



# INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS (IJCRT)

An International Open Access, Peer-reviewed, Refereed Journal

## FISCAL DISPARITY IN THE CENTRE AND STATE FISCAL RELATIONS

**B.Pramod Sagayaraj**

**Student**

**Christ Deemed To Be University**

### ABSTRACT:

India has enshrined in its constitution a federal form of governance in these form the relation between center and state are very crucial for the effective functioning of the system it has adopted for its governance. The federal form requires a sound and healthy relation between the center and the state with respect to many aspect of relations especially with respect to fiscal relations.

Finance form basis for strong governance and functioning of a country if it is not sound then the effect it going to have on the other aspects are going to very destructive. So the issues in it have to identified and addressed. Issues such as autonomy of the state, vertical and horizontal disparity. This paper tries to analyze the above mentioned issues, the aspects related to it and try to provide suggestions to address the issue.

### KEYWORDS:

Fiscal autonomy, aides of central to states and fiscal relations

### INTRODUCTION:

One of the most important provisions in the constitution which sustain the federal structure and which contribute to a larger extent to the effective governance of country are provisions which deal with the center and state relations. If we reduce our view to the question which is the basic and foundational essential provision or relations required for administration, administration of justice and for economic development of nation i.e provisions with respect to financial relationship between the center and states.

Part XII Article 268 to 290 of the Indian constitution expressly details about the financial relations between the center and state. The organs and machineries created by the provisions are namely goods and service tax council Article 279A and Article 280 finance commission to aid and advise government with respect to finance matters and to frame required strategies in accordance with the government's orders for effective implementations. Three resources are used in the process of administration namely taxes, grants in aid and loans.

Indian constitution is one of the constitution in the world which expressly demarcates the taxation power of the different tiers of governments present in the system. Especially constitution talks about the two different kinds of funds created for different purposes namely consolidated and contingency fund stating their purpose for their existence.

## **HISTORICAL EVENTS ROLE IN RAISING THE CONCERN ABOUT FISCAL RELATIONS:**

The contention with respect fiscal relations between the states was a contention which was present even before the dominance of majority government of India at the very soon after the independence but it was invisible due to rule of same party in most of the other State's most of the issues with respect to the subject matter remained dormant because of the dominance of single party in all the states. But these dominance of the party was broken down in the 1967 general elections which established lot of the other parties to rule in the other states but these didn't last for a long time bringing to rule again the congress government.

1971 -1972 there was a presence of the few different non congress parties in the different states who tried to bring the issue of fiscal relations to the notice of national government but it was not given much importance. But after 1977 subsequent elections many different government came to ruling in the different states which resulted in the demand for reviewing of fiscal relations between the state and center so that the fabric of federal structure won't be affected.

If we have deeper analytical view of the provisions of the constitution we can easily comprehend that the unitary form of governance element was present and effectively in operation. Even when during the era of British ruling central government under them in India was a similar to above mentioned governance for the sake of devolution of power with reluctance with respect to finance to states devolved some powers to local government at their demand. It is proved beyond doubt that by referring to such pharas that the center is more powerful than state due to division of powers and functions which make the center to get increased revenue compared to state which have to discharge higher function which requires a higher financial resources due to these difference there is development of vertical disparity.

As a result of these fiscal disparity of above mentioned nature it leads to horizontal disparity which will result in the difference in the growth of different aspects in the society and economic. So it is very imperative to devise a way to eliminate or reduce the disparity present at the different levels.

## **EMPHASIS ON FISCAL AUTONOMY OF STATES**

In one of the federal relations in India fiscal relations constitute important and contentious relation between the state and the center. Indian constitution has comprehensively expressly demarcated in its text the taxation powers of the center and the state in the seventh schedule. No other countries constitution compared to India makes such a prolific enumeration of the subject matter in addition to this constitution has established a finance commission for adjustment and allocation of finance related aspects of center and state.

But with respect to above relation where one of the contentious aspect is demand for the state's fiscal autonomy. It is one of the most imperative aspect of federalism. Where it is commonly said that political autonomy is myth without the fiscal autonomy. As a result of lack of fiscal autonomy it has led to horizontal and vertical disparity.

