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THE POLITICAL ECONOMY OF CENTRAL BUDGETARY TRANSFERS TO STATES IN INDIA, 1972–84

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I. BUDGETARY TRANSFERS IN INDIA

BUDGETARY transfers from the central government to the states in India go as far back as the passage of the Government of India Act in 1919 and the introduction at that time of the Meston Award, a system of financial adjustment between the center and the provinces. Under the federal government system that was established following national independence in 1947, some alterations were made to center-state financial relations. The purpose of India's budgetary transfer system today is twofold: to vertically correct fiscal imbalances between the "Union" or "Centre"[1] and the states; and to horizontally correct differences in fiscal capability that exist among the states. These two aims are not always independent of each other and have both been integrated into the actual operation of the system.

Looking at the Indian budgetary transfer system as it is being implemented today from the aspect of its binding effect on the central government, we can identify three types of allocations: (1) constitutionally based statutory grants to backward areas and states' shares of Union taxes and excise, (2) transfers by the federal government to state development plans, and (3) transfers made to states through central government departmental budgets, and "ways and means advances" by the central government to compensate for state budgetary deficits. The third form is categorized under the classification, "discretionary transfers."

II. THE RESEARCH TO DATE

Given the long experience in India with respect to managing a budgetary transfer system dating back to the colonial period, the research that has been done on the subject has accumulated into an enormous body of literature. Nevertheless, despite this huge volume, the approaches which have been taken to the subject have not changed very much over the years by virtue of an over-reliance on the normative view of the problems involved. What most of the studies that exist today have done is to concentrate on the two aims of the system, vertical and horizontal fiscal adjustment, and then analyze and evaluate the actual transfers that are being made in terms of whether the system is working satisfactorily or not. The present paper

[1] The Indian Federation is constitutionally defined as the "Indian Union." In common usage, however, the Union government is called the "central government." Union, Federation, and Centre are interchangeable in appropriate contexts.

will not proceed along such normative lines, but will adopt what is called "the political economy" approach, in order to supplement the conventional research by looking at the more dynamic aspect of the budgetary transfer activities. What I am concerned with is the process, often fraught with strain, through which revenues of the central government are distributed to states and adjusted between them. While the normative approach could look at present fiscal operations as a "deviation from norms," that is not the viewpoint this paper will adopt.

First, let us compare the two approaches and then discuss the analytical framework adopted in this paper to deal specifically with budgetary transfers in more general terms as a framework within which to view fiscal relations between the Union and states as a whole.

A. *The Normative Approach*

The characteristic features of the normative approach can be summed up in the following four points.

First, it tends to emphasize revenue side analysis of local government fiscal administration. It assumes that (1) the more budgetary transfers received from the central government the more effective is the vertical adjustment function, and (2) the more retrogressive are budgetary allotments to correct for income differences between local governments the better the horizontal adjustment function is working. In other words, the central issue of normative research is to find out to what extent budgetary transfers have a retrogressive effect on interstate allotment standards. It is this issue which tends to dominate the research concerning states' shares of Union taxes and excise.[2]

Second, revenue-side analysis is based on the assumption that low income regions necessarily have weak fiscal bases. Therefore, per capita expenditure standards are low and the fiscal income improvement effects weak. A vicious circle of low level balancing of expenditure with low revenue arises, necessitating budgetary transfers from the central government to remedy the situation. This argument, which is difficult to refute in a general sense, without a doubt forms the theoretical basis for budgetary transfers to local governments. This is because, as we shall see later on, the revenue and expenditure levels of local governments in India strongly reflect interregional differences in income. Nevertheless, it is a fact that local fiscal management as seen in the real world is not founded solely on such an economistic theory.

Third, with respect to fiscal expenditures by local governments, the level of freedom with which to spend budgetary transfer revenue occupies the dominant position in evaluating the system. For example, if we compare the three forms of allocations listed in Section I, freedom on the part of local governments as to their use decreases as we proceed from the states' shares of Union taxes and excise to state plan transfers, then to discretionary transfers, resulting in similarly poor evaluations of these forms of allocations.

[2] A compilation of the prominent articles on the subject appearing in *Economic and Political Weekly* in Bombay [7] gives an overview of the major issues related to center-state financial relations. For some other representative work, see [2] [6] [11].

Fourth, while the normative approach is well equipped to indicate optimum correction standards and systems, as well as to make policy suggestions as to what system will work best, it cannot explain under what kinds of conditions the central government, which preempts national fiscal sources, would be compelled to hand over portions of its revenue and authority to local governments.

Since the central government preempts fiscal sources for obligatory payments for national defense and to foreign governments (including national debt repayments), etc. and for funding national plan projects, the pool of revenue that can be transferred to local governments is already reduced.

Under such conditions, probably the most difficult question that the normative approach faces and continually fails to answer is what is the key factor that affects the central government's decision in implementing budgetary transfer systems with the aid of adjustment measures.

B. *The Political Economy Approach*

In order to overcome the above-mentioned difficulties inherent to the normative approach, I would like to offer an alternative view in looking at the India's state government fiscal situation over a specific period of time.

This approach will first look at both the levels and structures of revenues and fiscal expenditures at the state level, with particular scrutiny of the expenditure side. This approach has already been employed in the research on urban fiscal administration in Japan and elsewhere [1] [4]; and there has been work on what differences in expenditure structure there are among local governments and what has determined the causes of those differences (for India see [18]).

Second, especially when considering the limitations on local governments imposed by income levels, expenditure structures do not necessarily correspond to absolute income levels in the same way as to absolute levels of revenue or spending. Rather, differences in expenditure structures may be related to the sociopolitical bases of the governments under comparison. That is to say, in looking at the link between state-level finances and state-level politics, we can realize useful results by looking at expenditures rather than income. Furthermore, in terms of research methodology, it is now possible to introduce factors that focus on the importance of economies and fiscal administration at the state-level, not just the single factor of interstate income level differences. For example, it is now possible to do fiscal structure comparisons in terms of importance in the national economy by classifying local governments as either "core units" or "periphery units." Especially when analyzing local fiscal administration in such a multiethnic region as South Asia, it is all the more necessary to take heed of such factors.

Third, the fact that there exist notable differences among the fiscal structures of a country's local governments indicates that the fiscal regulatory system of the central government is not uniform, and indirectly allows us to determine how to measure the level of freedom local governments enjoy in fiscal spending as well as understand that freedom in more substantive terms. Differences in expenditure structures indirectly express the existence of, for example, policy-making autonomy on the local level and policy issues unique to each particular government. Such

differences also afford the opportunity to bare the antagonism that exists between the fiscal regulatory authority held by the central government and the interests of local governing bodies.

Fourth, bringing such conflicts of interests out in the open will probably have a lot of influence on rearranging fiscal relations between the central and local governments.[3] Conditions will be created under which the necessity of budgetary expenditures at the local government level, whenever special sociopolitical factors come into play, will force the central government to transfer funds despite its privileged authority to preempt budgetary sources. The methodology by which to clarify the process outlined in the above points is what we term the "political economy" approach. It will be used in the present paper to make the argument that the central government does not respond to central-local fiscal adjustments merely on the basis of abstract equity norms.

What follows is an attempt to focus on the problem of budgetary transfers from the Centre to the local governments, not taking up local fiscal administration in general. Because of this limited objective, several important issues related to center-state fiscal relations will remain untouched in this paper: for example, the complementary effect on local fiscal affairs brought about by spending by the central government or centralized public enterprise activities in particular regions,[4] or problem of different spending effectiveness (expenditure quality) in various localities.

III. TIME FRAME AND DATA

A. *Time Frame*

It was in 1967, when the fourth general elections were held, that the fiscal relationships between the Union and the states became an important political issue in India. As a result of those elections, one party dominance by the Congress Party was ended, and while the Congress Party was able to maintain its majority in the Union Parliament, in eight out the fifteen state assemblies, the majority of seats were captured by either opposition parties outright or alliances of opposition parties. Among the state administrations that became headed by opposing party members, the Dravida Munnetra Kazhagam of Tamil Nadu and the United Front governments of West Bengal and Kerala loudly demanded a reexamination of the fiscal authority then exercised by the states. It was this change in Union-state relations that resulted in the more or less universal application of the Gadgil Formula,[5] established in 1969 to deal with the transfer of plan sources under

[3] Section 1 of [14] gives an account of the longstanding debates and unusual circumstances immediately following the Great Depression that led the Indian government to concede part of the jute export duty to the jute-producing provinces, Bengal in particular.

