction. Therefore, the concept of equalization is considered to be a guiding principle for fiscal transfers as it promotes equity and efficiency in resource utilization. Equalization transfers minimize the deficiency in fiscal capacity and not in revenue effort. Under this approach, transfers are decided on a normative basis. The evidence suggests that Canada and Australia follow the equalization principle, though there are methodological differences.

M.M. Sury (2005) provided a detailed description and analysis of the evolution of Centre–State financial relations in India. The passage of the constitution (73rd Amendment) Act, 1992 marked a watershed in the history of modern India. With this amendment, a uniform structure of Panchayaths has emerged throughout the country. Similarly, the passage of the constitution (74th Amendment) Act, 1992 was a Landmark in the history of municipal administration in India. In short, Panchayaths and Municipalities are now constitutional bodies forming third tier to the federal polity of India. The constitution (80th Amendment) Act, 2000, considerably changed the manner of distribution of central tax collections between the Union and State governments.
Raghabendra Jha, Mukesh Anand and Santanu Gupta (2000) have focused on important principles of public finance where public expenditure decisions are decentralized, which would more accurately reflect the preferences of the population. It is quite likely that expenditure authority will be more decentralized than tax authority. In that case, lower levels of government would face perpetual problems of deficit, in the absence of any transfers from higher levels of government.

There would be a need for transfer of funds from higher to lower levels of government. This is an important rationale for vertical transfer of funds. Again, if it is to examine the buoyancy of state and central level taxes, then, as the Report of the Tenth Finance Commission has highlighted, the buoyancy of central tax bases is much higher than those which are assigned to lower levels of government. This reiterates the necessity of appropriately designing resource transfers from central to state government.

In addition to sharing of the proceeds of central taxes, stress has been put on grants-in-aid. This is done to achieve what have been termed in the literature as "Vertical Fiscal Balances" and "Horizontal Fiscal Balances". The attainment of vertical fiscal balance says that the revenue (from all sources, including shares in central taxes) and expenditure of state governments are approximately equal to each other. To be sure, transferring tax authority to the state government or reducing state government expenditure can also close such fiscal gaps.
A related gap is the horizontal fiscal balances. This is sometimes referred to as ‘equalization’ and transfers made there in are called equalization grants. If some states have low ability to create resources than others do, then they may be less able to take advantage of central grants to provide public goods. This would be particularly the case when the central grants are matching grants. In such cases, the gap filling process that may be required is called equalization. This tries to equate all states’ capacities to produce public goods with the help of central funds.

Business centre for Tax Research Canada (1995), has done a work on Canadian fiscal federalism, focusing on the clear assignment of tax and expenditure functions allows for the determination of the stages of responsibility of each public sector unit. An efficient assignment should provide sufficient flexibility to all governmental units to vary the mix of public services/taxation. This flexibility needs to be balanced with the other objectives of efficiency to minimize benefit (tax and expenditure) spill over across regions and to promote interjurisdictional and interpersonal equity. Intergovernmental transfers constitute one way of dealing with spill over and in equitable outcome, along with the optimal assignment of fiscal powers and harmonization in the tax system. Assignment is an issue that looks at both the revenue and expenditure sides of the fiscal system and it tries to accommodate these conflicting functions within a federal system.
The assignment of tax and spending functions depends on the degree of decentralization in the system. In a strong decentralized federal system, most functions will be meant for local governments. Under a centralized federal system, these functions will tend to fall under the higher level government’s control. Most often, the responsibility for macroeconomic stabilization and income redistribution rests with the central government for efficiency reasons. These functions are to have a national or international scope. Leaving these functions in the hand of subnational levels of government basically ends up creating separate mini states. Some of the tax powers of the central government may be allocated on the basis of mobility of the base, i.e., if the tax base is highly mobile across jurisdictions, then an efficiency argument can be made that the tax should be controlled by the central government in order to prevent resource distortions. However, in an era of increasing mobility across national borders, it is becoming more difficult to argue that the central government should or should not be in control of taxation because of mobility concerns.

State Finances: A Study of Budgets (2007-08), has clearly mentioned the concepts, constitutional provisions and Institutional Arrangements for fiscal transfers to the state governments. In a federal set-up, fiscal transfers take place through tax devolution and grants, which are supplemented by loans from the centre to the states. In line with the practice followed in other federal countries, fiscal transfers in India are guided by the principle of “equalization”. They
neutralize deficiency in fiscal capacity across states but not in revenue effort. The objective of fiscal transfers is to correct the vertical and horizontal imbalances. Vertical imbalances arise because higher resources have been assigned to the central government while state governments are linked with larger responsibilities. Horizontal imbalance arises on account of different fiscal capacities and needs of the states.

The features of the federal transfers in two of the major federations, viz., Australia and Canada, are discussed. Australia has a well-established federal setup to address the vertical and horizontal aspects of fiscal transfers. While the council of Australia governments decide the vertical transfers, the ministerial council for common wealth-State Financial Relations provides a platform to discuss the grant allocations to the states, which form a segment of the vertical transfers. In addition, the special purpose Ministerial councils look after Special Purpose Payments (SPP) given to the states by the Common wealth government.

The Common Wealth Grants commission (CGC), an advisory body setup in 1933, recommends the criteria for the distribution of horizontal fiscal transfers. The CGC does not look into the issues of vertical imbalances. The loan council tends to the borrowings of the Commonwealth and State governments. The inter-governmental transfers in Canada consist of equalization grants, Canadian Health and Social service Transfers (CHST) and Territorial Formula Financing (TFF). In addition to these, there is a new facility called the Health Reform Fund (HRF).
The equalization grants aimed at equalizing fiscal capacities are mandated in the constitution since 1982.

