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LANDMARK INCREASE IN STATES SHARE: A MOVE TOWARDS SOUND FISCAL FEDERALISM

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ABSTRACT:
The State Governments in India have been dependent on the centre for financing its development programmes. This has been a reason for lack of improvement in the social and economic conditions of the state. The recent move by the Modi led Central Government to increase the state's share in the net tax proceeds of the Central Government is a steep in the right direction. This paper analysis, the centre state relations in the Indian context and the impact of the recent increase in the states share for the country's future development

KEYWORDS
Gadgil Formula, Planning Commission, 42 percent share, centre state share.

INTRODUCTION:

The Indian constitution clearly demarcates the responsibilities of the Union Government and the State Government. However, at the time of Independence, there was an imbalance between the responsibilities assigned to the states and the revenue resources possessed by them to carry out their responsibilities. In order to reduce the disparities between the revenue resources of the Centre and the State, Article 282 of the constitution was formulated which ensured the facility of transfer of resources for development purpose to the state. However, the states were still largely dependent on the centre for financing their development. In 1951, realising a need for a separate body to look into division of resources, the Finance Commission was appointed.

Under the Indian planning process, the provision of financial assistance from the centre to the states for implementing planned development has been an extremely important matter. The Finance Commission provides for a settlement of finances between the centre and the states in two categories:

- Division of revenues
- Grants in special cases.

The Gadgil Formula, named after the then Deputy Chairman of the Planning Commission Dr. D.P Gadgil, was adopted for distribution of plan assistance during the Fourth & Fifth Five Year Plans. Under a special provision, states like Assam, Jammu & Kashmir and Nagaland were given special preference. It was decided that there needs should be first met out of the total paid central assistance and then the remaining balances of the central pool should be distributed amongst the remaining States. The basis of criteria is

- Population
- Tax effort.
- Per capita state income
- Special problems of individual states.
- Spill over of major irrigation and power projects.

The Gadgil Formula despite being well-intentioned did not achieve much success in reducing inter-state disparities. There was increasing clamour for modification of the formula, more so from the economically backward states. The formulation of the Sixth Plan saw modification of the formula.

The 10 percent share of on-going power and irrigation projects was dropped and that of per capita income was increased by 20 percent for distribution to states with per capita income below the national average.

The allocation according to the modified formula continued in the Sixth and the Seventh Plan showing a definite shift in favour of the poorer states. Since the beginning of the Fourth Plan till the Seventh Plan, the dependence of the states on centre's finances has been declining for all states. However the new formula failed to reduce the disparities among the state. It was increasingly felt that unless the distribution of the Central Plan Assistance is made sharply progressive, narrowing down of inter-state differentials in per capita out lays will be impossible.

Subsequently, in a meeting held in 1990, the National Development Council (NDC) approved a New Revised formula, more popularly known as the Gadgil- Mukherjee formula. The new revised formula gave maximum weightage to population, even though in comparison to the old Gadgil formula, its weightage has been reduced by 5 percent.

The share of per capita income has increased from 20 percent, to 25 percent. Fiscal management as a new criterion was introduced with a 5 percent weightage discarding the earlier effort criterion with a 10 percent weightage.

At the turn of the century, the formula was reviewed in 2000, introducing the component of 'performance' with a share of 7.5 percent. Within this, 2.5 percent allocation was on the basis of tax efforts of the states, 2 percent for fiscal management and the remaining 1 percent for undertaking population control measures.

INCREASE IN STATE SHARE

The Union Government has taken a landmark decision by accepting the recommendation of the Fourteenth Finance Commission to share 42 percent of its net tax revenue with states during the five year period starting 2015-16, up from the existing 32 percent.

This is a step in the right direction which will allow greater fiscal policy space to states even at the cost of earning less revenue with the centre for its own schemes and programmes.

The Fourteenth Finance Commission, headed by the former Reserve Bank of India Governor Y. V Reddy, has justified its decision of a higher devolution of net central taxes on the ground that since cess and surcharges are not part of the divisible pool of central taxes, the states need to be compensated with a higher percentage devolution from the central tax pool.

Accordingly to the Commission, increasing the share of tax devolution to 42 percent would serve to increase the flow of unconditional transfers to states and leave enough fiscal space for the centre to carry out specific purpose transfers to the states. This move towards greater tax devolution is definitely more conducive to sound fiscal federalism. However the formula - based transfers need to be supplemented by grants -in-aid in an assured basis and in a fair manner.

CONCLUSION

The centre's acceptance of the Commission's recommendation will lead to a sea change in the architecture of the centre-state relations. The state's economy has been enhanced by giving them more control to guarantee transfer. This will not only lead to greater efficiency but will also make state and local governments understand their priorities better. The higher tax devolution will allow states greater autonomy in financing and designing of schemes as per their needs and requirements.

However, the government has to enclave a new institutional arrangement to strengthen co-operative federalism by expanding the role of the inter-state council, especially with the Planning Commission now being abolished.

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