[4] Satō [17] looks into the indirect benefit of being allotted power from the National Thermal Power Corporation (NTPC) enjoyed by several states of India, that accumulated heavy arrears against the supply of power.

[5] In 1969 the Planning Commission devised a formula to distribute state plan transfers according to several criteria: population, level of state income measured in terms of state

central government discretion to the states. Meanwhile, after the splits that took place in the Congress Party during 1969 and 1970, the Indira Gandhi government won a landslide victory in the 1971 elections and then proceeded to promote greater centralization of both political and fiscal authority. Relatively little Union-state political friction characterized the short-lived Janata government regime of 1977–79; but when the third Indira Gandhi government was organized in 1980, trouble surfaced again on all the fronts of Union-state politics, to the extent of causing separatist movements in Assam and Punjab and bringing about constant demands for stronger state autonomy by the Left Front government in West Bengal. Even the Indira Gandhi government could not ignore such movements, as the Commission of Centre-State Relations was set up in 1982. The commission's report, which was released during 1987–88, contained important information about the relationship between the central and local governments [10].

The present paper will take as its time frame this period of the two Indira Gandhi governments spanning 1972 and 1984, which was marked by increasing importance of the problem of state autonomy within Indian politics. As a time of extremely hard fought political disputes over Union-state fiscal relations, this period most clearly defines where the problems lie in this area for India even today.

B. *The Data*

The data to be presented in this paper will geographically cover fifteen out of India's twenty-two states, by virtue of excluding its seven "special category states."[6] The data is divided into three periods, (1) 1972–74, (2) 1975–79, and (3) 1980–84, which correspond to the latter half of India's Fourth Five Year Plan, its Fifth Five Year Plan, and its Sixth Five Year Plan respectively. This period also includes two epoch-making political events in Indian history: the declaration of a state of emergency in June 1975 and Indira Ghandi's return to power in January 1980. The data on each state is in the form of average figures for each of the three periods; however, due to changes in accounting categories between 1972–73 and 1973–74, expenditure data analysis could be done only for periods (2) and (3).

I have used the concept of state domestic product (SDP) as the indicator of interregional economic disparity.[7] SDP figures, when viewed in relation to other variables, have been adjusted to 1970/71 prices. However in the calculation of the ratio of tax revenue to the SDP, current prices were used. Most fiscal data is expressed in per capita figures, state population figures for 1972–80 coming from the 1971 census results and those for 1981–84 coming from the 1981 census results.

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domestic product, and other contingent elements. The formula was named after then deputy chairman of the commission, Professor D. R. Gadgil. The formula has since been revised several times [9].

[6] Special category states are mainly mountainous states located on India's national borders, whose state plan transfer allotments are made according to a different framework from the other fifteen states. See Section VII.

[7] For an explanation of how SDP statistics are compiled, see [9, pp. 51–52]. Using SDP figures as the basis of fiscal source distribution has been questioned [13].

Due to limitations of space, the number of tables have been kept to a minimum. Tables that show actual raw data figures have been limited to just a few describing period (3). State names have been abbreviated according to Appendix Table I. All the data is based on fiscal statistics contained in the *Reserve Bank of India Bulletin.*

IV. STATES' REVENUE AND BUDGETARY TRANSFERS

A. *The Magnitude and Classification of Central Budgetary Transfers*

Before getting to the subject at hand, let us look first at the scale of India's national budget in comparison to the economy as a whole. Broadly speaking, fiscal affairs are carried out on three different levels: federal, state, and local. India's fiscal statistics are very easy to obtain for the federal and state levels, but for local bodies, data on a nationwide basis is extremely difficult to get due to institutional differences between the states that control them and frequent cessation of their activities as a result of supercession by state governments. Table I is a summary of the available statistics that give only a very rough idea of the fiscal situation of local bodies in India in connection with the federal and state levels.

As indicated by Table I, the scale of India's national budget as a percentage of the GDP was (accounting for overlapping calculations) 27 per cent in 1976/77 and 32 per cent in 1987/88. This is by no means low when compared with other countries around the world. One more characteristic feature that we notice about India is the comparatively large role played by the states in fiscal budgeting and the relative unimportance of local bodies.[8] Moreover, rural fiscal administration is markedly dependent on budgetary transfers from state governments.

Next, let us examine to what extent budgetary transfers from the central government have transformed the relationship between the fiscal scales of the Union and the states, then discuss in a little more detail the three types of transfer mentioned at the beginning of this paper (and laid out schematically in Appendix Figure 1).

Table II shows how during the period in question states' shares of the national budget changed as the result of their receiving budgetary transfers. According to these figures, on the average states' shares of current revenue rose from 37 per cent to 52 per cent and capital receipts from 24 per cent to 39 per cent as the result of budgetary transfers. Development expenditures are financed by capital accounts, and states' shares of these expenditures are relatively low.

Table III indicates the shares of total budgetary transfers taken up by the three specific forms of transfer to be discussed in this paper. The portion occupied by states' shares of Union taxes and excise and statutory grants, which are transferred

[8] The National Commission on Urbanization reports that the share occupied by municipal expenditure in total government expenditure remarkably declined from 8 per cent in 1960–61 to less than 4.5 per cent in 1980–81 [8, p. 134]. This figure does not tally with Table I, which gives a share of 2.4 per cent for urban local bodies participation to the total government revenue for 1976–77.

TABLE I

PUBLIC FINANCE IN INDIA'S ECONOMY

(Billion rupees)

	1976/77	1987/88
GDP	796.23	2,944.08
Union revenue[a]	143.46 (18.0)	610.18 (20.7)
States revenue[a]	119.21 (15.0)	602.33 (20.5)
Transfers from the Union	46.31	273.96
Urban local bodies revenue	6.60 (0.8)	n.a.
Transfers from the states	1.49	n.a.
Rural local bodies revenue	7.46 (0.9)	5.79 (0.2)
Transfers from the states	6.60	4.03
Share of the transfers in total revenue (%)		
States	38.8	45.5
Urban iocal bodies	22.6	n.a.
Rural local bodies	88.5	69.6

Sources: For GDP and Union and states revenues, 1977/78, 1978/79, 1988/89, and 1989/90 editions of [15]. For the local bodies revenue in 1976/77, *Report of the Finance Commission, 1978* (Delhi, n.d.), pp. 184–85. The figures for urban bodies lack data from Tamil Nadu, while the figures for rural bodies lack data from seven states (Karnataka and Tamil Nadu being the major ones). For rural local bodies revenue in 1987/88, Government of India, Ministry of Agriculture, Department of Rural Development, *Panchayati Raj at a Glance, Status of Panchayati Raj Institutions in India, 1987/88* (New Delhi, 1989), pp. 18–19. The data is incomplete but partially useful though the major states, including Andhra Pradesh, Bihar, Maharashtra, Rajasthan, and West Bengal, did not supply information.

Note: Figures in parentheses are expressed as a percentage of the GDP.

[a] Current account+capital account.

according to the recommendations of the Finance Commission[9] and have generally been accepted by the central government, decreased somewhat, while state plan transfers and discretionary transfers increased. This indicates that fiscal sources that bring with them relatively little freedom on the part of the states as to their use were on the rise. State plan transfers, which are allotted through the National Development Council[10] are handed over to the states in a ratio of 70 per cent loan / 30 per cent grant and thus become one factor in the fiscal subordination of states to the Union.

Discretionary transfers are the most complicated type, because they are granted in so many different forms: (1) grants and loans to states for implementing central plan schemes; (2) grants and loans for centrally sponsored schemes; (3) small savings allotments; (4) grants and loans in the case of natural disasters; (5) ways and means advances from the central government; (6) loans to settle overdrafts

[9] A commission appointed every five years according to Articles 268–270, 275, 280, and 281 of the Indian Constitution.