Thirteenth Finance Commission, in its report has discussed the design of Fiscal Transfers. The approach to design transfers by this commission is consistent with the approaches of recent Commissions. The availability of resources and expenditure requirements of the centre and the states has been assessed on the basis of certain norms. After having estimated these, the vertical and horizontal devolution of taxes is determined. Grants are then allocated to states, based on certain parameter. However, these are not to be understood as linear stages in the commission’s working. A normative approach, is followed, where the assessment of resources available and expenditure commitments forecast by different government entities is undertaken, bearing in mind the overall resource envelop available to the general government, viz., gross revenue receipts of the government of India and the state governments, as well as the desired roadmap for fiscal consolidation. An alternative process with application of careful judgment and appreciation of the evolutionary nature of past trends helped to determine the vertical sharing of resources between the union and states.

Vertical transfers can be justified on four principal grounds. First, transfers may be responses to the extant asymmetric decentralization of revenue-raising authority and expenditure responsibility. Second, they may be used to equalize the fiscal capacity of the regions to avoid inefficient migration of persons and business
among regions and for faster horizontal equality across the country. Third, these may also be used in conditional forms to minimize fiscal externalities imposed by regional governments on other regions, as well as to attain national standards in social programmes and to include efficiency in the internal economic union. Finally, these may be used as instruments for insuring regions against shocks to their fiscal capacities. Generally, the amount of grants-in-aid provided to the states by different Finance Commissions, since the first Finance Commissions, have been under the constitutional obligation of the union government as per articles 273(1) and 275(1). In addition, other kinds of grants have been given to the states to: (1) reduce disparities in the availability of various administrative and social services across states, (2) allow particular states to meet special financial burdens emerging as a result of their peculiar circumstances and (3) to provide resources for specific activities considered to be national priorities. Further, grants such as debt consolidation and relief facility to the Twelfth Finance Commission mean foregone revenues for the Centre.

The enactment of Fiscal Responsibility Legislation (FRL) in 26 states has resulted in significant fiscal correction. In aggregate, these states have reached their expenditure and debt targets ahead of schedule. Revenue buoyancy, both due to improved own tax revenues of the states and due to the derived benefit of high central tax buoyancies (through share in central taxes) has mainly been responsible for the fiscal correction. Another encouraging feature is that, in the aggregate, the
states have been able to reduce their debt to state Gross State Domestic Product (GSDP) ratio to less than 30 percent. An equally, noteworthy outcome of the implementation of FRL has resulted in general category and three special category states which form a post devolution non-plan revenue deficit. However, there is wide variation in performance among the states. The Commission’s objectives are, therefore, to maintain the virtuous improvements in state finances against exogenous shocks to the extent feasible and to incentivize those states that continue to face fiscal stress towards undertaking urgent fiscal correction.

Rangarajan C. and Srivastava (2004) in their article ‘Fiscal Transfers in Canada- Drawing Comparisons and Lessons’, discuss about the Canadian System of fiscal transfers which has been developed over a long period of time. The study points about the central features viz., equalization grants, which are constitutionally guaranteed and the Canadian Health and service Transfers (CHST). The paper examines the basic features of the Canadian system of sharing responsibilities and resources between the federal and provincial government and particularly the Canadian system of inter-governmental transfers with the objective of considering its relevance and applicability in the Indian case.

It is evident from the survey of literature that there is a large number of studies pertaining to fiscal federalism of both India and Canada. Canada, being the oldest federation and a developed country has developed a fiscal federalism worthy of model. Therefore a comparative analysis of fiscal federalism in India
and Canada has been done. The present research has attempted to identify the best practices and policies in Canadian fiscal federalism which can be replicated in India.

1.6. Objectives of the Study

1 To Study the trends and patterns of fiscal transfers in Indian federation excluding local governments.

2 To analyze the cases of vertical as well as horizontal fiscal imbalances in India and examine the trends in imbalances.

3 To study the trends and patterns of fiscal transfers in Canadian federation.

4 To examine the policies aimed at minimizing fiscal imbalances in Canadian federation.

5 To identify the best practices and policies in Canadian fiscal federation which could be replicated in India.

1.7. Hypotheses

1 Fiscal imbalances in Indian Federation are reported to be on the rise especially after the introduction of economic reforms.

2 The system of fiscal transfers, currently followed in India, are not conducive for minimizing horizontal and vertical imbalances.
1.8. Methodology

The present research is based on secondary data. The data has been taken from the published sources of both Government of India and the Republic of Canada. The study has been drawn heavily on Finance Commission reports and also reports of various commissions dealing with federal issues. The time series data has been taken from many journals and periodicals such as RBI publications (Budget documents, annual reports and Handbook on Statistics of Indian Economy), Economic survey of Government of India, Indian Public Finance Statistics by Ministry of Finance, report of the Thirteenth Finance Commission and others. The time period taken for the study is about 23 years, i.e., from the beginning of reforms in 1990-91 to 2012-13. Statistical techniques such as Percentage, Growth Rate, Co-efficient of variation, Average were used to analyze data.

1.9. Limitations of the Study

Though the study is titled as Fiscal Federalism the work confines itself to the study of Fiscal relations between the central/federal and state/sub national governments. The study does not cover financial relations between the state and local government.