

POLITICAL ECONOMY OF FISCAL FEDERALISM IN INDIA

A THESIS

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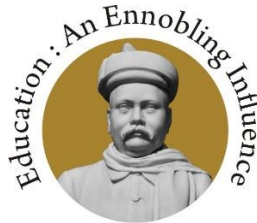
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CHAPTER - 1

INTRODUCTION

Fiscal federalism in India has its own characteristics and nuances. The patterns in Centre-State financial relations within the Constitutional framework of unique and well-defined transfers leave enough room for fiscal bargains and exigencies of coalition politics between the Union and the States. Understanding the framework of transfers in India requires an integrated view of the Finance Commission, the Planning Commission and the uneasy relationships between these two transfer agencies. It also requires an analysis of the discretionary transfers by Central Ministries. All these factors lead to a considerable variance in the funds transferred by the Centre to the different States. The persistent variability in transfers to different States is all the more interesting when one contrasts it against the stated objective of statutory arrangements, which is to use transfers as an equalizing instrument.

In this thesis, we analyze the trends in transfer of funds from the Centre to States in India and attempt to describe and explain the differences in fund transfers across States. In doing so, we check the validity of a rather popular argument in positive Public Economics; namely, Federal fund transfers are not just equalizing transfers, but rather are tools through which the Union of India enters political bargains with its constituent State units.

1.1 Why would political variables affect economic transfers?

The States are important for the Centre because of the powers of legislation that they carry in the Rajya Sabha. Further, States also function as useful means through which the political party at the “Centre¹” can access the remote voter. On the other hand, the Centre controls the funds in a constitutionally tax-centralized federal structure and wields control over the States by controlling some of the permissible routes through which transfers to States can be affected.

States and the regional parties in power are also important for the Centre particularly if there exists a coalition rule at the Centre, wherein a major National Party forms a coalition with State-level or regional or local parties. In India, the period after 1990 has been characterized by coalition politics. Weaker the position (in terms of number of seats held) of the major National

¹ The “Centre” henceforth refers to the Union of States

Party within a coalition, higher would be the possibility of using “discretionary” transfers to advance its own power within the coalition at both levels (Centre and the State). The term “discretion” has several connotations and meanings and hence, different usages. Discretion could be interpreted to be:

- a) being independent in an unconstrained manner
- b) practical intelligence exercised with a sense of balance of several considerations, and
- c) agreeing to others’ views with no reservations or surrender i.e. “bring at someone’s discretion”

Each of these interpretations can be witnessed in the discretionary transfers from the Centre to the States. There have been attempts by scholars to find causality between discretionary transfers and bargaining power of states (Rao and Singh, 2016). Some studies attempt to explain discretionary transfers to be a function of political and electoral variables (Singh and Vasishtha, 2016), whereas some position discretionary transfers to be dependent on political alignment of the States vis-a-vis the Centre (Khemani, 2003). Some studies have attempted to find causality between discretionary transfers and how close the State is to State Assembly elections (Dasgupta, Dhillon and Dutta, 2001). These kinds of arguments are fairly attractive and intuitively appealing. They help to relate the political aspects of the federal structure to discretionary transfers rather neatly.

However, to take such a view at its face value is to deny or ignore the complexity of the dynamics between Centre and States. Is it really possible to enhance scheme transfers to States merely because the State Government is the same as the one in power at the Centre? Is it really easy to transfer more funds to a State merely because elections have been declared therein? On the other side, is it possible to reduce transfers to a State just based on a political judgement about that State? Or could there be other factors that actually influence State-level differences in transfers?

1.2 Formulaic vs. Discretionary Transfers

It is important to note that transfers of funds from the Centre to the States in India are done under the recommendations of the Finance Commission, Planning Commission and Central Ministries.

The constitutional provisions provide significant powers to the Union Government of India through centralizing important, buoyant taxes while decentralizing expenditure functions to the State Governments. This creates a vertical inequality between the Centre and the States and a natural rationale for fund transfers from the Centre to the States. However, while providing for fund-transfers, in its wisdom, the Constitution does not provide the formula for the same. This is because the Constitution recognizes that the actual tax-sharing agreements between the Centre and the States should be dynamic and should change with the changing economic conditions of the country across time. For this purpose, the Constitution, under aegis of Article 280, provides for an institutional mechanism, namely, the Finance Commission to be set up by the President of India every 5 years, which then makes recommendations for tax sharing between Centre and States. The Finance Commission, under Article 275, also has the powers to recommend grants-in-aid to States to help to tide over revenue deficits. In this sense, the Constitution has created provisions to lend a flexible approach to the Centre-State fund sharing agreements.

So far, fourteen Finance Commissions have submitted their reports so far and their recommendations on tax sharing, grants-in-aid and other transfers have mostly been accepted by successive Governments. Finance Commissions recommend the overall percentage of tax sharing between Centre and States, and further also recommend the inter-se distribution of the shared resources based on a formula. The tax sharing component of the Finance Commissions is largely seen to be a formulaic transfer, whereas the grant-in-aid component is recommended in a more discretionary manner depending on the assessment of the needs of the States by the FC.

Given that the transfers made on the recommendation of the Finance Commission are largely formula-driven, they preclude any impact that political considerations and influences might exert on the process.

It is interesting to take note of another *non-Constitutional* institution that was in the making in the same time-frame as the making of the Constitution. In 1950, the Planning Commission was set up with a resolution of the Government, with the Prime Minister as the ex-officio Chairman.

The function of the Planning Commission was to assess the country's material, natural and human resources and to formulate a Plan to initiate investment planning in the State. The

Commission was also to review the progress of the Plan from time to time and recommend policies for successful implementation of the Plan (Planning Commission, n.d.).

The Government of India set up the National Development Council (NDC) in 1952 on the recommendations of the First Five Year Plan to secure co-operation of States in the execution of the Plan. Thus, the NDC was visualized in the role of an advisory body to help the States to create their own Plans. The idea was that the NDC would play the critical role of an integrator of State Plans into the National Plan and would assess the State's own resources for carrying out State Plan targets (Parvati, 2013). The NDC was to then recommend Central Assistance to State Plans from the Union Budget; if it found that the State lacked the resources to operationalize the approved Plan, to which it itself was an advisory. In its very set-up, thus, the NDC was a body that would create bargaining forum between the Centre and the States.

The Planning Commission used to recommend to the Government of India the amount of funds to be transferred to the States every year through Central Assistance to State Plans in every Budget. This Central Assistance was to be in the form of loans as well as grants. Thus, transfers done on the recommendations of the Planning Commission were somewhat discretionary and had an in-built element of political bargaining to it. However, over a period of time, these transfers too became increasingly driven by the Gadgil Mukherjee formula and hence became more predictable.

There is a third route of funds transfer to the State Governments. This is the fund transfer done by the Central Ministries. The Central Ministries (Agriculture, Health, Education, etc.) transfer funds to States for running developmental schemes with those funds. Those schemes which are directly implemented by the Centre are called as Central Sector Schemes. For example, the Crop Insurance Scheme (Prime Minister Fasal Bima Yojana launched in the 2017-18 Budget) or the Rashtriya Swasthya Bima Yojana (launched in the 2018-19 Budget) are Central Sector Schemes, which are implemented by the Union Ministry of Agriculture and Union Ministry of Health respectively. Apart from Central Sector Schemes, the Central Ministries also give funds for Centrally Sponsored Schemes (CSS). For example, Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA) is a Centrally Sponsored Scheme. CSSs are funded partly by the Centre and partly by the State Government. In contrast to Central Sector schemes, CSSs are implemented by the State Governments.

Transfers given by the Central Ministries for funding Central Sector and Centrally Sponsored Schemes are not formulaic and are at the discretion of the Union Government. Thus, the transfers given by the Central Ministries create a very interesting contrast when compared to the Finance Commission transfers, which are more formulaic in spirit.

Analyzing and contrasting the trends in these two routes of transfers would help us to understand if there are different sets of States that have stood to gain under the formula-driven and discretionary transfer routes. If there indeed are, and the States showing positive deviation from the formulaic transfers are the ones with political influence at the Centre (in terms of supporting the party in power at the Centre or in terms of being coalition partners), then it could indicate the validity of the conjecture mentioned above.

Nature of discretionary transfers

While carrying out this enquiry however, it is also important to bear in mind how the discretionary, scheme-based transfers actually work. The design of procedures and implementation of the Central Sector and Centrally Sponsored Schemes are normally created by the Centre. This is often necessary to bring about some uniformity in the implementation processes of the schemes in the different States. States have to create partial funding as is required by the CSSs and have to comply with the financial, administrative and implementation procedures mandated by the Centre for running the scheme.

It is here that an important issue arises. There are inherent capacity differences amongst States. Different States would have differential administrative and financial capacities. There would prevail differences in the capacities of local bodies of the different States, which, very often, implement the schemes. These differences could lead to differences in terms of receipt of funds under the schemes.

Major theme of the thesis

The major theme of the thesis is to identify those factors that lead to States getting differential transfers from the Centre. We thus wish to examine whether political considerations and influences have played a role in the discretionary transfers in India.

The thesis is organized as follows.

Chapter 2 offers a review of the literature that gives a sketch of the historical and political events that shaped federal structures across the world (USA, Canada, Switzerland and India). We also discuss the various asymmetries in the provisions of the Indian Constitution and how these accommodated the diverse regional, linguistic and religious identities in India. Fiscal federalism is largely a manifestation of the many contesting negotiations and bargains between the Centre and such pressure groups.

Chapter 3 describes design of fiscal federalism in India. It discusses the Constitutional provisions pertaining to the tax and expenditure powers of the Centre and the States. It also describes the workings of the Finance Commission, Planning Commission including the many unsuccessful attempts to reduce the proliferation of scheme-based discretionary transfers to States. States are not merely linguistically organized groups, but have emerged as pressure groups with strong political identities. These facts, together with the fund transfer mechanisms in India, create the *raison d'être* for the main hypothesis that the thesis wishes to explore and test for: Are Centre-State fund transfers in India impacted by political variables?

Chapter 4 presents an in-depth data analysis of Central transfers to fourteen large, general category States in India. Using cluster analysis, it examines whether Finance Commission transfers, Planning Commission transfers and discretionary transfers by Central Ministries to States are influenced by the political alignment of the State with the Centre.

Chapter 5 presents a view of how the inherent design elements of scheme-based transfers can create differentials in the transfers to different States. Using the examples of three major schemes in India, it attempts to identify design level rigidities that could potentially lead to differences in State-level transfers. We offer major conclusions of this study in Chapter 6.

CHAPTER - 2

VERSIONS OF FEDERALISM: A HISTORICAL PERSPECTIVE ON BARGAINS, NEGOTIATIONS AND CONSTITUTIONAL SAFEGUARDS

Federalism and the options and arrangements of centralization and decentralization amongst federating units, form the cornerstone of the debate on governance models in literature. Federalism is a structure wherein the powers of governance are distinguished and shared between a Centre and sub-units or constituents. This is often accompanied by an institutionalization mechanism coded and defined within a constitutional frame. Such a structure is viewed to be one way of offering autonomy, security, experimentation and policy flexibility to protect group identities in a nation. Such group identities could be based on geography, religion, ethnicity, castes or language. Thus, federalism is often seen to be a panacea in “plural democracies”. World Bank reports indicate that more countries have devolved fiscal powers to sub-national units over a period of time, indicating that federalism has been sought as a solution to the rigidities inherent to those countries (Norris, 2008). However, there also exist reverse claims: Too much autonomy for the constituents encourages bitterness and eventually could lead to secession in countries already made fragile by the group identity conflicts. Some IMF reports claim that except for transition economies, the level of decentralization in countries did not change significantly and substantially from 1990 to 2008 (Dziobek, Mangas and Kufa, 2011). Recent research also points to a move back to “recentralization” in some European countries like Netherlands and Sweden, primarily to enforce uniformity in critical issues such as health spending (Saltman, 2008, pp.104-106).