[10] An ad hoc consultative council composed of the central cabinet and state chief ministers. It is the supreme sanctioning body for the national plans, but has little substantive authority.

TABLE II

STATE FISCAL SHARES OF THE NATIONAL BUDGET

(%)

	Current Revenue		Capital Receipt	
	Before Receiving Transfers[a]	After Receiving Transfers[b]	Before Receiving Transfers[c]	After Receiving Transfers[d]
1972/73	35.7	51.8	28.8	49.2
1973/74	37.2	52.3	25.5	40.5
1974/75	36.0	49.5	28.2	39.7
1975/76	35.7	49.6	24.9	35.6
1976/77	37.0	50.8	22.9	34.1
1977/78	36.2	50.4	21.2	36.4
1978/79	36.4	50.9	24.0	42.6
1979/80	36.5	54.6	23.1	41.1
1980/81	38.4	55.9	24.3	37.2
1981/82	37.7	54.2	23.7	37.5
1982/83	37.7	53.9	20.1	35.0
1983/84	36.3	51.2	20.2	33.8
1984/85	37.0	52.9	24.4	38.0

Source: Compiled by the author with data from [15, various issues].

[a] (States current revenues—states' share of Union taxes and excise—grants)/(Union and states current revenues—grants—states interest repayment) × 100.

[b] States current revenues/Union and states current revenues × 100.

[c] (States capital receipts—loans from the Union)/(Union and states capital receipts—loans from the Union—states capital repayments) × 100.

[d] States capital receipts/Union and states capital receipts × 100.

at the Reserve Bank of India; and (7) special loans for reducing debts owed to the federal government. Furthermore, the Union government gives assistance similar to centrally sponsored scheme transfers for items originally under full state control, mainly agricultural and educational projects. Included here are transfers that have posed problems for India's Union system in that they involve Union intervention as to project content.[11]

B. *Budgetary Transfers and Interstate Economic Disparity*

Before going into the horizontal adjustment function of budgetary transfers, let us first make certain of what is meant by interstate disparity on the revenue side as indicated by per capita SDP levels. Table IV separates India's seven "special category" states from the fifteen others and ranks the two groups in terms of per capita income level. The first group of fifteen is divided further into three subgroups on the basis of 10 per cent differentials in averages.[12] One can see that the share of state self-generated fiscal sources in total tax and non-tax revenue strongly correlates in most cases to the level of per capita SDP. Table V shows in more detail the correlation between per capita SDP and various indicators of current

[11] For a critique of centrally sponsored programs, see [12].

[12] In official circles as well, these three subgroupings of the fifteen non-special category states have been adopted by the National Development Council [6].

TABLE III

RELATIVE SHARES OF BUDGETARY TRANSFER TYPES

(%)

	Transfers through the Finance Commission			State Plan Transfers	Discretionary Transfers
	States' Share of Union Taxes and Excise	Statutory Grants	Total		
1972/73	27.0	n.a.	n.a.	n.a.	n.a.
1973/74	31.8	4.2	36.0	17.3	46.7
1974/75	36.9	14.7	51.6	23.9	24.5
1975/76	38.9	12.4	51.3	26.2	22.5
1976/77	36.3	11.2	47.5	26.6	25.9
1977/78	32.5	10.1	42.6	33.9	23.4
1978/79	25.5	6.9	32.4	35.7	31.9
1979/80	41.8	3.1	44.9	27.5	27.6
1980/81	40.2	2.6	42.8	32.8	24.4
1981/82	41.1	2.4	43.5	28.8	27.6
1982/83	38.0	2.0	40.0	31.7	28.3
1983/84	35.0	1.9	37.7	32.0	30.3
1984/85	35.4	2.7	38.1	30.0	31.9

Source: Compiled by the author with data from [16, various issues].
Note: Statutory grants include grants to supplement current budgets under Article 275 of the Constitution and welfare benefits to scheduled tribes and tribal areas contained in act of law passed in the Union Parliament. Article 275 also provides for special assistance to Assam.

revenue (per capita market borrowing being an additional index) during the three periods. We see here that the two most important state fiscal sources, the sales tax and the state excise (i.e., liquor tax), are strongly correlated to per capita SDP levels. Market borrowing is also an important indicator of the strength of a state-level fiscal base. Looking at the share occupied by current revenue, the percentage of self-generated fiscal sources correlates to per capita SDP, but the actual composition of those sources have little relation to the per capita SDP figures.[13]

While the ratio of tax income to SDP (at current prices) does not correlate as strongly with per capita SDP (at constant prices) as the absolute figures, on the whole the coefficients are positive. That is to say, the determining factor of current government income is a state's income level rather than the so-called "tax effort."[14] Table IV also allows us to divide the fifteen non–special category states into three categories on the basis of current revenue composition and income (SDP) levels. The A subgroup represents high income states that generate 71 to 80 per cent of their fiscal sources; subgroup B are middle income states that generate 61 to 70

[13] The reason is that state excise (i.e., the liquor tax) occupies a very large share of revenue in states like Punjab and Haryana, while accounting for a very low percentage in states like Maharashtra and Gujarat.

[14] The ratio of tax income to SDP (at current prices) is only a crude approximation of the "tax effort." For a discussion of the "tax effort" calculation, see [3].

TABLE IV

PER CAPITA SDP AND THE STRUCTURE OF CURRENT STATE REVENUE, 1980–84

(Rupees)

	Per Capita SDP[a]	State Tax Revenue As % of Total Tax Revenue	State Non-tax Revenue As % of Total Non-tax Revenue	State Tax and Non-tax Revenue As % of Current Revenue	Sales Tax As % of State Tax Revenue	State Excise As % of State Tax Revenue	Per Capita State Tax Revenue	Per Capita State's Share of Union Taxes and Excise	Per Capita Grants from the Union	Per Capita State Plan] Grants[a]
A group:										
PJ	1,457	82.4	70.6	80.9	45.6	27.8	290.0	60.4	33.6	12.3
HR	1,098	81.3	74.6	78.9	46.3	19.3	252.7	58.2	42.8	14.8
MH	1,011	79.1	74.7	77.8	64.8	8.3	253.3	67.1	33.2	12.8
GJ	941	77.0	65.0	73.6	65.1	0.6	223.7	67.0	39.3	12.2
B group:										
WB	741	64.1	49.7	60.9	59.2	9.1	127.3	71.2	29.3	15.5
AP	705	69.6	56.2	65.7	50.8	28.7	158.1	69.0	41.5	14.8
KR	704	73.6	69.6	72.4	52.1	19.8	184.4	66.3	32.4	11.2
KL	681	70.4	60.8	67.8	62.3	16.6	177.4	74.7	35.5	14.2
C group:										
TN	631	73.0	52.0	68.5	64.6	14.1	203.9	75.4	36.3	12.1
RJ	585	63.0	56.7	60.4	58.4	12.9	108.6	63.8	51.5	19.5
AS	564	48.6	40.7	44.4	63.1	4.1	59.2	62.6	81.3	65.7
OR	542	46.1	34.6	40.7	57.4	7.5	67.8	79.2	83.9	24.0
MP	529	59.3	63.0	60.7	53.7	14.7	106.4	72.9	40.1	20.0
UP	521	54.6	40.3	49.8	54.6	14.4	81.7	67.9	45.5	18.6
BI	422	41.6	46.1	43.1	69.2	7.8	54.4	76.2	33.9	15.3

TABLE IV (Continued)

(Rupees)

	Per Capita SDP[a]	State Tax Revenue As % of Total Tax Revenue	State Non-tax Revenue As % of Total Non-tax Revenue	State Tax and Non-tax Revenue As % of Current Revenue	Sales Tax As % of State Tax Revenue	State Excise As % of State Tax Revenue	Per Capita State Tax Revenue	Per Capita State's Share of Union Taxes and Excise	Per Capita Grants from the Union	Per Capita State Plan Grants[a]
Special category states:										
SK	972	78.6	15.3	20.9	24.0	61.7	111.7	30.4	1,245.0	766.0
HP	684	63.7	23.4	33.5	40.2	31.9	111.6	63.5	402.1	216.9
JK	636	61.6	28.1	38.1	38.7	24.6	103.6	64.6	286.1	101.4
TR	620	29.6	13.0	15.6	54.1	7.7	31.0	73.7	478.9	249.5
MN	524	31.4	8.0	10.6	39.5	16.3	30.7	67.1	712.7	488.0
MG	n.a.	47.5	11.0	16.7	50.5	25.5	60.4	66.9	610.7	354.5
NL	n.a.	61.1	12.9	16.5	53.3	30.2	88.5	56.4	1,546.0	672.4
AI	726	66.8	51.7	61.7	58.3	14.1	138.2	68.7	51.3	23.1

Source: Compiled by the author with data from [16, various issues].

