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Centre-State Financial Relations – Issues And Concerns

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Abstract:
The Union Government on the other hand possesses very wide and ever expanding sources of revenue. This naturally places the Union Government in a favourable position and the states have frequently to look up to the centre for financial assistance. After making a study of the Constitutional provisions regarding the Centre-State relations, it would be fruitful to have an idea of the actual operation of the relations between the centre and the states. At the outset it may be pointed out that in the actual operation of the relations between the centre and the states. At the outset it may be pointed out that in the actual operation, every effort has been made to strengthen the already strong centre at the cost of the states. This has made certain critics like C.Rajagopalachari remark that "the independence of the states is being forgotten and a unitary state is being established in India thoughtlessly.
Key words: *financial powers, decentralized form of government, devolution*

Introduction:

A Federal setup is considered to be an optimal form of government as it combines the strength of a unitary as well as a decentralized form of government. The essence of federalism lies in proper division of powers and functions among various levels of government to ensure adequate financial resources to each level of government to enable them to perform their exclusive functions. In India, federalism has evolved from a highly centralised system under the British regime-Lord Mayo financial resolution of 1871. The present federal fiscal system has not sudden developed but over a long period of time starting from the late eighteenth century. Though the Government of India Act 1919 was a major breakthrough in the history of evolution of fiscal federalism in India, the Government of India act, 1935 established a clear-cut demarcation of subjects coming under the centre, states and, both centre and states. With the independence of the country, the federal status of India underwent a fundamental change with clear division of financial powers and expenditure responsibilities between central and state governments in the VII th schedule of the Indian Constitution. However, over the last 65 years many changes have been incorporated in the Indian federation through different constitutional amendments, changes in criteria for devolution of resources etc. to fulfill the objectives of fiscal federalism viz; reducing fiscal imbalances and ensuring provision of equal level of public services like education, health etc across all states at similar rate of taxes. Similar is the case of Indian federalism where there is a mismatch of resources and expenditure responsibilities at different layers of government. Though inter-governmental transfers take place to reduce fiscal imbalances and provide average level of public services across the sub-national governments, there exist fiscal imbalances and regional disparities across the states even after 67 years of independence. The transfers from centre to states take place through three channels, viz; Union Finance Commission, Planning Commission (Niti Ayog) and Central Ministries, of which the transfers from Finance Commission are predominant. Gross devolution and transfers comprises of states' share in central taxes, grants-in-aid and gross loans from centre.

The Union Finance Commission and Niti Ayog take equalization as the most important general objective while making federal fiscal transfers. Therefore as required from time to time, different Union Finance Commissions and Niti Ayog keep changing the method of federal fiscal transfers to ensure the objective of equalization. The tax sharing is based on the general criteria like population, geography, backwardness, poverty ratio, inverse per capita income, distance formula, revenue gap etc. After the Seventh Finance Commission, the high weightage (almost 90%) given to population has been gradually lowered and alternative measures such as inverse formula and distant formula have been given more importance in sharing both income and union excise duties. However these criteria have been multiplied by the scale factor population thereby giving more importance to population. The dependence of states on central Transfers varies depending on the capacity of the states to generate own resources. For high income states it varies from $1/4^{th}$ to $1/6^{th}$ of their revenues, for middle income states between $1/3^{rd}$ to $1/5^{th}$ and for low income states it is quiet high ranging from 42 to 80%. In case of special category states, these central transfers are very high varying from 64.98% to almost 93% of their revenue receipts.

ISSUES AND CONCERNS:

With the inception of economic reforms in 1991, the responsibility of the states has gone up substantially in meeting the increasing need of the basic services of the people. Over the years, the Centre has become stronger in terms of higher revenue potential while states got burdened with greater functional responsibilities in the areas of health, education, social and economic infrastructure, social security and welfare. As a result inequality across the states and with in the states has increased with respect to providing public services. Further, the enactment of Fiscal Responsibility and Budget Management Act by the centre which directs states to bring in discipline in the management of public finances has added pressure , particularly in improving productive assets of the poorer states. The fiscal discipline though necessary, has resulted in decline in the share of capital expenditures in most of the states, particularly backward states. As states are depending more and more on market barrowing on the face of declining central loans to states that has led to reductions of the tenure but increased the cost of borrowing and worsening state debt burdens.

The intra-state disparity on the other hand has been an area which lacks in-depth research and opinion is divided on whether finance commission should consider this dimension of disparity while designing the centre-state transfers. Given the varying taxable capacity across states and high revenue expenditure with rigid components like subsidies, pensions, salaries, wages, payment of interests, Union Finance Commission keep a portion of the revenues from union excise duties to distribute exclusively to the net deficit states even after devolution of taxes and grants-in-aid which is an encouraging step, particularly for backward states.

Generally, population and geography are considered as the most important criteria for tax devolution as it is perceived to be the most important indicator of the general need of a state. This approach is justified when there are very insignificant differences in area, distribution of population and per capita income among states. But, there are significant differences in these indicators among the states in India. Keeping this problem in view, more weightage has been given to distance and inverse formula in last few Union Finance Commissions but population has been used as the scale factor. This high weightage given to population may not result in more transfers to states which are underdeveloped and having low population. The central plan assistane is being given on the basis of Godgil formula, which takes population, per capita income, tax efforts and special problems into account. The criteria such as fiscal performance, tax efforts, prudent fiscal management, and elimination of literacy and successful implementation of land reforms etc., over the time have not helped states with differential fiscal and administrative capabilities.