Due to states major dependency on the center for their financial resources which has led to challenge to states to provide appropriate resource due to paucity of funds. States have to encounter problems with respect to developmental programs due to centralized resources. Some of the basic evidence of disparity in the constitution are where powers with respect to building of infrastructure like roads, irrigation and administration expenditure etc. are provided in state list but most of the powers with respect to raising revenues are given to center's list. This are some of recent evidence of the state and center expenditure where states total expenditure was 3.62 lakh crore of the former and 2.33 lakh crore of the latter.

## FINANCE COMMISSIONS AND OTHER COMMITTEES PROPOSALS

The thirteenth finance commission proposed a approach which can be called as incremental approach in favour of union government. Which lead to share devolution of state tax from 30.5% to 32.5% which was the frame work of goods and service tax in India which resulted in an attempt to the unification of entire fiscal systems. Fiscal autonomy is very important for states to maintain fiscal stability in order to ensure this then states should be given power to fix rate and collection of taxes. Otherwise the revenue neutral rate fixed should be of such that it doesn't have negative impact on the state or center with respect to its collection of revenues and doesn't affect their fiscal autonomy.

The statement of Punjab chief minister Prakash singh badal. Asserts that states must be strengthened financially. For that purpose he even demanded for a establishment of new constituent assembly to rewrite the constitution containing genuinely the federal principles he said this keeping in mind the fact to strengthen the states financially. He suggested that in order to achieve the goal center have return the 50% of the revenue from state to state themselves it had been affirmed by most of the states. Even the thirteenth finance commission has suggested that the states have requested for increase in the share of central taxes from 30% to 50%. One of the most important committee by name chaturvedi committee constituted for the critical evaluation and advisory of central schemes have submitted a report that the central schemes contained within itself lack of elasticity which have negative impact on the funding requirement of states finance and questioning the effectiveness of schemes in the field. Further the committee has stressed on the part of central government to make the central schemes flexible and add to it special where state government should be allowed to use the funds to sub schemes of the central scheme.

One of the imperative criticism with respect to planning commission from the time of its inception by the resolution of cabinet which has adverse impact on the center and state fiscal relations is its ultra vires function, which is also often criticized for its role as an organ similar to cabinet which is against the idea envisaged by the framers while framing the constitution and its implication on the constitutionally recognized finance commission where both organs role are quite similar. In order to remove the disparity in the fiscal relations between the State and center it is very important to strengthen the finance commission by having equal representation of states in the commission and regionalization of planning.

Most of the time central policies are are not providing the intended results because while implementation of policies state governments are not consulted about the requirement with respect to the intended policies expected effectiveness in the region instead they are implemented with conditions on the state government for implementation of the programs.

Federal policies of the center should be framed on the basis of needs of the center and the state. For government to build its infrastructure in society it should be having a reserve of adequate resources. For government to undertake its responsibility of development then it must possess with itself with adequate finance. If federal government transfers finance by considering the financial needs then state government can function in optimum way.

### CONSTITUTIONALLY RECOGNIZED RESOURCES FOR FISCAL TRANSFER AND THE PRESENCE OF DISPARITY:

Constitution recognizes three kinds of resources with respect to fiscal relation which play a important role in the fiscal relations namely shared taxes and duties, grants and loans. Finance commission is enshrined in constitution under Article 280 to take care of shared taxes and duties. Art.275(1) deals with the grants, Art.282 deals with the discretionary grants and ART.293 deals with the planning commission.

The feature of fiscal relations between the state and center can be outlined by the three points namely states majority and increased dependence of states on the center for financial resources, control over discretionary resources which are liable for transfer and center's loan as a powerful source of finance for central.

Thus the states dependence on the centers finance is very high which will be clear from the following data. Central resources formed 40% of states total expenditure in 1970 to 2000. Same formed 47% in the 2000 to 2010. If we have view of the dependence levels according to different plan periods. First plan 48% and second plan 52% and third plan 56%. We can infer from the above data that the states are not alone dependent on the center's resources their dependency is also increasing. Weak resources base of state is evident from the fact that if we view at the tax revenues of the both center and the state the difference between is so huge. The capital budget to a great extent fed by the central finance. 60% of the total expenditure of the states are by the loans of the central loans.

Many of the critics of the state blame that lack of fiscal management of the state and their lack of ability to exploit their tax is the main reason for disparity or imbalance it is also crucial element but the most imperative reason for it is states weak resources base.