Note: A key to state name abbreviations is provided in Appendix Table I.

[a] Figures adjusted to an average of 1980–83 prices.

TABLE V

CORRELATION COEFFICIENTS OF PER CAPITA SDP AND REVENUE STRUCTURE FOR THREE PERIODS

	Per Capita SDP		
	1972–74	1975–79	1980–84
Per capita revenue:			
State tax	0.905*	0.933*	0.887*
Sales tax	0.778*	0.819*	0.744*
State excise	0.732*	0.673*	0.737*
Market borrowing	0.665*	0.816*	0.717*
As % of current revenue:			
State tax (1)	0.841*	0.857*	0.805*
State non tax (2)	0.301	0.620*	0.715*
(1)+(2)	0.653*	0.775*	0.801*
Sales tax	−0.096	−0.130	−0.473
State excise	0.246	0.252	0.378
Ratio to SDP:			
Total state tax	0.549**	0.448	0.428
Sales tax	0.376	0.287	0.263
State excise	0.473	0.289	0.329
State non tax	0.201	0.059	0.021

Source: The same as Table IV.
Note: All calculations based on period averages.
* Significant at 1 per cent level.
** Significant at 5 per cent level.

per cent of their fiscal resources; while subgroup C are low income states whose self-generating fiscal sources come to between only 41 and 60 per cent of what is necessary. All of the special category states ranked separately fall into the 10 to 40 per cent self-generating fiscal sources group. These indicators give us the most accurate picture of economic disparity that exists between the states, as well as a good idea of the fiscal capability of each entity. Conversely, these indicators also show how effective per capita SDP is as a variable in the analysis of fiscal structure.

Table VI is a state-by-state summary of correlation coefficients between per capita budgetary transfer values and per capita SDP. By the fact of most of the values approaching −1.000, we can see how transfers function to adjust economic disparity among the states.[15] The table also shows negative values for states' share of Union taxes and excise, statutory grants, and state plan transfers; and with respect to Union taxes and excise shares for 1980–84, a negative correlation to income is to some extent indicated. This is due to the fact that an income redistribution standard was gradually being adopted in the process of distributing personal income taxes and Union excise among the states, as seen in the Seventh

[15] It should be kept in mind, however, that these figures indicate nothing about the actual intensity of income redistribution.

TABLE VI

CORRELATION COEFFICIENTS BETWEEN BUDGETARY TRANSFER TYPES AND PER CAPITA SDP (I)

	Per Capita SDP		
	1972–74	1975–79	1980–84
Per capita budgetary transfers:			
State's share of Union taxes and excise	0.089	−0.451	−0.629*
Statutory grants	−0.347	−0.465	−0.353
State plan transfers	−0.183	−0.093	−0.204
Discretionary transfers	0.398	0.546**	0.811*
As % of total transfers:			
State's share of Union taxes and excise	−0.198	−0.174	−0.565**
Statutory grants	−0.396	−0.481	−0.396
State plan transfers	−0.417	−0.152	−0.366
Discretionary transfers	0.656*	0.604**	0.762*

Source: The same as Table IV.
Note: The same as Table V.
* Significant at 1 per cent level.
** Significant at 5 per cent level.

Finance Commission's introduction of the concept of income-adjusted total population (IATP). The negative correlation shown for the Union taxes and excise share for 1980–84 was a direct result of this new system. In contrast, per capita discretionary transfers show a clearly positive correlation to per capital SDP. The problem here is what portion of many complicated forms of discretionary transfers tend to favor wealthier states. Table VII breaks down this type of transfer into its component parts and correlates each to per capita SDP. Transfer forms (1) through (3) in the table include both loans and grants. In the case of central plan schemes and centrally sponsored schemes, we see no significant correlation, with the exception of central plan schemes during the period 1972–74, indicating that these two forms do not perform any horizontal economic adjustment function at all. There is a clear tendency, however, in the case of small savings shares and ways and means advances, for wealthier states to receive greater amounts of loan money per capita than the other states. Total budgetary transfers (excepting Union taxes and excise shares) show slightly negative correlations in the grant category for 1975–79 and 1980–84, while the loan category clearly favors wealthier states. Current account surplus, in spite of the retrogressive distribution of grants and Union taxes and excise shares, still seems to favor wealthier states. Current account surplus minus Union taxes and excise shares (negative in many cases) still shows more positive values in the wealthier states. The two wealthy states, Punjab and Haryana, recorded surpluses in 1980–84 period even after deducing their shares of Union taxes and excise.

The above analysis may be summed up as follows, of the three budgetary transfer types under discussion, Union taxes and excise shares and state plan transfers perform the function of horizontally adjusting economic disparity between

TABLE VII

CORRELATION COEFFICIENTS BETWEEN BUDGETARY TRANSFER TYPES AND PER CAPITA SDP (II)

		Per Capita SDP		
		1972–74	1975–79	1980–84
(1)	State plan transfers:			
	Grants	−0.136	−0.200	−0.310
	Loans	−0.188	0.040	0.132
(2)	Central plan schemes:			
	Grants	0.764*	0.141	−0.115
	Loans	0.630*	−0.124	−0.135
(3)	Centrally sponsored schemes:			
	Grants	−0.197	0.292	0.028
	Loans	−0.005	0.032	−0.227
(4)	Small savings shares (loans)	0.444	0.522**	0.583**
(5)	Ways and means advances	−0.032	0.553	0.818*
(6)	Total budgetary transfers[a]:			
	Grants	0.097	−0.224	−0.339
	Loans	0.055	0.611**	0.736*
(7)	Current account surplus	0.515**	0.639*	0.444
(8)	Current account surplus[a]	0.477	0.648*	0.569**

Source: The same as Table IV.
Note: All calculations based on per capita period averages.
[a] Excludes state's share of Union taxes and excise.
* Significant at 1 per cent level.
** Significant at 5 per cent level.

states; however, wealthier states, by virtue of the transfer allotments they are receiving, can further improve their account surpluses, which are already greater than other states, due to superior self-generating fiscal sources. As for discretionary transfer grants and loans, beginning in the period 1975–79 wealthier states have gained advantage over the other states. Nevertheless, to conclude from these results that the wealthier states depend more on budgetary transfers than do the lower income states would be a mistake. Actually, the opposite is the case. For example, Table VIII lists the different categories of state expenditures and shows the percentage paid by corresponding budgetary transfers. According to the coefficients of correlation of these percentages to per capita SDP, the level of dependency on budgetary transfers from the central government was negatively correlated to state income levels in all cases, except non-plan expenditures (especially on capital account; i.e., discretionary transfer loans), dependence of the current expenditures on central grants having a strong negative correlation. We can say therefore that generally speaking the dependency of states on budgetary transfers from the Centre is higher for poorer states, with the exception of the circulation of discretionary transfer loans.