In most of the countries which host a federal model today, federalism exhibits a Principal-Agent framework, where constituent units surrender partial submission of their autonomy into a federation after securing rights to their essential identities. How much autonomy the constituents are willing to give up, and what type of autonomy structures are considered critical for survival by the constituents, creates the stage for bargaining. The constitutional framework sets the code for autonomy, bargains and alliance between the Centre and peripheral units.

Interestingly, even after adopting federalism, one finds that Centre-State relations go through interpretation, re-interpretation, appeasement, bargain, commitments, conflict, adaptation and

even skirmish and secession, or threats thereof. These factors affect the texture and meaning of federalism within each country uniquely. Federalism thus comes across as an overall principle of governance which is a result of multiple bargains between constituents which get manifested formally in the Constitution, but yet within the limits of the Constitution, it offers the Centre as well as the State further room for negotiation.

The political, ideological, cultural, ethnical dimensions of these bargains also create an impact on the design of federal finance and thus, on fiscal federalism.

In this chapter, we take a review of the literature that gives insights into the historical and political events that shaped federal structures across the world (USA, Canada, Switzerland and India). Research papers pertaining to Indian federalism in general and Indian fiscal federalism in particular have been reviewed in greater detail. The historical perspectives developed in this chapter will form the necessary background for analysis and appraisal of Central-State financial relations in India.

2.1 The American Federalism Model

The federal arrangements in the USA evolved out of the need of defence. The Revolutionary War between Britain and thirteen of its colonies led to the colonies successfully gaining independence from Britain and resulted into the “Articles of Confederation” in 1781. The Articles established a Confederation of States, which would unite for purposes such as defence, but in which the State Governments would be more influential in all other matters of economic, social and developmental policy. However, Alexander Hamilton, James Madison, George Washington and other national leaders called a Constitutional Convention to “correct” the Articles; it is after this Convention that the first American Constitution was produced in 1787 (Rakove, 2010, pp.137-145).

The Constitution set up federal arrangements in the country; this was seen to be one of the first such political experiments in the world. It is important to note here that the States came together voluntarily in order to form a federation. However, to call it a vanilla “coming together” federation might also be perhaps simplifying the issue too much. A union of the Northern States with their liberal outlook and the Southern States with their pro-slavery bias was more of a bargaining coup pulled off by the Constitution makers (Stepan, 1999).

One of the said goals of Madison and others was to give representation to the States based on population. However, the smaller States felt that this would lead to their interests not being represented properly. The pull of the contrary forces resulted in the Constitution providing for a Senate, in which every State would have equal representation and the House of Representatives in which the representation would be proportional to the population. The problem was that the Southern States had a huge population of slave workers, and were aggressive in terms of not doing away with slavery, which created a quandary for the Constitution makers. The result was the creation of the highly debated and debateable “three-fifths” clause (Waldstricher, 2010, pp. 3-21). Under this Constitutional provision, representation in Congress was to be based on "the whole Number of free Persons" and "three fifths of all other Persons."

The clause thus gave additional representation to the Southern States in the House of Representatives. Many political observers argue that the Constitution of USA thus protected and promoted slavery, albeit not in an obvious manner. Another consequence of the three-fifths clause was the fact that the Southern pro-slave States always had higher power, leading to larger control over politics. All Presidents between 1788 and 1850 have either been slave-owners themselves or Northerners with a pro-slavery bend.

This covert approval of the Constitution to slavery also seems to have manifested itself in the many Congress debates. By the 1850s, there were vocal dissents recorded on whether slavery was a matter for national or state policy. Many Southern politicians openly threatened nullification (of federal law which the State deems unconstitutional) or secession from the Union if the pro-slavery Constitutional provisions were changed (Finkelman, 2015).

In 1860, with Abraham Lincoln becoming a President of the USA and calling for abolition of slavery, the Southern States decided to secede from the federation. Thus, led by South Carolina, 11 Southern States seceded from the USA and formed their own country called the Confederation of States. This was not acceptable to the Central Government and the Civil War was launched in order to preserve the federation. The Civil War ended in 1865 with the Federal Government defeating the Southern States. A huge effort was launched to re-build the infrastructure in the South.

A striking constitutional consequence of the Civil War was the passage of the 13th Constitutional Amendment which ended slavery in the USA forever. In 1865, the Supreme Court also ruled in favour of a “perpetual union” i.e. the decision to secede from the Union was decreed to be unconstitutional and illegal.

The most interesting part about the secession is the following. Had the 15 States which seceded from the Union in 1860 remained inside it, the Constitutional Amendment abolishing slavery could never have been passed given their control over the legislature of the USA. Thus, ironically, the unconstitutional act of secession was what eventually allowed the USA to pass a Constitutional Amendment regarding abolition of slavery.

American history of federalism thus, goes to indicate that federal arrangements are themselves the result of negotiations and bargains. Once the arrangements are in place too, there is room for negotiations within the limits set by the Constitution. The negotiations themselves set the stage for constitutional amendments and in the event of such an amendment being denied or rejected, could lead to calls for skirmishes or even secession.

2.2 The Canadian Federalism Model

The aforementioned event of the Civil War of the USA has a great contextual importance, when one views the model of federalism that Canada adopted. In Canada, or the “British colonies of North America” (BNA), there was a recognized need for a strong Central Government that could protect the Province of Canada (including Province of Ontario and Province of Quebec), Nova Scotia and New Brunswick against aggression from the British and also ward off any possible annexation moves from the USA. There was thus, a recognized need for defence, which sparked off the process of the provinces coming together in a federation. However, the French Canadians living in Quebec were reluctant to join in the federation, realizing that doing so would push them into a minority at a national level. In fact, it was at Quebec’s insistence that a federal mode of governance was accepted by Canada (Bélanger, 2000).

Thus, on one hand, there were cultural forces demanding more powers at a sub-national level. On the other hand, the recently concluded Civil War in the USA had demonstrated that powerful sub-national governments also pose a threat of secession and hence, some leaders also desired the Constitution of Canada to be more unitary. Quebec’s demand for federalism was accepted,

but the federal model ultimately adopted by Canada was one, which was highly biased towards a strong Centre (Moore, 1997). Hence, the Canadian federal arrangements have been termed as “quasi-federal”.

In the words of John Alexander MacDonal, the first President of Canada (MacDonal- Laurier Institute, n.d.):

It has been said that the United States Government is a failure. I don't go so far. On the contrary I consider it a marvelous exhibition of human wisdom. It was as perfect as human wisdom could make it, and under it the American States greatly prospered until very recently; but being the work of men it had its defects, and it is for us to take advantage by experience, and endeavor to see if we cannot arrive by careful study at such a plan as will avoid the mistakes of our neighbors. In the first place we know that every individual state was an individual sovereignty - that each had its own army and navy and political organization - and when they formed themselves into a confederation they only gave the central authority certain specific rights appertaining to sovereign powers. The dangers that have risen from this system we will avoid if we can agree upon forming a strong central government - a great Central Legislature - a constitution for a Union which will have all the rights of sovereignty except those that are given to the local governments. Then we shall have taken a great step in advance of the American Republic.

The Canadian Constitution deviated from the American Constitution in two important ways; one, it created federal arrangements with strong unitary features (Bélanger, 2005), and two, it contained asymmetries vis-a-vis its federal components. A federal arrangement is said to be asymmetric when all constituent units follow the same Constitution, and enjoy the same Constitutional status, but some constituent units have more autonomy than the others within the Constitutional framework itself. As has been mentioned earlier, the French-speaking population in Qubec was apprehensive about entering the Federation since they would be in a minority in the Federation. The English speaking population in Quebec was worried about being a minority in a French-speaking province, should the new Federation give too much autonomy to the provinces. The Federation, as a whole, could not really be formed by leaving out such a significantly huge territorial part of the State.

From all these tussles emerged an asymmetric Constitution, which created certain provisions specifically to include Quebec into the Federation, not unlike what India would do some 80 years later through Article 370 to include Jammu and Kashmir in the Union. Thus, Quebec was given special treatment through certain provisions. In the House of Commons, the number of representatives from each Province was to be determined by Representatives to Population ratio, but Quebec was given a block representation of 65 seats. Thus, even if the population growth in the French speaking Quebec did not keep up with that witnessed in the rest of the Provinces, it would still be assured of a voice at the Centre. The other interesting provision was that linguistic rights were given to Quebec so that the debates in the Legislature or the work in the Courtrooms could be carried out in English or in French.

Similarly, the Constitution provided for three of the Supreme Court judges to be from Quebec. The other nine provinces would also have a representation in the judiciary, but no Constitutional provisions were made to assure the same.

Again, one finds the Constitution to be a manifestation of the tussle between constituent units trying to protect their linguistic or cultural autonomy and a Centre, trying to create a Union of such constituents.

2.3 The Swiss Federalism Model

Halfway across the globe, a series of events in Europe moved the Cantons of Switzerland towards federalism in 1848. After winning over Napoleon, there was a movement all over Europe to restore power of the countries to pre-revolution levels. In this movement, the Cantons of Switzerland got full provincial autonomy except for foreign policy and military control. With the French Revolution in 1830, liberal ideas made their way into Switzerland. Many of the bigger Cantons started making changes to their Constitutions so as to make freedom and equality fundamentally available for their citizens. The Liberalist movement, which was making a mark across Cantons, also was successful in creating a platform for a liberal national government. However, the Conservative lobbies in the different Cantons opposed this idea of a Central liberal regime. After a civil war between the Liberalists and Conservatives, finally the “Sonderbund Alliance” of the Conservatives was disbanded and work started on creating a federal constitution (Jones, 2009, pp.85-87).

The disbanded conservative Cantons took help from conservative forces in the neighbouring countries of Austria and France, in a major deviation from the existing Constitutional framework which prohibited individual Cantons to directly venture into foreign policy. The federal components contained in the Constitution of Switzerland reflect an attempt to accommodate both the Conservatists as well as the Liberals. The pressure groups of Conservatives, backed by the foreign powers, were fairly influential in getting more autonomy to the Cantons constitutionally. Thus, the Swiss Constitution defines the powers and functions of the Centre rigidly, and leaves the residual powers to the Cantons, thereby reflecting a bottom-up approach to federalism. Similarly, all Cantons were allowed to retain their own Constitutions so long as the Canton-level Constitutions were not in direct opposition to the provisos of the federal Constitution. The ideology of the Liberals is reflected in the fact that in certain Constitutional provisions, the people are directly allowed to vote on issues; for example, the proposal for a Constitutional amendment must come either from the Parliament or from 100,000 voters directly.