There is wide variance in the provision of basic services like health, education and other infrastructural facilities leading to discrepancies in major socio-economic indicators like literacy rate, infant mortality rate, poverty ratio, and life expectancy etc. For example the highest IMR (per 1000 births) can be seen in lower income states such as Madhya Pradesh in 2009 (67), Orissa (65), Uttar Pradesh (63), Assam (61), Rajasthan (59) respectively where as it is much better in middle and higher income states. Similar is the case of life expectancy and maternal mortality rate. A few states were able to attract investment and do better due to market reforms as well as their fiscal abilities to provide incentives and other utilities during post reforms period.

Here again the basic question is as to which government centre or state is responsible for all round and balanced development of the country and to remove imbalance in development. Obviously, this onerous responsibility can be undertaken only by the Central Government. But the distribution of subjects by the VII th schedule throws the responsibility of ushering of a welfare state based on socialism on the shoulders of the state governments. Agriculture, industries, food, cooperation, irrigation, electricity, education, etc. fall in the state list.

SARKARIA COMMISSION'S RECOMMENDATIONS:

The Commission has made a detailed study of the existing financial selections between the Union and the States and made several recommendations to improve them.

Taxation of agriculture income is a sensitive matter. Both the Union and State Governments are not inclined at present for a change in the constitutional provision in regard to this matter. Many problems have been highlighted by the Union and the State Governments in connection with the levy of such a tax. However, the Commission states that in

view of its potential, the question of raising resources from this source by forging political consensus and the modalities of levying the tax and collection of proceeds, etc. would require an indepth and comprehensive consideration in the National Economic and Development Council. Another important recommendation of the commission is that by an appropriate amendment of the constitution the net proceeds of corporation tax may be made permissibly shareable with the states, if and as Parliament by law so provides. This would have the advantage of enlarging the base of devolution so that in the revenues of the states there would be greater stability and 'predictability' in future. The Commission further recommends that
the surcharge on Income Tax should not be levied by the Union Government except for a specific purpose and for a strictly limited period only.

The Commission has made several recommendations for the improvement of the working of the Finance Commission, the Niti Ayog and the National Development Council. In its view the present division of responsibilities between the Finance Commission and the Niti Ayog is sound and it may continue. The Commission emphasizes the need for decentralization of the planning process. It says, "Since there is special need in a country like India for a conscious and purposive effort to counter it all the time. There is considerable truth in the saying that undue centralization leads to blood pressure at the centre and anaemia at the periphery. The inevitable result is morbidity and inefficiency. Indeed, centralization does not solve but aggratives the problems of the people."

14th FINANCE COMMISSION: The role of 14th Union Finance Commission is mandated with more burden some responsibilities in fiscal, economic and social areas. The 14th Finance Commission has been asked even to suggest measures to raise tax ratios of both centre and states, improve performance of public sector enterprises, tackle challenges in ecology, environment and climate change. Also it is supposed to suggest measures to amend the Fiscal Responsibility and Budget Management Act keeping in view its shortcomings. It has to address the rising trend of Widening inequality in government spending across states and take action towards fiscale autonomy, which has been substantially eroded over the years by the implementation of fiscal consolidation path since the 10th Finance Commission. It has got the Job to assess the impact of GST and device a compensation mechanism for both Centre and States and take the states in confidence, so that it can have higher acceptability.

Overall, though efforts have been made towards a full-fledged federation, India continues to have greater vertical fiscal imbalances at different levels of governments and horizontal fiscal imbalance across the levels of governments. India has evolved a noble kind of federation which is completely different from the accepted notion of federation. The evolved Indian federalism is very unique in character and centre-state relationship has also become extremely complex over the years. The role of Niti Ayog, Constitutional mechanism and working of various institutions will determine the future of Indian federation. The rising inequality in an increasingly market economy demands scientific approach for fiscal transfers from centre to states so that the objectives of fiscal federalism of equality and the provision of providing public goods across states is ensured. There are few issues which remain in the domain of centre-state financial relations such as multiple channels of transfer; limited scope of Finance Commission transfers; methodological weakness and too much reliance on the " gap filling " pproach, and multiplicity of objectives failing to focus on main objective of reducing disparities.

CONCLUSION: India, it must be recognized, is ideally suited to have a federal form of government. From times immorial, Indian history is marked by two contraductory trends, centripetal and centrifugal and India is again and again united and disintegrated. The framers of the Constitution recognized this truth and adopted the only suitable and workable form of government. In a recent article, Rasheeduddeen Khan has correctly described India as a "federal nation". He writes that "In India unity itself is a federal concept. It is certainly not the unity of a Unitarian Polity. It is the unity born out of the interdependence of diverse socio cultural entities that pass through the stages of competition, conflict and reconciliation, and realize the fatal truth that in mutual confrontation they might themselves destroy each other while in reciprocal cooperation they can thrive jointly and severally". In sum, the bitter truth has to be recognized that India can only have a decentralized form of government and administration and it is averse to any common and uniform pattern. It is evident from the above discussion that the states do not possess adequate financial resources to meet their requirements. Their sources are not only very limited but are also very inelastic. The Union Government on the other hand possesses very wide and ever expanding sources of revenue. This naturally places the Union Government in a favourable position and the states have frequently to look up to the centre for financial assistance.

After making a study of the Constitutional provisions regarding the Centre-State relations, it would be fruitful to have an idea of the actual operation of the relations between the centre and the states. At the outset it may be pointed out that in the actual operation of the relations between the centre and the states. At the out set it may be pointed out that in the actual operation, every effort has been made to strengthen the already strong centre at the cost of the states. This has made certain critics like C.Rajagopalachari remark that " the independence of the states is being forgotten and a unitary state is being established in India thoughtlessly."

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