TABLE VIII

STATE EXPENDITURES AND THE SHARES PAID BY BUDGETARY TRANSFERS, 1980–84 AVERAGES

	State Plan Transfers[a] As % of Plan Expenditure	Non-plan Transfers[b] As % of Non-plan Expenditure	Total Grants[b] As % of Current Expenditure	Total Loans As % of Capital Expenditure	Total Budgetary Transfers[b] As % of Total Expenditure
PJ	21.2	28.3	7.8	53.5	26.4
HR	20.9	19.2	9.8	39.2	19.8
MH	30.3	13.5	7.5	51.3	18.7
GJ	20.0	20.4	10.5	39.3	20.3
WB	39.1	24.6	10.1	87.1	28.2
AP	35.1	14.2	13.0	47.2	20.8
KR	22.7	19.3	11.0	40.1	20.5
KL	31.9	14.5	10.4	46.1	19.6
TN	28.3	12.6	10.7	31.3	16.8
RJ	39.1	23.3	18.1	49.0	28.5
AS	116.2	7.9	29.3	80.3	46.5
OR	43.9	32.3	30.6	51.2	36.7
MP	30.9	15.8	15.4	36.4	22.1
UP	34.4	23.9	20.9	41.6	28.1
BI	53.0	21.0	18.0	52.1	30.0
SK	96.8	60.9	97.2	29.4	79.4
HP	63.3	47.6	66.6	26.5	54.5
JK	95.4	36.6	46.9	77.7	57.9
TR	78.7	57.2	85.7	19.4	66.7
MN	129.7	45.5	103.9	35.3	76.8
MG	100.7	51.2	93.3	20.7	71.7
NL	102.2	61.0	92.9	21.9	74.3
AI	39.1	19.5	16.9	46.8	26.0
Correlation coefficients with per capita SDP[c]	−0.433 −0.419[d] −0.451[e]	0.171 −0.482[d] 0.519**[e]	−0.622*	−0.030	−0.337

Source: The same as Table IV.

[a] Grants+loans.

[b] Excludes state's share of Union taxes and excise.

[c] Excludes special category states.

[d] Current account.

[e] Capital account.

* Significant at 1 per cent level.

** Significant at 5 per cent level.

V. BUDGETARY TRANSFERS AND STATE EXPENDITURES

How are the characteristic features of budgetary transfer flows that correspond to income levels related to the expenditure structures of each state?

As was the case with revenue, there is a strong correlation between absolute per capita expenditures and per capita SDP (Table IX). On the whole, the stronger correlation for non-plan expenditures than plan expenditures means that non-plan expenditures that support maintenance expenses for plan projects are greater in wealthier states.

We have been able to confirm the seemingly obvious fact that the higher income states are able to spend more per capita; however, absolute levels of spending alone are not sufficient to connect the various aspects of budgetary transfers to the problem of spending. It is necessary to categorize spending that corresponds to the characteristic features of the three types of transfer under discussion: that is, the differences between plan and non-plan transfers and those between grants and loans. Through an analysis that incorporates absolute spending levels and the above categorizing procedure, we should be able to extract factors from the state fiscal side that determine budgetary transfers from the Centre.

Table X has been constructed with this aim in mind. It represents an attempt to classify development expenditure into three categories using average data from all twenty-two states. By focusing on development expenditure and combining the various sectors mentioned in the table's footnotes, the three categories of social, agricultural, and infrastructural spending came into view. The figures in the table indicate the percentages of state five-year plan spending devoted to each of the three categories from each budgetary source account in the three areas of plan, non-plan, and total development expenditures.

The three categories of social, agricultural, and infrastructural spending not only possess clear features as to purpose, but also have characteristics in their budgetary source composition unlike any other category. That is to say, social expenditure is mainly the concern of current budgetary sources, while agricultural expenditure depends more than the other two categories on capital accounts. In contrast, infrastructural expenditure tends to take the form of loans to such state-level enterprises as electricity boards and transport corporations. Moreover, while infrastructural spending is carried out almost exclusively as one part of state-level five-year plans, a high percentage of social spending is taken up by non-plan expenditures. The non-plan component of infrastructural spending can be said to follow the same pattern as social spending. It in fact takes the form of current expenditure and includes a great deal of so-called "committed expenditure" to finance maintenance expenditure after the completion of plan projects.

The relative shares of social, agricultural, and infrastructural spending occupying state-level development expenditures contained in Table XI indicate not only the structural features of state fiscal administration, but also where emphasis is being placed in state-level policy-making. Table XI, in which the states are arranged in descending order of their shares of social expenditure, shows differences in

TABLE IX

CORRELATION COEFFICIENTS BETWEEN PER CAPITA EXPENDITURES AND PER CAPITA SDP

	Per Capita SDP	
	1975–79	1980–84
Plan expenditure	0.806*	0.727*
Non-plan expenditure	0.898*	0.948*
Total expenditure	0.929*	0.945*
Total development expenditure	0.908*	0.905*
Plan expenditure	0.814*	0.733*
Non-plan expenditure	0.856*	0.920*

Source: The same as Table IV.
* Significant at 1 per cent level.

these relative shares among the fifteen non–special category states between 1980 and 1984. Both the percentages and actual per capita figures in the table show fairly large differences among states in development expenditure patterns. In most states social spending takes priority over agriculture and the infrastructure.

Social spending amounts to 50 per cent and above in the three states of Kerala, West Bengal, and Andhra Pradesh, while agricultural spending surpasses 40 per cent of the total in the states of Orissa, Maharashtra, Karnataka, Madhya Pradesh, Bihar, and Uttar Pradesh. Infrastructural spending on the average occupies the lowest share overall, but is characteristically large in Punjab and Haryana. The remaining four states of Rajasthan, Assam, Tamil Nadu, and Gujarat show what could be called the average balance between the three categories.

In the right hand side of the table indicating average per capita expenditure figures, there is more than a doubling in the difference between the states ranked first and last. The problem that will be discussed here is the relationship between development spending levels (i.e., SDP levels) and expenditure shares. Their correlation coefficients are contained in Table XII.

According to these results, high-level per capita development outlays pull up per capita expenditure in all three categories, and in the expenditure share relationship push up infrastructural spending percentages (for such industrial development predeterminants as electricity and transportation). On the other hand, social and agricultural spending shares are not significantly correlated to level of development expenditures, to the extent that social spending shares were negatively correlated, if only slightly, during 1980–84.

Looking at the interrelationships among the three categories, it is clear that with respect to social and agricultural spending, any increase in the share of one will tend to push down the absolute expenditure level of the other. The infrastructural spending category is a typical case of high expenditure shares resulting in high levels of absolute spending amounts.

The following conclusions can be made from the above results. First, the absolute spending levels of the three categories are all determined by development

TABLE X

DEVELOPMENT EXPENDITURE CATEGORY CHARACTERISTICS

	Share of Plan Expenditure in:	Accounts As % of Plan Expenditure			Accounts As % of Non-plan Expenditure			Accounts As % of Total Development Expenditure		
		Current	Capital	Loan	Current	Capital	Loan	Current	Capital	Loan
1975–79:										
Social spending	25.4	69.1	17.8	13.0	97.4	0.4	2.2	90.2	4.8	4.9
Agricultural spending	56.2	33.3	64.6	2.1	92.8	2.4	4.8	59.4	37.4	3.2
Infrastructural spending	81.6	3.3	15.5	81.2	69.4	2.2	28.4	15.4	13.1	71.5
1980–84:										
Social spending	28.4	72.0	18.5	9.5	98.3	0.5	1.2	90.8	5.6	3.6
Agricultural spending	60.1	46.9	51.7	1.4	93.2	2.2	4.6	65.4	32.0	2.7
Infrastructural spending	70.7	4.7	17.0	78.2	59.6	0.7	39.6	20.8	12.3	66.9

Source: The same as Table IV.

Notes: 1. Social spending=education, health care, social welfare, and housing.
2. Agricultural spending=cooperatives, agricultural concerns like small-scale irrigation, forestry, fishing and animal husbandry, rural industry, large-scale irrigation, and multipurpose river development.
3. Infrastructural spending=industry (excluding village industries), electrical power, and transportation concerns like roads and bridges.