The following table summarizes the central features of the federalism model as observed in each of the countries discussed above.

Table 2.3.1: Central Features of Federalism across Countries

Name of the country	Prominent features of Federalism
USA	<ul style="list-style-type: none"> • Precursor to modern federations • Constitution written in 1787 • Confederation of 13 Colonies had been established through the Articles of Federation; these were later modified into the Federal Constitution • Colonies came together into the Federation of their own volition: “Coming together federation” • Residuary powers with the States; powers of Central Government were defined and limited • Federal structure for judiciary • Governor of States elected by people of the State • Federal taxation powers co-exist with State taxation powers

Name of the country	Prominent features of Federalism
	<ul style="list-style-type: none"> • National as well as State citizenship
Canada	<ul style="list-style-type: none"> • Often called Quasi-federal due to its unitary tendencies: More unitary than the USA • Constitution written in 1867 • French Canadians in Qubec wary of losing their majority in the Federation created a lobby for provincial autonomy • Civil war of the US demonstrated that a weak Centre might lead to secession from the federation • Residuary powers with the Centre; powers of States were defined and limited • Centre retains control over judiciary, but provisions of judiciary appointments from Quebec given constitutionally • Governor of States appointed and paid by the Centre • The Federal Government may raise funds by “any system of taxation” • No separate citizenship of States
Switzerland	<ul style="list-style-type: none"> • One of the most decentralized federal systems • Constitution adopted in 1848 • Civil war amongst the Conservatives and the Liberalists ended in 1848; 22 Cantons adopted the federal structure • Colonies came together into the Federation of their own volition: “Coming together federation” • Residuary powers with the Cantons; powers of Central Government were defined and limited • Federal structure for judiciary • Governor elected by people of the State • Federal taxation powers co-exist with State taxation powers • National as well as State citizenship
India	<ul style="list-style-type: none"> • Often called Quasi-federal due to unitary tendencies: More

Name of the country	Prominent features of Federalism
	<p>unitary than the USA</p> <ul style="list-style-type: none"> • Constitution adopted in 1950 • Constitutional federal features heavily borrowed from the Government of India Act, 1935 • Constitution was written to preserve the unity of India “Holding together federation” • Article 246, Schedule VII describes the functions under Union, State and Concurrent List; Residuary powers with the Centre • Federal structure for judiciary • Governor appointed by President of India • Taxation powers of the Centre extensive as compared to States • No separate citizenship of States

2.4 Asymmetries in Federalism

The above discussion shows that even while all the above mentioned countries namely USA, Canada and Switzerland adopted federal arrangements constitutionally, it was the unique historical, cultural, social, linguistic, political and economic forces that gave a different flavour (unitary tendencies or highly decentralized) to every country. The basic balance between the Centre and constituent units shaped each federal Constitution uniquely. This, in turn, dynamically fed into redefining the balance of power again. Thus, federal systems and their agents enjoy an interesting iterative relationship vis-a-vis each other.

William H. Riker, one of the more influential political scientists of the last century, takes a more restricted view of federalism. According to him, federalism (and he essentially analyzes only the American case) is only possible when a large number of constituent units come together and agree to give up part of their sovereignty willingly for defence, or commerce, or other purposes. Further, Riker stresses on the fact that federal systems are necessarily symmetrical; thus, each of the constituent units should necessarily derive the same benefits from the federation.

The commentary by Alfred Stepan (1999) on Riker is interesting, and argues that whilst the American model of federalism is more of a “coming together” federal structure, many democratic federations (such as India) emerge from a “completely different historical and political logic.”

Thus, in reality, constituent units may enter the federal structure with vastly different bargaining powers and hence the resulting Constitution, while it grants different competencies to certain States or groups of States, could still be inherently federal in its nature. These differences in the bargaining powers, which give rise to tensions between the Centre and constituent units, are referred to as “asymmetries”. Stepan’s argument offers an apt platform to view the political economy of federalism in India, which is discussed next.

2.5 The Indian Federal Arrangements

India has had a checkered history of federalism; the British model of administration in India had a strange combination of extreme unitary features vis-a-vis the Provinces and decentralized features vis-a-vis the Princely States. On one hand, all powers were concentrated in the hands of the Secretary of State, who governed the British provinces through the Viceroy of India, who in turn had all powers of the legislature, judiciary as well as the administration. On the other, the British had also allowed the Princely States limited autonomy over their own provinces (Rao & Singh, 2005, p.42)

2.5.1: Federalism in India: Pre-Independence to drafting the Constitution

To begin with, the British had kept the administration of the Provinces of Bombay, Madras and Bengal distinct from each other; in the earlier part of the nineteenth century, only the Bengal Province ran surpluses whereas the other two provinces normally ran deficits. In order to control the system better, every part of the expenditure as well as revenue structure of the Provinces was minutely examined by the Centre. This extreme centralization left the Provinces with no autonomy and also created inefficiencies at the Central level. It also created petty disputes between the Centre and the Provinces over getting funds sanctioned and expenditures audited. Surpluses in one account could not be diverted to another by the Provinces without express permission of the Centre and any reduction in overall expenditure could only mean lesser grants

in the next financial audit. Due to all these reasons, the Provinces exhibited a system of fiscal excesses despite the tightest possible control of the Centre.

Political and economic commentators were urging the British to change this arrangement in which inefficiencies and deficits had become a systemic issue. In 1870, Lord Mayo introduced his Decentralization Scheme through which a few expenditure heads such as prisons, police, education, medical services etc. were transferred to the Provinces, together with a provision of Rs.4.68 crores as an annual fixed grant from the Centre. Though this was a great improvement over the earlier system, it created another pressure within the Provinces. The grant was sometimes not enough to fund expenditure on the Provincial functions and hence, Provinces were forced to put local taxes into place.

Later, under Viceroy Ripon, it was recognized that a system of “fixed grants” was unfair and hence, further decentralization was put into place. Certain revenues (from public works and civil departments) were completely put under control of the Provinces. Land Revenue was put under the “Imperial Head” together with other revenues from Customs, Railways, Opium, Salt, Mint etc. For the first time, revenue from income tax, excise, registration etc. were to be “divided” between Centre and the States, the guidelines for which were to be revised every 5 years.

However, many of the Provinces found the guiding principles of revenue sharing to be totally arbitrary. The guidelines regarding which revenue sources would be devolved to the Provinces used to change arbitrarily; this added to inefficiencies in planning and also created mistrust between the Centre and the Provinces. To add to the problems, when the quinquennial assessments of the Provinces were carried out, the surplus of a Province, if any, was transferred to the Centre, creating a culture of overspending within the Provinces.

Lord Curzon, in 1904, made the quinquennial assessments “quasi-permanent”, implying that the revenue heads assigned to the Provinces would not be annulled except under extreme circumstances.

The true precursor of financial decentralization perhaps happened under the Montague-Chelmsford reforms culminating in the Government of India Act, 1919. Under this Act, divided heads of revenue were abolished completely and a clear separation was made between Central and Provincial revenue heads. For the first time, the Provinces were given express permission to

levy taxes on a number of subjects without taking permission of the designated British authorities. Further, local governments were also given the rights to directly take loans for development expenditure.

With these arrangements, the British Government estimated that the Centre would endure a fiscal deficit of Rs.9.5 crores whereas the Provinces would run a surplus of Rs. 18.5 crores. In 1921, a Committee set up under Lord Meston actually recommended that the Provinces give some contribution to finance the fiscal deficit of the Centre.

The Provinces perceived the guidelines for the contributions to be arbitrary and unfair and this again caused a great deal of angst amongst the Provinces.

The Montague-Chelmsford Committee (1919) had declared that another Committee would be set up after a period of ten years to assess the impact of the reforms and to “examine the state of Indian constitutional affairs”. And thus, the Simon Commission was instituted and came to India in 1928. Enraged by the fact that not a single member on a Committee set up to debate the Constitutional structure of India was an Indian, the Commission was met with protests and a complete boycott throughout the country. In the meanwhile, in response to a challenge thrown by the then Secretary of State Lord Birkenhead, Motilal Nehru created a draft Constitution called as the Nehru Report.

Although it was passed by a majority vote at an All Parties Conference in May 1928, Jinnah voted against the Nehru Report due to the fact that it did not support a separate electorate for Muslims. Further, it also demanded only a Dominion Status rather than full independence for India a fact which Jawaharlal Nehru himself was not acquiescent with. However, the Report was fairly successful in garnering support for the idea of a federal India.

In the 1930s, the issues of structure of governance were discussed in the Round Table Conferences, but the Congress did not participate heavily in them. The British realized that the demand for total independence would have to be acceded in near future; an intermediate system of giving responsible government to the people and yet retaining power in India was devised. This was the Government of India Act, 1935.

The Government of India Act outlined powers to be distributed to the federal, provincial and concurrent lists. It also provided for existence of a federal court to settle disputes between the Provinces. It divided the revenues for the different layers of Governments into 4 distinct categories:

1. Taxes to be exclusively levied and used by the Centre
2. Taxes to be exclusively levied and used by the Provinces
3. Taxes to be levied and collected by the Centre but used by the Provinces.
4. Taxes to be shared between the Centre and the Provinces

The Act also provided for certain grants-in-aid to be provided to the Provinces. The Neimeyer Award of 1936 gave practical shape to the provisos of the GOI Act of 1935. It was under this Award that a prescription was created to share a certain percentage of the Central revenue with the States and to decide on the inter se allocation of the taxes using a formulaic approach (Gopa, 2012).

Thus, a distinctive federal system of governance was beginning to take shape under the provisos of the Government of India Act, 1935. However, the Congress had intensified its struggle for independence and hence in the time period from 1935 to 1946, was more aggressive in pushing its demand for independence rather than entering debates on Constitutional structures for an independent India. In 1946, the Cabinet Mission came to India to discuss the potential constitutional provisions for an independent India and recommended that a Constituent Assembly be set up to draft the Constitution of India. Given the anxiety of the Muslim league towards an overly powerful Centre and given its aggressive demand for a separate Muslim State, the Mission recommended that residual powers rest with the States.

The GOI Act of 1935, recommendations of the Cabinet Mission of 1946 and the December Resolution of the Constituent Assembly in 1946 had logically created the platform for a federal structure in India, with residual powers resting with the States. However, the separation of Pakistan from India on the eve of Independence completely removed the necessity of a bargaining platform that the Centre would have to host vis-a-vis the Muslim League. Further, the separation in itself created an apprehension about potential secessionist tendencies of other

states, should the Centre be too weak. Eventually, the result of these forces was to create a Constitution that was highly centralized in its timbre (Rao & Singh, 2005, pp 46-49).

2.6 An analysis of asymmetries in Indian federalism

There were a number of asymmetries which the Constitution makers had to take into consideration in drafting the Constitution. The different stakeholder groups created huge pressure lobbies, which resulted in a Constitution that created ways of imparting more autonomy to certain groups based on religious, ethnic, linguistic or caste-based identities. The following discussion highlights some constitutional provisions which reflect these pressures.

