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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. At the time of Independence there was an imbalance between the responsibilities assigned to states and the revenue resources at their disposal. 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 division of finances between the centre and the states through division of revenues and grants in special cases.

The distribution of planned assistance amongst the states in the Fourth and Fifth Five Year Plan (1969-78) took place via the Gadgil Formula. It was named after the leading Economist and the then Vice Chairman of the Planning Commission Dr. Dhananjay Ramchandra Gadgil. For some states like Assam, Jammu & Kashmir and Nagaland having specific issues, it was decided that out of the total central assistance, the needs of these states will be first met and then the remaining balances of the central pool will be distributed amongst the remaining States. The basis of criteria is

- Population (60%)
- Tax effort (10%)
- Per capita state income (10%)
- Special problems of individual states (10%)
- Spill over of major irrigation and power projects (10%)

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. There was an increase by 20 percent in the share of those states with per capita income below the national average. This was done by reducing the share of power and irrigation projects. The modified formula continued in the subsequent plans with a special focus on providing finances to the comparatively poorer states.

Under the planning era, the dependence of almost all states on centre's kitty of funds has been declining especially since the Fourth Five Year Plan till the Seventh Five Year Plan. However, the new formula failed to reduce the disparities amongst the states. Till the Central plan assistance is made increasingly progressive the interstate differentials in per capita out lays will not be narrowed.

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. The new criteria included a 5 percent weightage doing away with the previous criteria which had 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. This included:

- 2.5 percent allocation for tax efforts of the states
- 2 percent for criteria of fiscal management
- 1 percent for undertaking measures to control population.

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. An increased devolution of net central taxes was justified by the Fourteenth Finance Commission headed by Y.V Reddy on the ground that since cess and surcharges are not part of central taxes offered for division ,the States have to be compensated by offering a higher percentage devolution from center's tax collection.

According 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 total funds available with the States have been enhanced by the Fourteenth Finance Commission and they have been given more control to transfer these to local bodies such as Gram Panchayats and Municipalities thereby ensuring better efficiency and flexibility in prioritising the funds in right direction as per specific development requirements of the State. The higher tax devolution will allow states greater autonomy in financing and designing of schemes as per their needs and requirements . However,it is expected that States share a greater fiscal responsibility for implementation of such schemes for more meaningful contribution to overall growth and development of their regions With the Planning Commission now being abolished, there is a need to formulate a new institutional arrangement to strengthen co-operative federalism and expand the role of the inter-state council.

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