TABLE XI

COMPOSITION AND LEVEL OF DEVELOPMENT EXPENDITURE BY STATE, 1980–84 AVERAGES

	Spending As % of Development Expenditure			Per Capita Development Expenditure (Rupees)			
	Social Spending	Agricultural Spending	Infrastructural Spending	Total Development Expenditure	Social Spending	Agricultural Spending[a]	Infrastructural Spending
KL	59.5	29.4	11.0	320.0 (7)	190.5 (2)	115.9 (12)	13.6 (10)
WB	58.7	24.4	16.9	255.0 (13)	149.8 (8)	84.5 (15)	20.7 (9)
AP	50.0	37.4	12.6	306.9 (8)	153.4 (7)	149.8 (8)	3.6 (14)
RJ	48.1	33.5	18.5	293.3 (10)	141.0 (9)	124.3 (10)	28.0 (8)
OR	47.2	44.2	8.6	280.7 (12)	132.4 (10)	140.5 (9)	7.7 (12)
BI	46.8	40.4	12.8	193.0 (15)	90.3 (15)	89.1 (14)	13.5 (11)
AS	45.9	32.7	21.4	281.0 (11)	128.8 (12)	102.6 (13)	49.6 (3)
TN	44.5	31.3	24.2	352.9 (5)	157.2 (6)	164.5 (6)	31.2 (6)
GJ	41.9	34.3	23.8	425.7 (3)	178.3 (3)	211.7 (3)	35.6 (4)
MH	41.1	43.3	15.7	410.9 (4)	168.7 (4)	273.5 (1)	−31.4 (15)
KR	39.1	42.1	18.8	332.6 (6)	130.1 (11)	197.0 (5)	5.5 (13)
PJ	38.8	30.0	31.3	493.5 (2)	191.3 (1)	204.4 (4)	97.7 (1)
UP	38.2	40.3	21.5	238.8 (14)	91.3 (14)	117.3 (11)	30.2 (7)
MP	36.5	41.7	21.8	298.9 (9)	109.2 (13)	156.5 (7)	33.5 (5)
HR	33.3	39.4	27.3	501.1 (1)	166.6 (5)	252.8 (2)	81.5 (2)
Average[b]	44.0	36.8	19.2	310.9	136.7	149.2	25.0

Source: The same as Table IV.

Note: Numbers in parentheses indicate ranking.

[a] Per capita figures based on the rural population only.

[b] Twenty-two states.

TABLE XII

CORRELATION COEFFICIENTS OF AVERAGE CATEGORY SHARES AND PER CAPITA AMOUNTS OF DEVELOPMENT EXPENDITURE

	1975–79[a]				1980–84[a]			
	Development Expenditure	Social Spending	Agricultural Spending	Infrastructural Spending	Development Expenditure	Social Spending	Agricultural Spending	Infrastructural Spending
Share in total development expenditure:								
Social spending	−0.260	0.423	−0.536**	−0.375	−0.484	0.185	−0.644*	−0.382
Agricultural spending	−0.209	−0.675*	0.260	−0.239	−0.068	−0.486	0.361	−0.363
Infrastructural spending	0.630*	0.220	0.453	0.833*	0.642*	0.238	0.428	0.800*
Per capita expenditure:								
Development expenditure	1.000	0.755*	0.839*	0.622*	1.000	0.761*	0.860*	0.490
Social spending		1.000	0.420	0.307		1.000	0.505**	0.220
Agricultural spending			1.000	0.278			1.000	0.094
Infrastructural spending				1.000				1.000

Source: The same as Table IV.

[a] Per capita averages.

* Significant at 1 per cent level.

** Significant at 5 per cent level.

outlays (i.e., SDP levels). Second, the interstate characteristics of development outlays are found, on the other hand, in the different expenditure shares occupied by the three categories. Third, social expenditure shares are probably not determined by absolute levels of development spending, but rather more by policy-related factors. This point is closely related to the fact of the highest social spending shares being realized by Kerala and West Bengal.[16] Fourth, agricultural spending shares seem to be unrelated to total outlays for development purposes. States with relatively higher outlays (Maharashtra and Karnataka) and those with relatively lower outlays (Orissa, Bihar, Uttar Pradesh, and Madhya Pradesh) clearly divide up in two distinct groups. Finally, both infrastructural shares and absolute amounts are strongly correlated to absolute levels of total development outlays. Looking from the budgetary aspect as well, this applies to states that are the most active in capital investment, like Punjab, Haryana, Tamil Nadu, and Gujarat. Assam has a set of different circumstances because being a border state road-building is raising both its infrastructural expenditure share and the actual amount spent.

VI. STATE-LEVEL FISCAL STRUCTURE AND UNION-STATE RELATIONS

It should be clear from the above discussion that the three categories of development expenditures are related to both differences in current, capital, and loan expenditure accounts and differences in budgetary source patterns. One important part of a state's budgetary source pattern being budgetary transfers from the central government, it is only natural that its expenditure structure would clearly respond to the particular character of the budgetary transfers it receives.

Table XIII shows the relationship of development expenditure shares and per capita amounts to fiscal revenue/expenditure balances and ways and means advances, a transfer type from the central government that acts to supplement fiscal balances.

By focusing here on expenditure shares, we can see the negative correlation in the relationship of social and infrastructural spending to fiscal balances. In other words, a high share of social spending is related to inferior current balances. This is an obvious result, because social expenditures come mainly from current expenditure. On the other hand, a high share of infrastructural spending is related to inferior capital balances and superior current balances, having the opposite effect of the social spending share. The agricultural spending share seems to resemble infrastructural spending in its relationship to fiscal balances, but its effects are far less telling. This is because of the previously mentioned difference in the agricultural spending characteristic of two distinct groups of states.

[16] I have chosen here not to go into the problem of "quality" in the area of fiscal spending. It is of course necessary to address in detail the problem of whether or not fiscal spending, especially social spending, is in fact effectively servicing state citizens. This point shows that the problem does not stop at a discussion of mere transfer of funds, but rather extends into such realms as reviewing the present delegation of public administrative powers and the content of development-oriented policy decisions.

Looking at the per capita figures, in all categories the higher the level of spending is, the better current balances and the worse capital balances become. Furthermore, in relation to ways and means advances, loans in the form of discretionary transfers show a positive correlation to infrastructural spending shares and per capita development expenditure values. In other words, as seen in Table VII ways and means advances have a positive correlation to per capita SDP levels; and content-wise they were shown to possess a development expenditure bolstering character, especially in the area of infrastructural spending.

What Table XIII means, therefore, is (1) whenever state governments adopt policies to raise the rate of social spending, they face the direct barrier of current balances, giving rise to account overdrafts with the possible consequences of facing restrictions issued by the Reserve Bank of India or the central government; and (2) wealthier states are presented with the opportunity to expand beyond the limitations of state-level capital balances their own capital expenditure (including loans) that promote asset formation in addition to better current balances they are already building. At least according to the figures after 1975, ways and means advances have clearly tended to bolster capital expenditure in wealthier states.

That is to say, central government policy toward state finances, when looked at from the aspect of fiscal structure, can be said to be "limiting" with respect to rises in social spending shares and to be "supportive" with respect to investment activities carried on by wealthier states.[17] However, this policy lacks impact for increasing shares of social spending, resulting in low-level SDP states being unable to escape the quagmire of low-level development expenditure.

Even in the case of state fiscal dependency on the Centre, as shown in Table XIV, even though wealthier states pay more in interest and principal repayments than the poorer states, the ratio of debt to SDP (at current prices), an indicator of the gravity of debt vis-à-vis the scale of the state-level economy, is greater, with the exception of market loans, in poorer states. (This is indicated by the correlation coefficients in parentheses.) Interest payments to the Union are particularly burdensome for the poorer states; and as to why market loans are an exception, poorer states merely do not have the borrowing power to obtain commercial credit.

The same conclusion as in the case of Table XIII holds true here with respect to the connection between fiscal revenue/expenditure balances and per capita SDP. Poorer states (with the possible exception of Madhya Pradesh) are inferior with respect to current balances, but in comparison to Kerala, West Bengal, and Andhra Pradesh, the states of Uttar Pradesh and Bihar have larger per capita surpluses. With respect to capital accounts, the poorer states' per capita deficits are smaller than those of the wealthier states. In other words, many of the poorer states neither resemble Kerala and West Bengal nor the higher income states like Punjab, in that they operate on low-level balanced budgets due to their low expenditure / low investment structures.

Therefore, the problem of state dependency on the Centre takes on different forms of expression depending on differences in state-level fiscal structures, which are determined mainly by state SDP levels and development expenditures. Based

[17] "Supportive" in the sense that ways and means advances are none other than discretionary loans and by no means constitute unconditional assistance to capital balances.

