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Indian Fiscal Federalism : Some Issues Since Liberalization

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INTRODUCTION

The present federal fiscal system in India has evolved over a long period of time starting from the British regime. Since independence, Fiscal federalism in India has undergone many changes through different constitutional amendments, changes in criteria for develution of resources etc. The 73rd and 74th amendments to the constitution have brought about a transition from a two-tier to three-tier form of federation. Similarly, the New Economic Policy (NEP) since 1991 and coalition politics have had different implications on Indian federal fiscal structure. Further, the efforts for tax harmonization through Value Added Tax (VAT) system will have different impact on differentially developed states and ultimately on the centre-state relationship.

Prior to 1991, the over-grown national government with its enormous economic power and regulations resulted in a virtual stagnation of the market economy. Therefore, the economic reforms in India were born out of government failure rather than market failure and in all probability are likely to generate forces in the direction of decentralising powers. In the case of government failure, there is inevitable demand for deregulation and restoration of market economy. In a market economy, there is more possibility of inter-governmental relationships being based on decentralised networking rather than on centralised control. The proven capability of states in recent years in managing economic affairs has enhanced the statys if tge state giverbnebts. In this context, the central government has given up much power voluntarily since the reforms introduced in 1991 like licensing of industries, ownership of industries etc. Now states are given larger space without much bureaucratic delay caused by the different central government ministries. This opens up opportunities for more decentralised federation in this country. However, there are some emerging issues in Indian fiscal federalism at present scenario.

SOME RECENT ISSUES IN INDIAN FISCAL FEDERALISM

In a liberalised market economy, competitive federalism has come to stay where each state government tries to gain from the market by attracting investment and transporting the tax burden to other states. Though a certain degree of competition among the governmental units is

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required to provide better quality public, the system should be developed in such a manner that this competition is harmonised in an efficient manner (Ray Amal 1992). We have to build a federation where different governmental units have mutual trust both vertically and horizontally. Unless we develop a system of trust and confidence, it wouldt be very difficult to function as a nation. Any inter-government competition or relationship among different states has to be monitored, Otherwise developed states may gain by tax exportation and other burdens to backward states that will increase the horizontal fiscal imbalances.

In recent years, the responsibilities of the states have gone up tremendously, particularly after the inception of economic reforms. So greater independence should be given to the states to formulate their own plans for socio-economic development. Above all, Planning Commission (PC) and Finance Commission (FC) have to remove the regional disparities by giving more financial support to backward regions to cope up with new economic reforms. At present, the PC should be more concerned with the development of the backward areas and leave the forward areas with more freedom to develop, as they like.

To achieve the objective of equity and growth in Indian federation, the advanced states have a stake in the growth of income, output and the welfare of the people of backward states. Thus, a proper environment should be created for co-operative federalism where different state governments work together. However, the states don't realise the need to get together and form wide common markets that can prove to be very important in the present context. The idea of interdependence of the states and formulation of policies with concurrence of most of the states would protect the common market in India and enable productive forces to be activated over a wide area. This will contribute to maintain horizontal equity in Indian federation.

In the context of liberalisation and decentralisation, develoed states could attract more resources while backward states will suffer if they are not supported with huge transfers from cental government for their economic development. This necessitates having a total pool with central government. Keeping this in mind, the Tenth Finance Commission 1999 (TFC) suggested for pooling of all taxes and sharing a definite portion, 29 percent with states. States are not ready to give up their autonomy of taxing commodities lcoming under their preview. All these changes will have different impact on differentially developed states and ultimately on the federal fiscal arrangement between center and states in future. This gives rise to two conflicting objectives, first everybody wnats to reduce the central government financial power over states, on the contrary there is also a demand to give more financial assistance to the backward states.

One of the major recommendations of the tax reforms committee headed by R.J. Chelliah was gradual replacement of central indirect tax and states sales tax by Value Added Tax (VAT) to bring about tax harmonisation and to avoid the cascading effect of central excise and states lales tax. Implementation of VAT in Indian federation involves lot of difficulties and discussions between center and states. VAT is generally considered as a federal tax and levied by federal government to ensure uniformity in commodity taxation across the states. Since sales tax is the major source of revenue of state governments, approximately 60 percent of own tax revenue, it's replacement by VAT would have different implications of federal fiscal arrangement in India (Gurumurty 1993). Though state governments rejected central VAT, there are efforts to implement VAT at the state level. There is a lot of confusion about its manner of implementation (whether origin or destination based) and its consequences on federal fiscal system in India.