2.6.1 Article 370: Special Constitutional Provision for the Accession of Jammu and Kashmir

The first asymmetry was in terms of addressing the integration of Princely States into India. Before partition of the country, there were 565 Princely States which enjoyed a fair amount of autonomy under the British Raj; these were given the choice of joining India or Pakistan. The Congress took the stance that leaving the Princely States out would be akin to Balkanization of independent India and hence took huge efforts to get the Princely States to accede to the Union. There were different reasons why the Princely States acceded; most important reason was that there was no unity amongst them. The Hindu states mistrusted the Muslim princes and vice-versa. The smaller Princely States were not sure that the bigger ones would help them in the event of any aggression. Finally, the Princely States were geographically dispersed and hence had very limited bargaining power vis-a-vis the Union of Indian States. Under the leadership of Sardar Vallabhbhai Patel and V. P. Menon, most Princely States were coaxed to join India over a period of time by allowing them administrative autonomy. However, as the State boundaries were eventually re-drawn in 1956 along linguistic lines, the presence of the acceded Princely States as a separate entity became non-consequential and thus, led to most Princely States losing their platform as a bargaining entity over a period of time.

However, the accession of the State of Jammu and Kashmir (J&K henceforth) became a complicated matter, largely due to the fact that unlike other Princes, Maharajah Hari Singh of J&K had not taken a stance to join either of the two countries by 14th August 1947. This indicated either that he was indecisive or wanted to stay independent. When he sent Standstill

Agreements to both countries, Pakistan signed the agreement but India refused making clear her intentions of getting Jammu and Kashmir to accede to it. Later, when Sheikh Abdullah was released from imprisonment, he, together with Nehru, became the Chief Architect of Article 370, with which J&K joined the Indian Union on 26th October 1947. Amongst other provisions, Article 370 provided the State of Jammu and Kashmir with its own Constitution, and also stated that the other Constitutional powers of the Central Government would apply to J&K only with the concurrence of the State Government. All other residual powers rested with the State's legislature.

Why were such special provisions created for the accession of J&K? Maulana Hasrat Mohini had famously asked in the Constituent Assembly debate on the Article 370 in October 1949, "Why this discrimination please?" In answer to this question, Gopalaswami Iyengar, PM Nehru's confidante on the issue replied that the discrimination arose from the fact that the part of the State itself was in the "hands of enemies and rebels" and hence its joining the Indian Union could not be considered on par with other Princely States since the situation there was "unusual and abnormal". Further, the state was under a UN peace treaty resolution and hence had to be handled differently (Mattoo, 2016). Given that PM Nehru had unilaterally broached the idea of holding a plebiscite in Kashmir to ascertain the "will of the people" to the UN, the accession of J&K to India had to be done on special terms (Kishwar, 2016).

Finally, the most obvious answer for the discrimination was the close proximity of J&K to Pakistan and its Muslim majority (in Kashmir), which gave J&K a very strong bargaining position vis-a-vis the Union of India. Rao and Singh (2005, pp. 66-67) compare the strength of the non-Hindu Muslim population in J&K to an equivalent non-Hindu Sikh population in Punjab to conclude that though Punjab could also have potentially bargained for special treatment on the strength of religious minorities geographically clustered within Punjab, there were two reasons why these attempts did not succeed. One, the Sikhs themselves were not very organized due to the trauma of the recent partition. Second, the "outside option" of "joining the Islamic State of Pakistan" was far less attractive and feasible for the Punjabi Sikhs as compared to the Kashmiri Muslims.

2.6.2: Article 371: Special Provisions for Preserving Ethnicity within the North Eastern States

The Constitution did not give special treatment to the State of Jammu and Kashmir alone. A “wide range of other safeguards” have been given to 11 other States within the Constitution; all of these are covered under Articles 371, 371A to 371H and 371J. Many of these Articles pertain to the North Eastern States and were written as Constitutional Amendments while re-drawing State boundaries along linguistic lines or while changing the status of the North Eastern States from Union Territories to individual States (Hausing, 2014).

During the linguistic re-organization of Indian States, as the name itself suggests, the factor used for re-organizing State boundaries was language, and not ethnicity. However, the States of the North East have been carved out using an entirely separate focus of not language, but of ethnicity. Whilst this could also be due to benign recognition of ethnic existence from the Centre, it also reflects usage of a unique bargaining platform that these small States were privy to: Their ethnic majorities, together with their strategic geographical positions, made them logical contenders to host secessionist tendencies. The geographical and cultural proximity of the population in some States such as Mizoram to China further accentuated their bargaining strengths.

2.6.3: Article 371: Safeguards, Linguistic Re-organization of States and the Case of Vidarbha and Telangana

The aforesaid Articles from Article 371 A – 371H do not only encompass special provisions made for the hilly, ethnically defined, economically less developed states of the North-East, but they also include provisions that give special status to or offer “safeguards” for parts of very well-developed States such as Maharashtra and Gujarat.

Article 371(2), which was created for Maharashtra and Gujarat in 1960, gives special responsibility to the Governors to establish separate Development Boards in the States for the Vidarbha and Marathwada areas in Maharashtra and the Saurashtra and Kutch areas in Gujarat, to make sure that budgetary allocations are equitable across the State. Vidarbha, Marathwada, Saurashtra and Kutch earlier belonged to different States and were combined to form the State of

Bombay in 1956. Later in 1960, the Bombay Reorganization Act truncated Saurashtra and Kutch from Bombay to form Gujarat.

In keeping with the arguments made earlier in the chapter, it is possible to position the special status under Article 371 (2) as a commitment being made by the Centre towards the economic development of those parts of the State that have newly been inducted into the State through the re-organization. In the absence of such a commitment, there could be obvious repercussions of the new linguistic States not giving enough allocations to the newly inducted geographical areas resulting in demands for secession from the linguistic State.

Leaders from the Marathi-speaking Vidarbha as well as the State Re-organization Committee (SRC) had favoured a separate State of Vidarbha with Nagpur as the capital. However, with Ambedkar's insistence on the principle of one language- one State, Vidarbha was merged into Maharashtra and Nagpur lost its position as State capital. Another probable political reason for including Vidarbha in Maharashtra was that Vidarbha was a Congress stronghold and its inclusion in Maharashtra would greatly aid the Congress in retaining its position at a State level. The apprehensions of the local elements demanding a separate Vidarbha were appeased by creating a special provision- Article 371 (2) in 1960 (Pitale, 2009, p. 282).

However, after the formation of Maharashtra inclusive of Vidarbha, the resource allocations done in Maharashtra were seen to be highly biased towards the politically savvy region of Western Maharashtra. This led to a huge disparity between the development profile of Vidarbha and the rest of the State.

The Dandekar Report quantified the regional imbalances in the development profile of Maharashtra in 1983 itself. Politically, the imbalance manifested itself in repeated demands for a separate State for Vidarbha. Many of the Lok Sabha constituency seats in Nagpur, Chandrapur etc. have been won by politicians supporting the cause of a separate Vidarbha, thereby showing the popular will in the region.

The movement for a separate State gained momentum in the eighties. Resurgence of the secessionist tendencies led to action and finally, in 1994, thirty four years after it was written, Article 371(2) was invoked by the Government of Maharashtra to set up the Vidarbha Statutory Development Board.

However, even setting up the Board has not solved the issue. The problem with Development Boards is that they are given responsibility of development plans and are also expected to raise funds for the same. After creation of the Development Boards, the State Plans devolved equal amounts of funds to the Development Boards in Vidarbha, Marathwada and Western Maharashtra. However, the Vidarbha Development Board, due to the backward profile of the region, could raise only one-fifth of the revenue that was raised by the Krishna Valley Development Corporation in Western Maharashtra (Ganguly, Diamond & Platner, 2007, p.216). Thus, the regional imbalance has continued due to a number of reasons despite the Constitutional provision being made to avert the same problem.

There are instances of similar stories in the country; however, some stories had drastically different endings in that the regions separated from the States. The most notable number of separations in recent times were seen when the new States of Chhattisgarh, Uttarakhand and Jharkhand were formed on the 1st, 9th and 15th November 2000 respectively. Telangana was declared as a separate State in 2014. Whilst the linguistic reorganization exercise of 1956 clubbed populations with same languages into geographical areas, there were regional identities even within people speaking the same language, for which safeguards were being demanded. These identities did assert themselves at the time of linguistic re-organization too; the Jharkhand and Telangana leaders had asked for a separate state based on regional identities. But in the case of Jharkhand, the SRC was not convinced of a separate existence given that there were several sub-tribes within the region and there was no one criterion on the basis of which the re-organization could be considered. In Telangana, SRC was against the merger of the Telugu-speaking part of Hyderabad with Andhra State, but the merger happened after the leaders affected a soft safeguard in the form of the “Gentlemen’s Agreement.” This soft safeguard failed to play its role and eventually translated into the 32nd Constitutional Amendment to give legality to the 6-point program for the development of Telangana. When even the constitutionally provided safeguards failed to result into proper economic development, the agitation reached a peak and Telangana was given a separate existence.

In Jharkhand, the issue was of one of socio-economic exploitation of the Bihari tribals by the Bihari non-tribals (Chaudhuri, 2000). Over the years, the mineral resource rich areas of Chhota Nagpur and Santhal Pargana in Jharkhand continued to be over-exploited, whilst the racial

discrimination of the tribals by outsiders, or “dikus”, as they are called in the local dialect, continued unabated. The case of Uttarakhand, on the other hand, is that of a regional “identity” rather than being one of economic exploitation. There was no common ground for culture, traditions and language between Kumaon and Garhwal regions and the rest of Uttar Pradesh; in fact the traditions of Kumaon and Garhwal found greater resonance with the people in Himachal Pradesh rather than with Uttar Pradesh.

Thus, three distinct entities are observed in the above discussions, namely, the Centre, the linguistically re-organized States, and the regional identities within the States based on culture, ethnicity, traditions, deities, education, geography, religion, castes etc. The Articles are one way of the Centre offering safeguards to the most distant entities affected by the laws i.e. the small groups within the States so that the autonomy offered to the States would not stand misused. Of course, just provisioning is hardly a guarantee for enforcement; as Dr. Ambedkar himself said in his last address to the Constituent Assembly:

The working of a Constitution does not depend wholly upon the nature of the Constitution. The Constitution can provide only the organs of State such as the Legislature, the Executive and the Judiciary. The factors on which the working of those organs of the State depend are the people and the political parties they will set up as their instruments to carry out their wishes and their politics (Lessons for today in Ambedkar’s last address to the Constituent Assembly, 2017).

These dynamics between the Centre, States and groups would lend themselves very well to a game theoretic situation with the different players playing for autonomy. One could argue that these games would essentially be multiple-equilibria games, with some eco-political strategy combinations leading to groups getting their rights recognized within the re-organized States and some eco-political strategy combinations leading to the constituent group breaking away to assert its own identity.