TABLE XIII

CORRELATION COEFFICIENTS OF PER CAPITA DEVELOPMENT EXPENDITURE AND FISCAL BALANCES

	1975–79				1980–84			
	Ways and Means Advances	Current Balance	Capital Balance	Total Balance	Ways and Means Advances	Current Balance	Capital Balance	Total Balance
Share in total development expenditure:								
Social spending	0.145	−0.661*	0.609**	−0.040	−0.137	−0.759*	0.750*	−0.146
Agricultural spending	−0.527	0.193	−0.139	0.145	−0.429	0.388	−0.233	0.387
Infrastructural spending	0.402	0.713*	−0.706*	−0.120	0.570**	0.540**	−0.677*	−0.192
Per capita expenditure:								
Development expenditure	0.442	0.750*	−0.816*	−0.245	0.663*	0.663*	−0.735*	−0.168
Social spending	0.497**	0.261	−0.347	−0.204	0.605**	0.207	−0.268	−0.236
Agricultural spending	0.028	0.736*	−0.788*	−0.220	0.327	0.695*	−0.638*	0.167
Infrastructural spending	0.656**	0.657*	−0.659*	−0.106	0.671*	0.397	−0.645*	−0.547**

Source: The same as Table IV.

* Significant at 1 per cent level.

** Significant at 5 per cent level.

TABLE

PER CAPITA NON-DEVELOPMENT EXPENDITURE AND

	Non-development Expenditure	Interest	
		Total	Union
PJ	132.0 (4.0)	54.9 (1.7)	19.7 (0.6)
HR	110.3 (4.0)	42.5 (1.6)	20.7 (0.8)
MH	150.8 (5.6)	27.9 (1.0)	17.0 (0.6)
GJ	87.9 (3.5)	30.1 (1.2)	16.6 (0.7)
WB	77.1 (4.3)	30.2 (1.7)	21.1 (1.2)
AP	75.2 (4.3)	21.2 (1.2)	14.3 (0.8)
KR	101.4 (6.0)	23.9 (1.4)	13.5 (0.8)
KL	95.4 (5.5)	29.6 (1.7)	13.4 (0.8)
TN	79.4 (4.7)	23.0 (1.4)	12.7 (0.7)
RJ	86.9 (5.4)	35.2 (2.2)	23.7 (1.5)
AS	80.6 (5.2)	28.7 (1.8)	21.7 (1.4)
OR	72.9 (5.4)	29.9 (2.2)	18.6 (1.3)
MP	58.4 (4.0)	15.2 (1.0)	7.1 (0.5)
UP	63.9 (4.3)	20.6 (1.4)	13.8 (0.9)
BI	55.0 (4.8)	18.8 (1.6)	15.5 (1.4)
Correlation coefficient between:			
Amount and SDP[a] (1980–84)	0.817*	0.817*	0.308
Share and SDP[a] (1980–84)	−0.337	−0.191	−0.542**
Amount and SDP[a] (1975–79)	0.801*	0.622*	−0.022
Share and SDP[a] (1975–79)	−0.568**	−0.492	−0.609**

Source: The same as Table IV.
Note: Ratios to per capita SDP are in parentheses (at current prices).
[a] At constant price.
* Significant at 1 per cent level.
** Significant at 5 per cent level.

on the data collected, we can identify four types of state-level fiscal structure for India: (1) states like Kerala, West Bengal, and Andhra Pradesh with large social spending shares; (2) states like Punjab and Haryana with large infrastructural spending shares and large overall spending levels; (3) states like Maharashtra, Gujarat, and Karnataka, which emphasize agriculture, but are fiscally strong; and (4) states like Orissa, Bihar, Madhya Pradesh, and Uttar Pradesh mainly in the Hindi Belt, which also put relative emphasis on agriculture, but are fiscally weak with low absolute levels of expenditure.

Such are the various structural conditions under which states have maintained dependent, often strained, fiscal relations with the central government.

VII. SPECIAL CATEGORY STATES

In order to obtain a complete picture of state-central government fiscal relations, we should conclude with a comparison of the fifteen states we have focused up

XIV

ITS SHARE OF PER CAPITA SDP, 1980–84 AVERAGES

(Rupees; %)

Repayment	Principal Repayment		Current Balance	Capital Balance	Total Balance
Market Borrowings	Domestic Borrowings	Union			
31.0 (0.9)	5.9 (0.2)	88.8 (2.7)	27.8	−46.5	−20.9
11.3 (0.4)	7.7 (0.3)	42.9 (1.6)	40.2	−68.8	−26.9
5.0 (0.2)	5.7 (0.2)	18.3 (0.7)	10.7	−13.1	−4.6
6.1 (0.2)	6.1 (0.2)	20.2 (0.9)	30.2	−34.4	−7.6
6.8 (0.4)	3.9 (0.2)	32.7 (1.8)	−34.1	21.8	−16.3
4.8 (0.3)	5.0 (0.3)	15.8 (0.9)	2.2	−12.7	−11.1
6.2 (0.4)	5.4 (0.3)	28.6 (1.7)	10.4	−23.9	−14.1
8.5 (0.5)	4.6 (0.3)	34.0 (2.0)	1.9	−17.6	−27.8
6.0 (0.4)	6.6 (0.4)	16.0 (0.9)	15.7	−19.0	−3.1
5.3 (0.3)	5.0 (0.3)	35.1 (2.2)	7.2	−21.8	−15.4
4.9 (0.3)	2.8 (0.2)	48.3 (3.1)	−19.0	−11.2	−26.8
6.9 (0.5)	5.3 (0.4)	23.3 (1.7)	0.9	−5.5	−7.5
3.2 (0.2)	3.1 (0.2)	15.7 (1.1)	30.3	−34.3	−11.9
4.3 (0.3)	2.8 (0.2)	17.2 (1.2)	8.6	−22.0	−11.0
2.5 (0.2)	1.4 (0.1)	16.6 (1.5)	5.5	−9.2	−12.2
0.821*	0.657*	0.683*	0.444	−0.536**	−0.218
0.613*	−0.108	0.115			
0.853*	0.327	0.804*	0.639*	−0.670*	−0.213
0.498	−0.303	−0.103			

till now with India's seven "special category" states, which are located on the nation's northeast and northwest borders. The total population of these latter states amounts to only 2.4 per cent of the total population of India; but they are especially favored in budgetary transfers from plan fiscal sources.

The first fiscal characteristic we notice about the special category states is their extremely low rate of self-generating tax revenue (see Table IV). Jammu and Kashmir and Himachal Pradesh generated 30 per cent of their revenues, while the other five states were able to generate only 20 per cent or less. Plan budgetary transfer amounts to these states are in the range of ten times greater the amounts received by the other fifteen states, with the exception of Assam. Furthermore, the share occupied by outright grants within these transfers amounts to 50 per cent for Jammu and Kashmir and over 80 per cent for the six other special category states. From this revenue side of the picture, these states, with the exception of Jammu and Kashmir and Himachal Pradesh, can be said for all intents and purposes to be totally dependent fiscally on the central government.

From the expenditure side of the picture, the shares of our three categories making up development expenditure amounted to social 37.2 per cent, agricultural 31.3 per cent, infrastructural 31.5 per cent for 1975–79, and 43.1 per cent, 31.1 per cent, and 25.8 per cent respectively for 1980–84. The infrastructural shares are much larger than those of the other fifteen states. Road and bridge-building, which are expensive projects in these mountainous areas, but deemed strategically necessary to defend national borders, dominate the actually large outlays of funds. Of the other fifteen states, only Assam, also with its extensive road-building projects, comes close to the per capita shares of plan budgetary sources enjoyed by the special category states.[18]

We can therefore add one more type of Indian state fiscal structure to the four already discussed.[19]

VIII. CONCLUSIONS: THE POLITICAL PROSPECTS OF CENTER-STATE FISCAL RELATIONS

In the present article I have attempted to focus on the relationship between the flow of funds and income differences with respect to the horizontal adjustment function of budgetary transfers from India's central government to its states. As Indian experts on the subject have already indicated, flows of states' share of Union taxes and excise and state plan transfer grants and loans through the Planning Commission are becoming increasingly retrogressive, due to policy measures. Within this situation, it is also noteworthy to mention that discretionary transfers, which account for one-third of all budgetary transfers, now tend to flow into wealthier states in the form of loans to bolster their investment activities.