Most of the jurists who are in favour of the state autonomy state that the already existing system with respect to the fiscal relations between the state have to reviewed in the light of the current context and circumstances that are prevailing in the society. New lines of demarcation have to made sure on the healthy grounds. The resources and function can be achieved by reducing the disparity. But in India the power is tilted toward the center. The states have to be given sufficient independence it doesn't mean they have to be entirely left independent with respect to fiscal matters which will have direct impact on the integrity of the nation have to be held with the union and other aspect have to left to states. The main thing here is there have to be a proper balance between both the state and the central government. I would like to quote here the statement by one of the prominent professor by name colin where he points out that "the state governments which rely for grants from central government rather than their own resources rapidly become irresponsible in their demand in long run it will lead to concentration of political and financial resources in one hand which is not conducive. Therefore it very much important for the center and the state to have their independent control of their financial resources.

Some of the suggestions by which these can be achieved are by adding the some of the independent tax items to the state list. Secondly to enhance the statutory prescribed transfer of funds. Considering the present scenario it very much important to adopt statutory. In order to achieve a step towards independence the corporation tax can be included which is a important source of income for the state.

Prof.babatosh data, member of the fourth finance commission he states that if we include the changes in the distributions of functions between the center and the states the situation can be rectified by expanding the sharing of levy then the whole scheme by distribution more flexible than it is now.

### ➤ Discretionary modes of transfer

The second important feature which will be detailed here is with respect to transfer where most of the transfer of resources transfers to the states happens through the discretionary modes of transfer by the utilization of the government's decision or by planning commission where most of the time with respect to adjustment or balancing of fiscal relations the role of finance commission must be the important player using of another modes and ways goes contrary against the idea of constitutional framers. Use of such unadvised method will cause conflict in the fiscal relations between the state and center.

It is highly advisable for the state government to be not to be dependent of the discretionary resources. Which can achieved by enhancing the statutory transfers which result in prevention of interference of central. Further the discretion of the government is felt in the transfer of resources one of such instances outlays in a following way where the revenue and expenditure estimates of the center and the states are performed by the finance commission. During implementation of schemes or undertaking developmental action it is very difficult for the finance commission as well as state to anticipate the incidental expenses occur at that moment the planning commission or central government make discretionary intervention which is most of the time unacceptable by the states.

One of the suggestions for the above mentioned situation where the discretion of the center interferes with the relations is to strengthen the finance commission by extending its function and vesting it with the adequate power handle the incidental situation which will lead to prevention in the interference and increase in the state's autonomy.

➤ **Dominance of central loans in fiscal resource transfers to states.**

After going through some of the graphic figures of recent survey it shows that totally fiscal transfer through loan of center form total 60% of transfers to states compared to other modes of transfer to states. So it is clear from such data that one of the major source of finance source is central loans. One of the data shows that outstanding of central loan to states remain up to 70%. Which makes the states indebted to the center. Which will have a lot of stress on the capital budget of the state. Due to states absence of any strategy to deal with the loan of the central government then to repay the borrowed amount they obtain fresh loan to payback loan as well as interest.

Proper effort must be initiated by the finance commission to reduce the burden of states with such respect and a mechanism must be installed where such amount can be granted to states on the reasonable grounds as a grant. If the state's request of finance is for any other reason than it can be granted as a loan. The analysis of the above circumstance faced by the state makes us to stand in scenario were the debt relation of center and state begins to form. Both the state and central government are in place to achieve the common national objectives as a result they both are seen equal in the eyes of the law. But as a result of central extending loans to the states it have made the equal organs of the constitution one subservient to other which will make the way easier for the union government to interfere in the sphere of state and can make state which is indebted to the center feel inferior.

As a solution to above situation in which the state has caught which is in contrary against its purpose of its existence. Mr. santhanam in his report he suggested a solution to deal with the debt problem. He states that state's should be allowed to borrow from public and remaining from the reserve bank of India where it can provide loan only on commercial basis as the world bank does. A special wing must be created to oversee and keep watch over the spending of these funds.

Another suggestion to deal with the particular issue is that loan for plan schemes should be given only when they are productive schemes. Whether it is productive scheme or not it have to be decide by the planning commission in consultation with the finance commission and other concerned ministries.

Non-productive schemes should be granted capital grant. These system is quiet similar to independent system in Australia which is named as Australian loan council for the distribution of loan between the center and state through which dependence of states on the center can be reduced.