2.6.4 Article 44, Article 30: Autonomy to religious minorities

John Stuart Mill had given an opinion that democracy cannot exist in the face of deeply divided societies. In stark contrast, the theory of Consociation believes that democracy can hold its own

even in the face of deep social divisions, but the resulting democracy always exhibits power-sharing structures politically (Lijphart, 1996). These are:

1. Federal Arrangements in which the State borders get defined linguistically, thereby protecting groups with the same language
2. Rights given to religious minorities to establish their own schools, which would be funded by the Federal Government
3. Existence of separate personal laws for religious minorities
4. Proportional representation to group identities

The Indian democracy in fact, exhibits all of the constitutional arrangements mentioned in the consociation theory. A discussion on the Constitutional provisions that facilitated linguistic re-organization of the States, has been presented in the earlier section. However, in a country where the Hindu population was 83 per cent of the total population at the time of independence, and especially in face of the partition of the economy, clearly, linguistic autonomy would not be enough to give a signal of stability to the minorities. The Constitution gave recognition to 5 religious groups as National Minorities namely, Muslims, Sikhs, Christians, Buddhists and Parsis (Nahar, 2007). Separate personal laws were allowed for Hindus, Muslims and other religious minorities. Examples of such laws include 1955 Hindu Marriages Act or the 1937 Muslim Personal Law (Shariat) Application Law etc.

The Constitutional debates on personal laws make for interesting reading and amply demonstrate the kind of pressures that existed on the Constitution makers to safeguard the identity of every religion by accepting their rights to their separate personal laws, especially in the case of inheritance, divorce petitions etc. Interestingly, it was not only the Muslims who were keen on safeguarding their personal practices, but also Hindus. Dr. Ambedkar seems to have made a plea for “social reform”, recognizing that only a constitutionally provided Uniform Civil Code could perhaps reduce the inherent inequalities in the society (Jaffrelot, 2003). “I personally do not understand why religion should be given this vast, expansive jurisdiction, so as to cover the whole of life and to prevent the legislature from encroaching upon that field.” However, as the bargain proceeded, all that the Constitution could eventually host was Article 44 of the Directive Principles, “The State shall endeavour to secure for the citizens a uniform civil code throughout the territory of India.” Nehru, in a bid to get the code passed, divided it into 4 parts and presented

it to the Assembly on 17th September 1951. The next 4 days saw some of the most bitter debates in the Assembly, with Hindu as well as Muslim Congressmen vehemently opposing the spread of a common law to their personal lives and practices as given in their respective religions. It is also pertinent to note that Dr. Ambedkar resigned from the Government on 27th September 1951 immediately thereafter.

Apart from allowing separate personal laws, the Constitution, after keen debates, also passed Articles guaranteeing the right of minorities (based on religion as well as language) to establish and administer educational institutions. These rights, given under Article 30, are a part of the Fundamental Rights given to citizens and hence have a status higher than other laws. These have to be seen on a backdrop of the anxiety of the minorities to access educational institutions which respect their linguistic and cultural liberties (Rahman, 2016).

2.6.5 Articles 330, 332: Proportional Representation to SCs and STs

An earlier reference has been made to Stepan's commentary on the US federal model to be a "coming-together" model of federalism. Stepan also believed that India hosted more of a "holding-together" federal model, in which he cites Dr. Ambedkar who said that the Constitution was designed to "maintain the unity of India- in short, to hold it together." An essential component of holding together the diverse cultures and inherent inequalities was also to create a Constitution that would not only allow "political democracy" but also "social democracy." Ambedkar's forceful arguments for abolishing untouchability translated into Article 17 of the Constitution. When Ambedkar's proposals for giving proportional representation to the SCs and STs through reservation of seats in the Parliament (Article 330), and reservation of seats for SCs and STs in the State Legislative Assemblies (Article 332) came up for debate in the Constituent Assembly, there was again a huge debate on whether these additional Articles were required after Article 17, in which "provision for eradicating untouchability has already been included in the Constitution." It was the forceful counter position taken by Ambedkar that "social, political and economic upliftment of the untouchables is not possible simply by making provisions and passing motions" that created the platform on which Article 330 was then passed in the Constituent Assembly (Mitra, 2012).

The above discussion looks at federalism from a historical perspective. The historical perspective creates an understanding of the forces and counter-forces that influenced the creation of respective Constitutions in the different countries. The discussion also suggests that socio, political and economic forces created asymmetries in the bargaining platform between the Centre and States in India. Federalism in India is a product of these unique circumstances and asymmetries. Thus, the above discussions go to illustrate the following points:

1. Federal arrangements are unique to the history and political context of every country.
2. While federalism necessarily implies distribution of powers and functions over two or more layers of Government, the distribution per se may not be symmetric vis-a-vis all constituent units of the federation. Thus, federations are asymmetric; in fact, this asymmetry is very often the necessary condition for the federation to exist
3. Definitions of constituent units in a federation are not inspired by the kinds of considerations discussed in economic theories. Efficiency considerations in economics often have to do with defining constituent units as per population size. However, the discussions of federal arrangements across the globe indicate that constituent units have been formed more often through political or regional or linguistic considerations rather than through economic considerations.
4. One of the main political reasons for federations to exist is protection of regional identities, wherein the groups might be defined geographically, linguistically, or ethnically.
5. Thus, federalism is the outcome of the strategies employed by the Centre, States and groups within States in a game-theoretic framework. The Constitutional provisions are the manifestations of the eco-socio-politico strategies used by the players.
6. Bargains, negotiations, commitments and safeguards are often useful lenses from which to view the unique federal structure of a country.

A study of the history of federalism thus enables us to identify the nature of bargains and negotiations that occur between the Centre and the constituent units. It is in the context of such bargains and negotiations that the unique structures defining federal finance are created. In the next chapter, we study the design of fiscal federalism in India.

CHAPTER - 3

DESIGN OF FISCAL FEDERALISM IN INDIA

We have sketched the pulls and pushes that were involved in defining the Indian federal structure in the earlier chapter. At the time of Independence, there were serious and significant political tensions and divergences between the Union and the States. Different political circumstances at the time of accession to the Indian Union implied that the Constitution had to create certain special provisions in order to accommodate the security and autonomy of some Princely States.

States as we know them today were created later as constituent units along linguistic lines and/ or along “ethnic”¹ lines. This is a different way of designing constituent units than how they would be designed using economic considerations alone.

However, despite having created the constituent units through other-than-economic considerations, the constitutional design of Indian fiscal federalism embodies certain critical economic principles. Firstly, the most buoyant taxes with high allocative impacts have been centralized. Secondly, the Constitution delineates expenditure functions of the Centre and the States clearly and delegates local development tasks to the States. This centralized design of taxation and decentralized system of allocation (of functions) creates a vertical imbalance and leads to an inherent case for transfers from Centre to States. In designing the transfers however, there is also recognition of the horizontal developmental inequalities between States themselves. Thus, while transfers are a consequence of vertical imbalances, they are treated to be means of correcting the horizontal imbalances as well.

It is interesting to note that the Constitution does not create any pre-conceived guidelines for transfers; this would have created unnecessary rigidities in transfer designs. Instead, the Constitution provides a statutory (binding) institutional mechanism of the Finance Commission under Article 280, which is set up by the President every 5 years and is assigned the task of designing the transfers from Centre to States. Union to State transfers as well as inter-se distribution of funds amongst States are recommended by the Finance Commission.

¹ Punjab and Haryana, for instance, were created along religious ethnicities rather than on a regional basis.

However, the design of intergovernmental transfers in India post-independence had an overbearing influence of a non-statutory body, namely, the erstwhile Planning Commission. Planned development as envisaged by the Planning Commission exercised significant influence in defining the expenditure programs of the Centre and States.

These two routes of transfer *pari passu*, namely the Finance Commission and the Planning Commission, created a unique process in Indian fiscal federalism. Apart from the Finance Commission and the Planning Commission, fund transfers to States have also been effected by Central Ministries through the Central Sector and Centrally Sponsored Schemes. The Central Ministry transfers are discretionary in nature and hence lend themselves to an interpretation of being tools to wield control over States.

In this chapter, we study the unique framework of fiscal federalism in India.

The chapter is organized as follows. Section 3.1 describes the constitutional provisions pertaining to revenue and expenditures of the Centre and States. Concentration of taxation powers with the Union Government and allocation of expenditure functions to the States creates an inherent case for fund transfers from Centre to States. Section 3.2 describes the fund transfers done through the Finance Commissions. Section 3.3 comments on the evolution of the Planning Commission as a bargaining platform between Centre and States. The States have been vociferous in demanding a re-look at Centre-State relations on different fora from time to time. These demands have led to the setting up of various Committees on Centre-State relations. The Committees have examined the overall friction points between Centre and States and have also given recommendations for reducing the irritants in fiscal transfers. The recommendations of the Committees have been examined in Section 3.4. Section 3.5 describes the discretionary fund transfers given by Central Ministries through Central Sector and Centrally Sponsored Schemes. It also reviews the recommendations given by the Chaturvedi Committee on restructuring the Centrally Sponsored Schemes and flags the major issues and challenges concerning Centrally Sponsored Schemes. In Section 3.6, we create the main hypothesis for our study: Are Central-State transfers in India affected by political variables and coalition arrangements?

3.1 Expenditure and Revenue Powers assigned in the Constitution

The Constitution of India creates a clear listing of the developmental responsibilities and taxation powers of the Centre and the States. It is only after passage of the 73rd and 74th Constitutional Amendments that rural and urban local bodies were given a constitutional existence and hence were included, albeit obliquely, with same spirit but very different manifest expression in the fiscal decentralization design of the Constitution. This created the constitutionally recognized third layer of Governments in India. However, in its original arrangements, the Constitution recognized only two layers of Government, the Union and the States and hence, the expenditures and revenues of both these layers of Governments were delineated clearly in the original Constitution.

3.1.1 Normative Principles of Decentralization of Expenditures

The Constitution demarcates the functions assigned to the Union Government and State Governments exclusively. It also demarcates those functions which could be controlled concurrently by both Governments. This listing of functions is given under Schedule VII of the Constitution. One of the main reasons for decentralization of functions or expenditures was the huge heterogeneity in the resources, legacies of policies and observed levels of economic development across States. Decentralization is intended to impart flexibility to the State Governments to provide relevant services to the people as per the unique conditions and requirements in the different States, thereby enhancing public welfare.

Normative literature on fiscal federalism states that decentralization can usher in welfare. The Decentralization theorem given by Oates (1999) states, “In absence of cost-savings from centralized provision of a local public good and of inter-jurisdictional externalities, the level of welfare will always be as high (or higher) if Pareto-efficient levels of consumption are provided in each jurisdiction than if any single uniform level of consumption is maintained across all jurisdictions”. Thus, decentralization allows for higher levels of welfare, since the needs of people differ across localities. Local governments can perceive and respond to local needs of the public and provide for optimal quantities of public goods.

Oates (1997) points out yet another advantage of decentralization. When there exist decentralized layers of governance, the Federal Government may ask the State governments to

experiment with legal frameworks concerning say, environment, before it creates a central legislation regarding the subject. Oates refers to this phenomenon as laboratory federalism. Laboratory federalism offers the Centre a chance to gauge the effectiveness of its policies before trying it out at a national level. In the Indian context, the Constitution confines the scope of laboratory federalism to functions under State or Concurrent list. In recent times, there have been a few examples of States experimenting with the given subjects innovatively. For example, Haryana and Rajasthan amended their State laws to make minimum education a qualification for contesting elections at the Panchayat Raj level. Similarly, Rajasthan also initiated experiments with labour law reforms, which are covered under the State list (Panagariya & Rao, 2015). Another interesting example is that of Agriculture Market Regulation. Since this is a State subject, different States have written their own laws. However, in writing these, they have been guided by the Model Law written by the Union Government.