In other words, within the process by which the Gadgil Formula became the dominant regulating factor within the flow of loans for state-level plans, the wealthier states have come to depend for their capital source procurement on debt in the forms of market borrowing and discretionary transfers. Moreover, these budgetary sources are being allocated into the infrastructure category (electric power, transportation, etc.), which has the strongest investment character of all state-level expenditure categories.

It is this kind of mechanism that has given rise to the phenomenon, and concomitant criticism, that budgetary transfers from the Centre enrich high SDP states that are already fiscally sound. In other words, when we look at the problem only from the aspects discussed above, no matter what the interregional imbalance correction policy issues may be, the transfer of fiscal capital, like the flow of capital through commercial and public financial institutions, is bound in the end to be limited by strong barriers imposed by the laws of economics.

[18] The National Front government, which was set up after the Union parliamentary elections of 1989, designated Assam as a special category state, due to pressure from the Assam-based Ahom Gana Parishad, which was a member of the National Front alliance.

[19] In 1986, India added three more states to the Union: Mizoram, Arunachal Pradesh, and Goa, bringing the total to twenty-five. Goa has not formally been designated as a special category state, but the other two states have been classified as such. In either case, all three match the special category fiscal structure characteristics discussed here.

Nevertheless, it is clear that as long as budgetary transfers from the Centre to the states continue to be thought of as essentially a fiscal problem, the economic problems they give rise to will constitute only one single aspect among several.

The question arises, then, about the possibility of solving existing budgetary transfer problems by seeking to improve further their horizontal adjustment function and to bring discretionary transfers under criteria similar to those governing state plan transfers (i.e., the Gadgil Formula). This question is today being discussed on a practical level fairly widely throughout India and is one policy direction that will certainly be pursued in the future.

However, putting aside for the moment the fiscal problems existing at the Centre, what determines the relationship between the Centre and the states is not just the policy decisions that are being made concerning the institutions governing budgetary transfers. Just as important in this relationship is state-level fiscal structure, especially the structural aspects of state-level expenditures.

In India today, there are a number of groups demanding more state-level autonomy and fiscal authority within the relationship between the Union and the states. They include the leftist parties of Kerala and West Bengal, the Telugu Desam of Andhra Pradesh, and the Akali Dal of Punjab.

All of these states show quite unique characteristics in their expenditure structures, and for this reason constitute a force that represents the interests of states that are facing in various forms fiscal spending difficulties arising from the budgetary transfer system in effect today. Within the framework of present center-state relations, these difficulties can only be temporarily overcome by short-term discretionary loans from the central government (or the Reserve Bank of India). Here, there is ample room for the Centre to manipulate the relations between the Centre and the states.

On the other hand, however, the Hindi Belt states including Bihar, Uttar Pradesh, Madhya Pradesh, Rajasthan, and a non–Hindi state Orissa, that are unable to overcome low levels of spending for development within the present budgetary transfer framework, have not shown any movement for change, despite the fact that in one sense they have the most to gain from radical changes in the present system.

The passivity shown by the Hindi Belt states, which has something to do with the fact that they have formed an important political base supporting the Congress Party, stems in a more fundamental way from their fiscal management of low level, but balanced, budgets. Even though it is possible to break through such low-level balance by means of large-scale expansion of budgetary transfers from the Centre, one conclusion based on the present analysis is that policy competition within these states will raise the share of social spending (and thus worsen current budgetary affairs), which in turn will support demands for reform in center-state fiscal relations. The low levels of social spending in absolute terms by the Hindi Belt states (especially Bihar and Uttar Pradesh) sufficiently prove the social legitimacy of fiscal expenditure.

In the ninth Union parliamentary elections held in 1989, the Congress Party sustained heavy losses in the Hindi Belt states, followed by similar results in the 1991 elections, where the Congress Party was able to carry only Haryana, while

the Bharatiya Janata Party won Uttar Pradesh, Madhya Pradesh, Himachal Pradesh, and Rajasthan, and a Janata Dal–led government was set up in Bihar. The conclusion reached here that political competition will bring about the opportunity to overcome low-level balance in fiscal spending seems to have entered its experimental stages in Indian politics today.

Furthermore, from the viewpoint of the enormity of Hindi state population in absolute terms, the realization of what I have proposed here will require serious changes in terms of both quantity and quality in the existing center-state and interstate budgetary distribution systems. What the analysis offered in this paper implies is the necessity of long-term, structural changes in the specific area of center-state budgetary transfer relations.

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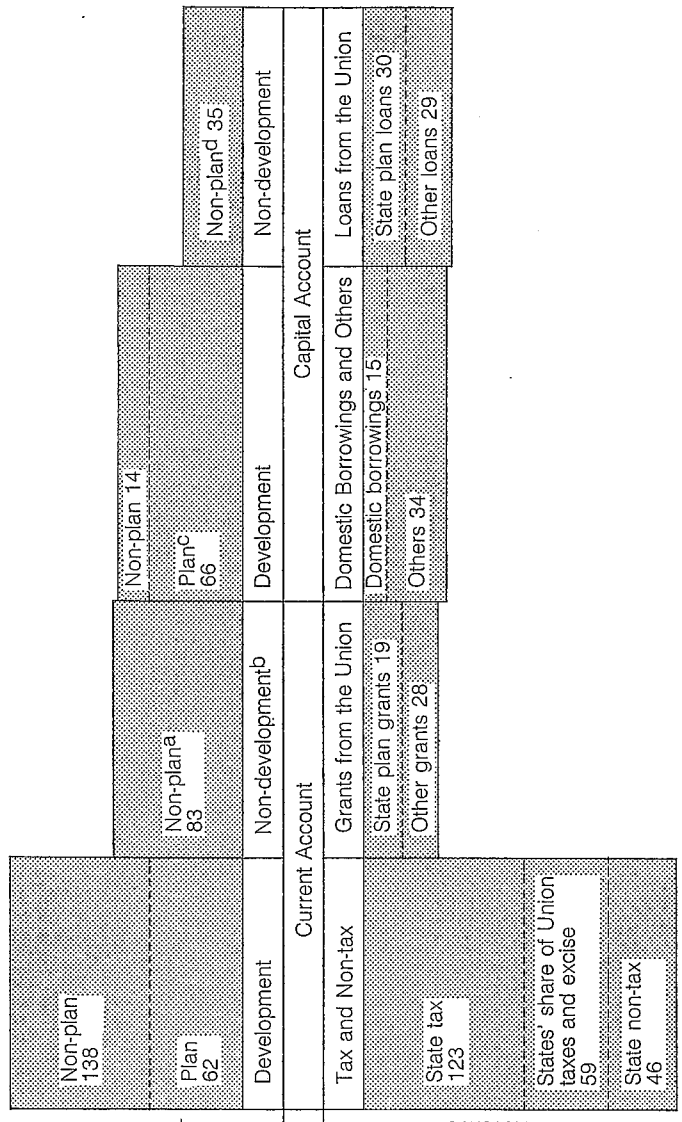
APPENDIX TABLE I

STATE CODES

A P	Andhra Pradesh	M P	Madhya Pradesh
A S	Assam	N L	Nagaland
B I	Bihar	O R	Orissa
G J	Gujarat	P J	Punjab
H P	Himachal Pradesh	R J	Rajasthan
H R	Haryana	S K	Sikkim
J K	Jammu and Kashmir	T R	Tripura
K L	Kerala	T N	Tamil Nadu
K R	Karnataka	U P	Uttar Pradesh
M G	Meghalaya	W B	West Bengal
M H	Maharashtra	A I	All India (Average)
M N	Manipur		

APPENDIX FIGURE 1

Financial Accounts of the States in India, 1984/85 (in Billion Rupees)



Source: *Reserve Bank of India Bulletin*, Vol. 40, No. 11 (November 1986).

[a] Plan expenditure (0.7) is not indicated.

[b] Includes subvention to local bodies.

[c] Includes loans to autonomous bodies.

[d] Plan expenditure (0.1) is not indicated.