After having view of the above events with respect to fiscal relations It will be a forum where central can consult with the state when it takes any decision which is expected to have impact on the fiscal relation of the state and it will provide for an opportunity to continuously review the status of fiscal relations between the states. between center and state it becomes imperative to constitute it into a permanent commission with the following specific functions namely

## **CONCLUSION:**

In order to have a strong federal system of governance in the country it is very important to ensure that the relation between center and state are strong and sound with respect to many aspect. Especially sound with respect to fiscal relation but it is clear from the above advanced evidences that there exists disparity of both at the vertical as well as horizontal. So some of the suggestions suggested to remove the disparity are namely to establish a strong independent body to keep check over utilization of fund by the state, increase the autonomy of state with respect to financial matters and to enumerate some of the matters to state list etc.

**BIBLIOGRAPHY:**

- Himmat patel, center state financial relationship, Indian political science association, VOL .41, 1980
- George A. Akerlof, center state fiscal relations in India, department of economics Delhi school of economics university of Delhi, springer, VOL.4, 1969 O.C Sud and Punnam kumara, ambiguities between center and state, Indian political science association, VOL 74 and 2013
- J.V.M. Sarma, Fiscal relations in India: issue of horizontal transfers, economic and political weekly, VOL.32,
- 1997REPORT OF THE FINANCE COMMISSION,
- 1965 administrative Reform Commission, Study team on center and state relations , op. eil., pp. 45-47
- Santhanam.k federal fiancé relations in India, Indian finance,12 Dec 1966,p.785
- The constitution of India 1950

**LITERATURE REVIEW:****Himmat patel, center state financial relationship, Indian political science association, VOL .41, 1980**

In this particular article the author begins the work by stating the need and demand for the reviewing the articles with respect to center and state financial relationship. Where he states that most of the provisions in the constitution with respect to such relation between the states and center are in favour of central government. He states about the evolution of emergence and existence of unitary form of government system where he refers as semi federal or quasi federal system which has federal and parliamentary system in the place. He explains India how after enumeration of provisions in constitution indicating it has federal form of government how it persisted for long period of time containing the essence of unitary form of governance what was the role of that times political parties role in achieving such role. He talks about the resources that are available in the constitution during any relation with respect to facilitating the finance between the states and the center.

**George A. Akerlof, center state fiscal relations in India, department of economics Delhi school of economics university of Delhi, springer, VOL.4, 1969**

The author begins the work by stating the significance of the center state financial relation. Specifically he deals in a detail way about the consequence and the distribution of funds to the states. How it is going to have a major impact in the developmental aspects of the state. He focuses mainly on the discussion. The possible goals of the center state finance policy. How this goals are going to be met by adopting what method. He moves little bit away from the discussed area he introduces to the other related aspects claiming that the dynamic and complex goals that are in place to be achieved makes the instrument in place makes it complex for the center state finance relation policy. He mentions the survey conducted by the planning commission of India to the states where author makes an attempt to brief his discussion on the topic by using answers given by the commission as foundation. He uses many formula to explain the link between distribution of funds, success and failure of programme's that are intended to be achieved.

**O.C Sud and Punnam kumara, ambiguities between center and state, Indian political science association, VOL 74 and 2013**

The author begins his research writing by expressing his words about the unique, contentious and questionable feature of the India's federal structure which is commonly called as quasi federal structure. Where goes on to specifically deal with the importance of center state financial relationship, how it is important for the sound

balance of federal structure. He appreciates how the taxes and duties are divided between the center and states by constitution. Where un-enumerated tax goes to center. The author specifically after presenting answers, appreciation to the mentioned problems and statements. He comes to main problem which the entire research work tries to answer i.e Need and significance of financial autonomy to states which will contribute to their role in the development of their respective states. The paper also focuses on the planning commission, finance commission pertaining to the financial aspect of federalism.

**J.V.M. Sarma, Fiscal relations in India: issue of horizontal transfers, economic and political weekly, VOL.32, 1997**

Fiscal relation between the central and state is very contentious for often for a very long period of time .In that there are so many issues which makes the relation very contentious and challenging. One of the issue that the author tries to provide answer is with respect to horizontal transfers of fund. Which play a very important role in the development of the state. He focuses specifically with respect to subject matter and states that disintegrated component approach and subject wise assignment of weightage of factors which are basic cause for the federal system. He proposes the above study as a model for determining the criteria and weightage for the factors for deciding the revenue of shares by observing their association with the fiscal balance of the states. He discusses about the nuances of the relations between the center and state.