Inman and Rubinfeld (1992) have included political variables to explain the advantages of decentralization. They argue that citizen involvement and efficiency increase as the size of the Government reduces. In their research, they create a “federalism frontier” in which only reduced political interference can usher in economic efficiency. This trade-off itself creates a case for decentralization.

Along similar lines, Brennan and Buchanan (1977) liken the Federal Government to a Leviathan, which would keep on drawing taxes from the public in order to grow larger in size. There is a case for decentralization wherein the Leviathan gets controlled and the centre and the state continue to exert control over each other.

There are several other research studies that emphasize why decentralization is beneficial. Some authors stress on the fact that voters can identify decision-makers and can hold them responsible for service delivery, enhancing efficiency (Persson and Tabellini, 1994). There are others who point out that decentralization reduces rent-seeking since the size of the rent reduces (Sato, 2003).

Advocates favouring decentralization have also argued that decentralization and economic growth are positively correlated (Huther & Shah, 1998). According to Oates (1993), it is evident that decentralization and growth are positively correlated because Centre’s share of taxes in

developed countries is only 65% as compared to the same in developing countries, which stands at 89%. However, their simultaneous causality makes this argument circular and tricky. Much as it is true that decentralization may spur growth, it could also be the case that the political will to effect decentralization is a consequence of growth.

Decentralization of functions to the States as contained in Schedule VII manifestly delegates as well as prohibits the functions to be allocated the sub-national level. And this de-cluttering or unbundling of functions into delegation and prohibition is perhaps, a significant aspect of decentralization.

Though the Constitution creates the framework for decentralizing some functions to the sub-national governments, this by itself is no guarantee for either efficiency in the provision of the same or enhanced welfare as a result of the spending. Bahl and Martinez- Vazquez (2006) suggest that fiscal federalism involves more than just devolving functions and revenue sources to local Governments. It also necessarily includes issues such as the administrative framework for implementing the functions, as well as political accountability. To the extent that the Government administration does not have the capacity to implement the functions and to the extent that elected representatives are not held accountable for the level of service delivery in the sub-national constituencies, constitutional provisions of decentralization would remain merely ornamental but devoid of creating actual impact.

Further, if constitutional provisions are to truly translate into good economic impacts, it is also necessary that fiscal decentralization follow a specific sequencing structure.

In the normative literature pertaining to sequencing of fiscal decentralization, conventional wisdom is that expenditure sources are decentralized first, next is the assignment of revenue or tax powers, and transfers from Centre to State are designed last. This pattern of sequencing fiscal decentralization is called “finance-follows-function” (Bahl, 2006). There are a number of reasons for this conventional wisdom.

Firstly, it is impossible to understand the revenue needs at a sub-national level unless the expenses to be undertaken locally are defined. Secondly, and more importantly, the design of the tax systems can follow logically only from the knowledge of pre-defined expenditure assignments. Once the nature of expenditure assignments is known, we can then envisage which

services can be taxed through user charges, which can be taxed through a region-based tax, and which expenditure programs can be sponsored through transfers (Bahl, 2006). Thus, knowledge of both quantity as well as design of revenue sources flows logically only from an expenditure assignment program.

Bahl's recommendation that good decentralization models should use the "finance-follows-function" sequencing framework is seen in the Indian model of fiscal federalism.

The design of sequencing fiscal decentralization embodied by the Constitution of India also seems to have a historical context and flows from the learnings of the pre-Independence period. As has been mentioned in Chapter 2, semblance to fiscal decentralization in India began only with Lord Mayo decentralizing some expenditure functions to the Provincial Governments with a fixed grant given to cover any deficits. This was obviously a flawed design in that it gave spending responsibilities to the sub-national governments without recognizing the fact that expenditure needs are extremely dynamic across time and across provinces. If dynamic needs of expenditure are clubbed together with static revenue assignments (which is exactly what happened under Lord Mayo's rule), then it creates resentment at the level of the sub-national governments, which are hard-pressed to create the amenities expected within the specified grants.

Under Lord Ripon, this was recognized and certain revenues were also decentralized, but the revenue heads could be and were arbitrarily changed every 5 years. This created issues in terms of clarity and in terms of the required planning of amenities at the decentralized levels of Government.

The design of federalism was thus, largely experimental in the period prior to Independence. The learnings from these experiments were then embodied in the Government of India Act 1935 in the format of a clearly delineated revenue and expenditure assignment to the different levels of Government in India. The fiscal federalism structure of the Constitution of India has largely evolved from the Government of India Act 1935.

Thus, in the Constitution of India, expenditure assignments to the Central, State and joint jurisdictions are clearly delineated in Schedule VII under the Union List, State List and Concurrent List. Further, the expenditure assignments have been designed symmetrically vis-a-

vis all State Governments, even if the initial economic conditions and administrative capacities in the States were not the same. This implies that all State Governments, irrespective of their initial conditions, have been given control over the same expenditure functions. Thus, one notes that while the Constitution of India gives an asymmetric political treatment to include the differential interests of group identities, it does not clutter the economic framework with asymmetries. (The asymmetries in the economic framework came about by virtue of transfers from the extra-constitutional Planning Commission, a point that will be discussed in the next section.)

Presently, there are 97 items in List I or the Union List (the last item is numbered 97), which enlist the functions and areas over which only the Centre may legislate. These include subjects such as Defence, Firearms, United Nations Organization, Extradition, Public Debt of the Union, Currency and Coinage, Reserve Bank of India, Banking, Insurance, Stock Exchanges, all taxes under the jurisdiction of the Centre, etc. List II or the State List contains 47 functions such as Police, Prisons, laws pertaining to Local Governments, Public Health, Agriculture, Water, Land, State level taxes etc. There are 66 functions in List III or the Concurrent list. The main functions include Criminal Law, Marriages, Property, Social and Economic Planning, Forests, Education, Narcotics, and Labour Welfare etc.

Thus, the Union List has a much broader scope than the State List. Further, the Union Government has got overriding powers to legislate on the subjects mentioned in the Concurrent List in case of any conflict (Article 254(2) of the Constitution). The residual powers i.e. powers to legislate over any function not mentioned in any of the three lists also rests with the Centre (Article 248 and Entry 97 of the Union List). Thus, the Constitution of India reveals dominance of unitary character rather strongly in the provisions pertaining to the decentralization of functions across the layers of the Government.

The highly controversial 42nd Amendment Act of 1976 transferred five subjects to Concurrent List from State List, that is, (a) education, (b) forests, (c) weights and measures, (d) protection of wild animals and birds, and (e) administration of justice; constitution and organisation of all courts except the Supreme Court and the high courts. Reasons were given to justify the decision to do so. For example, the arguments in favour of moving education from the sphere of State Legislature to the Concurrent List rested on different States exhibiting differential standards in providing higher

education. The move would facilitate Central Organizations such as the University Grants Commission or the National Council of Educational Research and Training to “use their power to shape the education of the country” (Ghosh & Mohan, p.67). However, whilst the transfer from the State List to the Concurrent List was backed by rational arguments, many observers have interpreted this to be a move towards further centralization (Debroy, 2015).

3.1.2 Taxation powers in the Constitution of India

The earlier section argues that the Constitution, much in keeping with the norms of sequencing the fiscal centralization, firstly creates a decentralized structure of expenditure functions. Whilst some functions are assigned exclusively to the Centre or to the States, some of the functions also have been designed to be undertaken concurrently.

However, there was no “concurrence” in tax assignments within the Constitution in the pre-GST era; thus, tax assignments were based on the principle of strict “separation” and were under the exclusive jurisdiction of either the Centre or the States (Rao & Singh, 2001).

Having said that, it is pertinent to note that the most broad-based, buoyant and productive taxes are assigned to the Centre (This pertains to the pre-GST scenario). Thus, taxes on income other than agriculture, tax from wealth other than agriculture, corporation tax, taxes on production (other than liquor, opium, hemp and other narcotics) and customs duties have been assigned to the Centre. Taxes on income and wealth from agriculture, transfer of property (stamp duties and registration fees), taxes on motor vehicles, transportation of goods and passengers, sales tax on goods, excise duties on narcotic substance for human consumption, alcoholic beverages, entertainment tax, profession tax, tax on trade, callings and employment and octroi have been assigned to the States.

Again, the nature of such centralized tax assignment, wherein the most buoyant and broad-based taxes are assigned to the Centre has its *raison d'être* in the normative principles of tax assignment. The basic principles of tax assignment suggest that taxes should be levied in a manner that brings about equity and efficiency, but at the same time should also be administratively simple. In most countries, it has been found that centralization of taxes satisfies these criteria rather well. There are three main reasons for this.

The first reason is that decentralization of taxes very often creates distortions in the movement of goods and services and mobile factors of production across tax jurisdictions. If tax decisions were

decentralized, it could lead to a “race-to-the-bottom” phenomenon with various tax jurisdictions reducing the tax rates to invite more investments into their respective regions. In the process of race-to-the-bottom, even collectible tax revenue remains uncollected and in turn affects potentially provided services.

Secondly, taxes are some of the most powerful ways of enhancing equity between citizens or groups of entities and equity, very often, is a federal objective. As has been outlined above, decentralized tax regimes could lead to perverse redistributive consequences and hence, federal Governments normally do not surrender their control over broad-based taxes.

Finally, it is important to “equate revenue means with revenue needs”(The World Bank Group, n.d.). If a particular Government layer is responsible for a particular objective, say, redistribution, then a broad-based income tax which helps to satisfy that objective should be levied by that layer. It is hence appropriate that taxes which lead to redistribution impacts, stabilization or resource allocations over sub-national jurisdictions should be assigned to the Centre. On the other hand, taxes that are designed as user charges, say tolls on roads, or taxes on immobile assets such as property could be assigned to the decentralized Government layers.

In India, the most broad-based taxes seem to be delegated to the Centre. However, a further administrative peculiarity of the federal system is that “assignment” of a tax to a particular layer of Government does not imply the right to appropriate the proceeds of the same. Following are the (pre-GST) Constitutional provisions for distribution of revenues between the Union and States of India:

Article 268: Duties levied by the Union but collected and appropriated by the States.

Article 268 (A): Service tax levied by Union and collected and appropriated by the Union and the States

Article 269: Taxes levied and collected by the Union but assigned to the States.

Article 270: Taxes levied and collected by the Union and distributed between the Union and the States.

Article 271: Surcharge on certain duties and taxes for purposes of the Union.

Article 272: Taxes which are levied and collected by the Union and may be distributed between the Union and the States

Article 275: Grants from the Union to certain States.

Article 276: Taxes on professions, trades, callings and employments.

The laws for determining the exact tax incidence for the taxes covered under Article 268, 268(A), 269 and 270 are passed by the Union legislature since the powers to levy the taxes rests with the Centre.

3.1.3 Goods and Services Tax (GST): Harmonization through Convergence and Centralization

With the passage of the Constitutional 101st Amendment Act, 2016 (for GST), some existing Articles of the Constitution were changed and some new Articles were inserted in the Constitution to allow the GST to function as a tax to be concurrently levied by both Union and State legislatures. Introduction of the GST implied a change in the base of taxation, wherein manufactured goods, services, sales as well as import/ exports were to be treated as “supplies” taxable under GST. Article 246(A) states:

Notwithstanding anything contained in articles 246 and 254, Parliament, and, subject to clause (2), the Legislature of every State, have power to make laws with respect to goods and services tax imposed by the Union or by such State. (2) Parliament has exclusive power to make laws with respect to goods and services tax where the supply of goods, or of services, or both takes place in the course of inter-State trade or commerce.