With the opening up of the economy, intergovernmental fiscal arrangements and institutional framework.

The major impact of the reforms is likely to be through the indirect and more long term effect of the shift in policy from widespread governmental intervention to more market oriented one with a reduced role for central planning (Gupta 1996). The reduced emphasis on planning is likely to bring more federal elements and will increase the responsibilites of the states. In the new economic environment, human resource development will be a mojor thrust area where state governments have a predominant role in providing social services like education, housing, welfare etc (Rao and Sen, 1996). This certainly increases the expenditure responsibilites of the states. On the political front also, the recent multi-party system due to emergence of the regional parties has increased the bargaining power of the states leading towards a decentralised market economy and towards a sort of true federalism.

Resource transfers is considered as the balancing factor in the center-state financial positions. But the aggregate transfers from center to states as a proportion of center's total receipt has, somewhat, declined over the last decade. Expect first and fourth plans, aggregate transfers from the center to states never exceeded one third of the aggregate central receipt but these transfers have been of great help for the states to caryy out their expenditure responsibilities. The transfers made through FC can be said to be free from discretionary interfercence from center than the PC. From early eighties, centrally sponsored schemes constitute around 35 percent of the total plan transfers and in most of the cases, state governments have to sponsor the matching portion which disturbs their own priorities (Shingh. S. 1980). Over a period of time, central loans have been a major part of the central transfers and state governments are indebted to center for servicing of their debts. It affects the autonomy of the states and their policies. Above all, the reduction of central loans to states compels the state governments to borrow from market at a higher rate of interest (Gulati and

George 1988). Today, interest payment is one of the major components in state government expenditures. To meet the expenditure, states have been continuously incurring over drafts and this over-draft facility has been remotely controlled by the central government. Therefore, central dominance is clearly reflected even after 50 years in every sphere of center-state financial relationship.

In recent times, the proceeds of the taxes levied by center constitute 2/3rd of the total proceeds from all taxes while the share of states is 1/3rd of total tax proceeds. The central government has been maintaining 2/3rd share in total tax proceeds without much tax efforts due to lucrative and elastic tax resources, states have been struggling to maintain their share (Raipuria 1992). It gives the indication of heavy dependence of the states on center over a period of time and shows the presence of high vertical imbalance in Indian federation. The share of the centre in the public sector outlay is very high in agriculture, 23 percent, rural development (70 percent), village and industry, 40 percent, and general education, 42 percent, which come under state list. Consequently, centralisation continues to dominate the Indian federation.

The focus of the present federalists is therefore decentralisation and subsidiarity. They seek to increase the participation of the common people over the decisions of the government that affect them most proximately. After fifty years of quasi-federalism in India, there have been pulls and pressures for limiting the centre's dominance, making room for what is called co-operative federalism and even some form of confederacy. In this context, the 73rd and 74th amendments to empower people to take decisions for provisions of public goods is a good step. Decentralisation of the authority to run the governments is market preserving which is a requirement considered indispensable for promoting growth and prosperity. Today, the debate is whether to have the merits of provision of public goods to match the tastes and preferences of the people by decentralised provision of services. Now the objective of decentralisation is to increase the efficiency of the public service provision to suite the tastes of the people. It is difficult to decide sitting at the centre what kind of health, education and other services ought to be provided in the states (Verma, 1994). In this context, the most debatable question is that what king of decentralisation and to what extent we should decentralise with financial constraints ? However, the 73rd and 74th constitutional Amendments have given a new dimension to Indian fiscal federalism. Now there has been a transition from two-tier form of federation to a three-tier form of federation.

In the last fifty years, the stress and strain experienced in federal relations have been largely the result of the difficulties faced by the states in mobilising resources to discharge teh assigned responsibilities. The acceptance by the sub-committee of the interstate council of the Sarkaria

Committee's recommendations that the consultations with the states in the council should precede any central legislation in the subject of the concurrent list may be perceived as a good step in this direction.

CONCLUSION

From the above analysis, it is evident that we have been examinig the division of resources and responsibilites between center and states for a long time on a trial and error basis to meet different national objectives at different times. This experiment is still on with changes like 73rd and 74th amendments to the constitution, efforts for value added taxation, economic reforms and 29 percent devolution formula etc. Though efforts have been made towards a full-fledged federation, we continue to have greater vertical fiscal imbalances at different levels of governments and horizontal fiscal imbalance across the levels of governments. The evolved Indian federalism is very unique in character and the union-state relationship has also become extremely comples.

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