This implies that intra-State GST comes under the jurisdiction of both Centre and States, but inter-State GST will be under the sole jurisdiction of the Centre.

Similarly, Article 269 A (1) states:

Goods and services tax on supplies in the course of inter-State trade or commerce shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services Tax Council.

Thus, under this Article, GST will be levied and collected by the Government of India and shared between the Union and States as per recommendation of the GST Council. The provision to create the GST Council is given under Article 279(A). Further, the Article also comments on the procedural aspect of the tax and states that the apportionment of the GST will take place outside the Consolidated Fund of India.

The 101st Constitutional Amendment also necessitated some changes in Schedule VII. Similarly, some changes were required to those provisions which gave full residual powers to the Parliament; residual powers are now subject to Article 246 (A).

The GST Council consists of the Union Finance Minister as the Chairman, the Minister of State for Finance, and the Ministers of State for Finance or any other Minister nominated by all the State Governments. So, State Governments do find representation in the body that takes the decisions on rates and on classification of commodities. The minutes of the GST Council also indicate how vociferously States argue in favour or of against provisions when their autonomy is under question.

It is also pertinent to note that with the definition shift in the tax-base to “supplies”, the tax-base of the States has been significantly widened. Sales of services are also included in the tax-base. Very importantly, share in the tax on manufactured goods, services and import/exports has become in-built and is not dependent on the Finance Commission.

These arguments indicate that GST is an experiment in cooperative federalism and that it is a move towards decentralization in taxation.

However, there are arguments in literature which state that the GST ushers in an era of further centralization within the federal structure. This is because when the GST Councils fixes the GST rates, all goods and services are divided into categories and a rate is fixed for that category. Thus, States lose their autonomy in terms of shifting particular goods into lower or upper slabs.

The autonomy to the State is ruled out in that even if there are special requirements of certain types in a particular State, the State will have to accept the rule of the majority which emerges in the GST Council (Sampath, 2015). Thus, even with the rollout of the GST, the tax identity of the federal structure of India has continued to be rather centralized.

3.2 Centre- State Transfers in India and the Finance Commission

The above section describes that the more buoyant and productive taxes have been delegated to the Union. While the GST is a unique experiment in cooperative federalism with significant gains to Union as well as States, the overall tax design of the country is one with a bias towards the Centre.

On the other hand, the expenditure structure is fairly decentralized in keeping with the normative arguments of efficiency and welfare. The share of State Governments has only been one third of the

total taxes accruing to the Government sector, whereas their share in the total spending on economic services of India has been about 50 per cent and their share in the total spending on social sector has been 75 per cent (RBI Publications, 2011). Thus, there is a huge in-built vertical imbalance between revenue sources and expenditure liabilities of the Centre and the States, for the correction of which revenue transfers from Centre to States would be necessary.

In order to do this, the Constitution, in Article 280, provides for the creation of the Finance Commission. The Finance Commission is set up every 5 years by the President of India and recommends the exact share of taxes that would be distributed between the Union with the States under Article 270 of the Constitution. It gives formula based recommendations for the inter-se distribution of taxes. It also recommends grants-in-aid under Article 275 to assign additional revenues over and above the taxes assigned to the States so as to meet specific needs of some States. Thus, the Finance Commission is the constitutional mechanism for rectifying the vertical as well as horizontal inequality in the economy.

The Finance Commission typically has 2 mandates: 1) To recommend the share of the divisible pool of taxes which is to be devolved to the States 2) To give formula-based recommendations for inter-se allocations of these resources amongst States.

So far, fourteen Finance Commissions have submitted their reports and with a few exceptions, the Centre has accepted most of the recommendations of the successive Finance Commissions. The divisible pool of taxes is shared among States as per the distribution formulae devised by the Finance Commissions. While different Finance Commissions devised different criteria for tax sharing, most of them have adhered to population, tax collection share of the State, distance of the per capita State GDP from the best or average of best performers in per capita State GDP, infrastructure development, forest cover etc. as variables for determining the share of central resources with the states.

Upto the tenth Finance Commission, separate sharing criteria used to be prescribed for the sharing of Income taxes and Union excise duties, which were the two major taxes that were constitutionally divisible.

Table 3.2.1: Recommended Share of States in Major Divisible Taxes

(Per cent)

Finance Commission	Income Tax (%)	Basic Excise Duties (%)	Number of Commodities Covered
1	2	3	4
First FC (1952-57)	55	40	3
Second FC (1957-62)	60	25	8
Third FC (1962-66)	66.6	20	35
Fourth FC (1966-69)	75	20	All
Fifth FC (1969-74)	75	20	All
Sixth FC (1974-79)	80	20	All
Seventh (1979-84)	85	40	All
Eighth FC (1984-89)	85	45 *	All
Ninth FC (1989-95)	85	45	All
Tenth FC (1995-2000)	77.5	47.5 *	All
	All Central Taxes#		
Eleventh FC (2000-05)		29.5	
Twelfth FC (2005-10)		30.5	
Thirteenth FC (2010-15)		32.0	
# Inter se Share of States in net proceeds of all shareable union taxes and duties; * 40% of the net proceeds to be distributed while the remaining 5% would be earmarked for the non-plan revenue deficit States; ** 40% of the net proceeds to be distributed while the remaining 7.5% would be earmarked for the non-plan revenue deficit States.			

Source: Finance Commission Reports.

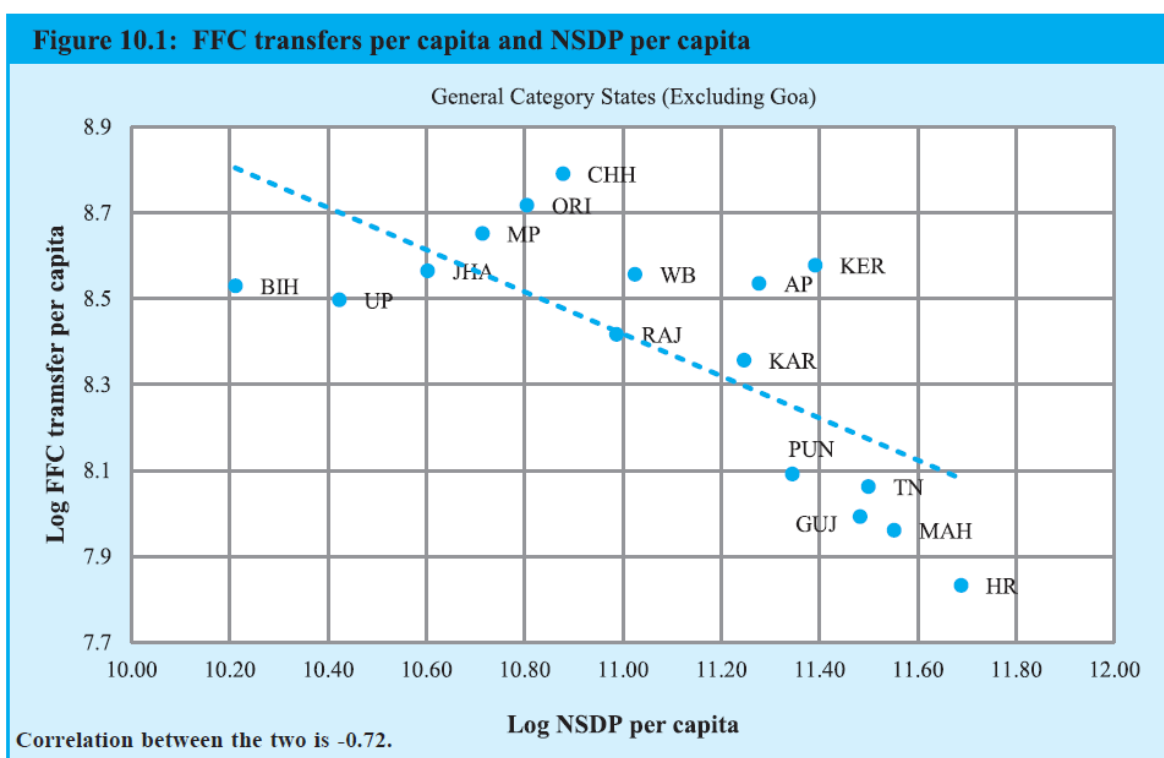
A major change towards simplification and rationalization in the design of the divisible pool of taxes was brought about by the Tenth Finance Commission. The Tenth Finance Commission recommended that Central Taxes such as Income Tax, Corporation Tax, Union Excise Duties, Customs Duties, Service Tax, Wealth Tax and Gift Tax be considered as a divisible pool for the purpose of tax

devolution to the States. This recommendation was accepted through passage of the 80th Constitutional Amendment in 2000 in which Article 270 was amended to include all taxes appropriated by the Centre as the divisible pool of taxes.

Tax devolution funds are untied funds i.e. they are not given to the State Governments for any specific purpose.

Studies suggest that sharing of taxes done by successive FCs has been progressive in nature, with the most developed states getting the least share in tax sharing and vice-versa. The following chart shows that there exists a broad negative correlation between NSDP per capita and Fourteenth Finance Commission (FFC henceforth) transfers per capita for the period 2011-14.

Graph No. 3.2.1: FFC transfers per capita and NSDP per capita



Source: <http://indiabudget.nic.in/es2014-15/echapvol1-10.pdf>

Apart from tax devolution, under Article 275, the Finance Commissions are also mandated to recommend general purpose grants or “grants-in-aid” to the State Governments. Grants-in-aid have been given for covering Non-Plan Revenue Deficit (NPRD), State-specific or sector-specific expenditure and under recent FCs, also for enhancing the resources of the local bodies.

3.2.1 The changing nature of Centre- State relations and the Finance Commission

The scope of the work done by the Finance Commissions (FCs henceforth) differs as per the mandates given to them by the President in the Terms of Reference (ToR).

The ToRs as well as the recommendations of each Commission offer a lens for observing how the Centre-State financial relationships changed across time. The first FC, which had not received specific ToRs, created commentaries on existing Centre-State financial relations and came out with a number of relevant principles that succeeding FCs have followed. Amongst its many observations, it states that while there is an urgent need to transfer more funds to the States, this cannot be done so by making the Centre fiscally deprived of resources. It also states that grants-in-aid to States need to be governed by some uniform principles. The second FC adds to the vein by further stating that grants-in-aid should be typically looked at as a residuary resource, and that primarily, the revenue gap of the States ought to be funded only through tax sharing.

However, another tenor was already emerging in the reports of the second FC, which was amplified by that of the third. This had to do with the fact that the FCs were mandated to give grants-in-aid to States after assessing the non-Plan revenue sides of the State budgets. However, the revenue side of the budgets were highly impacted by the presence of interest payments, which arose out of the capital spending done by States as approved by the Planning Commission. Thus, the Finance Commissions were largely left to fill the revenue gaps of the States, whereas the actual assessment of development requirements and capital transfers was being handled by the Planning Commission (Sharma, 1960).

The report of the fourth FC specifically states that constitutionally, there is absolutely no such categorization such as Plan expenditure and Non-plan expenditure and hence, there is actually no case to keep Plan expenditure out of the purview of Finance Commission recommendations. But, given the way the systems had been created, it also suggested the responsibilities of both the Commissions should be clearly demarcated to avoid overlapping of functions.

The sixth FC emphasized the fact that all areas of critical social spending had been constitutionally put under purview of the States and hence, supported the idea of “realignment of resources in favour of States.” However, it was also quick to point to the intra-state inequality and suggested that unless similar rules were devised to further transfer the resources to local bodies, people’s needs could not be effectively addressed.

The ninth FC was somewhat uniquely disposed since the TORs given to the FC contained analysis of “Revenue Expenditure”. The Commission took the view that the fiscal deterioration witnessed at both Centre and States was all the more worrisome since the proportion of revenue deficits within the fiscal deficits was huge. The reason for the prevalence of the huge revenue deficit was in the burgeoning public debt of the Centre, which created high interest rates, thereby leading to high revenue deficits. Whilst discussing the public debt profile of Centre and States, the Commission also accounted for the Plan Expenditure done by the States; this line of assessing the need of States was in deviation with the practice of the earlier Commissions.

The tenth FC again only considered the non-Plan expenditure undertaken by the States for assessing the revenue gaps at State level. Its important contribution was in the recommendation that all taxes at the Central level be pooled together to form the divisible pool of resources. This would enable the States to share the buoyancy of the Central taxes. As has been mentioned earlier, this in fact resulted into the 80th Constitutional Amendment being passed in the year 2000.

The decade of the nineties propelled major changes in decentralization in India with the passage of the 73rd and 74th Constitutional amendments, which gave constitutional recognition to the rural and urban local bodies respectively. True empowerment of local bodies could only be possible with fiscal powers being shared with them and hence, the eleventh FC recommended augmenting the Consolidated funds of States so as to help them to nurture the finances of the local bodies further. An ad hoc grant of Rs.2000 crore, amounting to 0.78 per cent of the divisible pool (newly defined under Article 270) was earmarked by the eleventh FC for this purpose.

The twelfth FC took this task ahead, and raised the grants to Rs.25000 crores, amounting to 1.24 per cent of the divisible pool, over the period 2005-10. Apart from this, it was asked to look into the issues of fiscal consolidation by the Centre and States, and its assessments eventually led to the enactment of the Fiscal Responsibility and Budgetary Management Act by the Government of India. It was also the first Commission to sanction separate grants for maintenance and preservation of forests depending on the forest area of different States.

The Eleventh FC was the first FC to recommend transfers to States from a common divisible pool of taxes. It recommended that 29.5 per cent of the shareable taxes be transferred to the States; the Twelfth and Thirteenth FCs further increased this percentage to 30.5 per cent and 32 per cent respectively.

The ToRs of the Thirteenth FC were distinctly more inclusive than the earlier ones. The ToRs mandated the FC to comment on the impact of the then-proposed implementation of the GST and also consider the need to manage ecology, environment and climate change consistent with sustainable development. It was also asked to take into consideration the commercial viability of irrigation projects, power projects, departmental undertakings and public sector enterprises through various means, including levy of user charges and adoption of measures to promote efficiency. Amongst the notable recommendations of the Thirteenth FC were reductions of the Central Revenue Deficit to zero till 2014-15, grants of Rs.5000 crores for forest management, incentive grants of Rs. 5000 crores for grid-connected renewable energy and grants of another Rs.5000 crores for water management subject to setting up Water Regulatory Authorities by the States. Importantly, the Thirteenth FC also recommended reduction in the number of Centrally Sponsored Schemes so that the dominance of formula-based Plan transfers would continue.

The Fourteenth FC increased the tax share of the States from 32 per cent to 42 per cent, which has been the biggest increase in tax share of the States ever done by any Finance Commission. Many observers criticized the sudden jump, stating that devolution to States could not be affected at the cost of Central fiscal health (Gurumurthi, 2016). However, the Fourteenth FC defended its decision by stating that the ToRs given to it required it to consider the total Revenue Expenditure of the States without making a distinction between Plan and non-Plan expenditure. Thus, the grants that would be given under the Gadgil formula were also subsumed under the transfers to States; such transfers that have been given in lieu of Plan grants themselves account for 5.5 per cent of the divisible pool. Secondly, the Fourteenth FC did not give any conditional grants such as those given for lake and temple rejuvenation etc. by the Thirteenth FC, and in the process saved 1.5 per cent of divisible pool. Hence, even if the increase ostensibly is from 32 per cent to 42 per cent, the actual increment in the shared percentage is from 39 per cent to 42 per cent i.e. an increment of only 3 per cent.

One of the reasons for the increment of 3 per cent is that the Centre had been foraying into subjects listed in the Concurrent list through various schemes, indicating that lack of fiscal room was never really an issue for the Centre. The fiscal space available to the Centre was calculated and accordingly, the increment in untied transfers was recommended by the FC (Rao, 2017). From the above discussions, one may claim that the mandates given to the different FCs through the ToRs as well as the stance taken by them reflect the different peculiarities of Centre-State

relations at that point in time. And yet, it is also possible to discern some commonalities in the arguments given by the FCs. Following is a summary of the major trends in Finance Commission transfers in India.

- One definitely observed trend is that most FCs have preferred direct tax sharing programs with the States as a way of financing their expenditure needs, rather than give grants-in-aid which are more discretionary in their timbre. This reflects the preference that the FCs have accorded to untied transfers vis-a-vis conditional grants.
- Second, the direct tax devolution done by the FCs has increased over a period of time; as has been mentioned above, the Fourteenth FC recommended a record high tax share at 42 per cent of divisible pool.
- Third, some of the FCs, especially after the Ninth FC have experimented with a normative assessment of grants. Assessments were done as to how much States ought to raise internally given their respective frameworks, and the grants were worked out by comparing the expenditure for social and economic development with the normative revenue assessment.
- Finally, earlier FCs have often commented on their ToRs being restricted to the non-plan revenue expenditure of the States. The role envisaged for the FCs was one wherein they would assess the resources of the State and give grants for development. However, in reality, the resource assessments of the States for creating the State Plans were done by the NDC. The loans and/or grants to States were also recommended by the Planning Commission. The loans created interest burdens on the revenue accounts of the States. The role of the Finance Commission was restricted to only filling the revenue gaps created on the basis of assessments done by the NDC and transfers recommended by the Planning Commission. In order to bridge the information gap between the Finance Commission and the Planning Commission, the member of the Planning Commission in charge of the Financial Resources Division was made an ex-officio member of the Finance Commission.

These points go to highlight the major issues and irritants in the design of fiscal federalism in India. The next section discusses transfers from Centre to States done through the Planning Commission route and goes on to highlight the political economy considerations that the Planning Commission brought in its wake.

3.3 Centre- State Transfers in India and the Planning Commission

In contrast to the Finance Commission, the Planning Commission was not set up as a Constitutional Authority. Rather, it was set up by a Resolution of the Government of India in 1950. Item No. 20 of the Concurrent List in the Constitution pertains to “Social and Economic Planning,” but the Planning Commission was not set up under this provision.

The basic functions of the Planning Commission included assessment of the country’s material, natural and human resources and formulation of a Plan so as to achieve optimal utilization of the same. The Commission was also to review the progress of the Plan from time to time and recommend policies for successful implementation of the Plan (Planning Commission, n.d.).

The Government of India set up the National Development Council (NDC) in 1952 on the recommendations of the First Five Year Plan to secure co-operation of States in the execution of the Plan. Thus, the NDC was basically visualized in the role of an advisory body to help the States to participate in the planning process and hence in a way, was a cornerstone of introducing the federal element in decision making. The idea was that the NDC would play the critical role of an integrator of State Plans into the National Plan and would assess the State’s own resources for carrying out State Plan targets. The NDC was to then recommend Central Assistance to State Plans from the Union Budget, if it found that the State lacked the resources to operationalize the approved Plan, to which it itself was an advisory.

Thus, the Planning Commission used to recommend resources to be transferred to the States through Central Assistance to State Plans in every Budget. This Central Assistance to State Plans was to be in the form of loans as well as grants. There are three components of Central Assistance: Normal Central Assistance (NCA), Additional Central Assistance (ACA) and Special Central Assistance (SCA).

The first 3 Five-Year Plans and the Annual Plans from 1966-69 could not distribute the Plan funds in a satisfactory manner. The amount of funds made available to different states under NCA was hence determined by the Gadgil formula from the fourth Five-Year Plan and by the Gadgil-Mukherjee formula after 1991, and this component typically comprised of untied transfers. The Planning Commission also gave ACA transfers to States for carrying out Externally Aided Projects (EAPs). A big component of ACA transfers has been scheme

expenditures. The Centre used to transfer resources to States for programs such as Rashtriya Krishi Vikas Yojana (RKVY), Jawaharlal Nehru National Urban Renewal Mission (JNNURM) etc. These were called as ACA schemes. Additional funds were also made available for State specific development projects for mitigation of backwardness and poverty, with a special thrust on development of the SC and ST population through the SCA route. SCA transfers were largely discretionary in nature.

The Gadgil-Mukherjee formula was again revised in 2000; according to the new formula, 30% of Plan funds are allocated to Special Category States (SCS) and 70% are given to the General Category States (GCS). Further, in terms of distributing the resources to the states, the formula gives a weightage of 60% to population, 25% to per capita GSDP, 7.5% to fiscal management and 7.5% to special problems of states. 70% of the funds given to the GCS are in the form of loans and 30% in the form of grants. Of the 30% of the total amount that is given to the SCS, only 10% are in the form of loans and 90% is in the form of grants.

3.3.1 Evolution of Planning Commission as a Political-Economy Platform

The role of the Planning Commission in terms of creating a blue-print for growth and development through a consultative approach is undisputed. However, it is equally true that its role as an essential element in the Centre-State federal polity transformed it into as much a political bargaining platform as an advisor for fund transfers. As D. R. Gadgil, the Deputy Chairman of the Planning Commission for the 4th Five Year Plan stated:

The root of failure lies in the process by which the Planning Commission, essentially only an advisory body, has come to mix itself with the actual process of formation of public policies even in matters other than that of development....The misdirection has largely been helped by the membership of the Prime Minister and the Finance Minister of the Planning Commission which appears to have vested the Planning Commission and its decisions with an unnatural kind of prestige and importance (Laxmikanth, 1969, p.434).

Thus, through the tendency to move from a plan platform to a policy platform, Plan transfers created centralist tendencies in their wake, forced national priorities into State Plans, and also created a lopsided transfer structure for the Finance Commission devolutions. Some of these

issues, flagging the role of the Planning Commission as more than a mere Plan body, are discussed below.

- The Plans used to be created at the Central level and States emerged as mere implementation arms of the Plan. Since the resources were made available for what the Centre perceived to be a priority rather than what the States did, the process of planning often took away the verve of the States to decide what development patterns were uniquely needed at the local level (Patil, 1995, p.116). Thus, “uniformity and commonality” were emphasized much more than “diversity and divergence”.
- Further, since Plans created by the Centre encompassed all social and economic activities, many States perceived Plans as an encroachment by the Centre into areas that were constitutionally reserved for the States. The process of planned development allowed the Centre to emerge as a power centre to dictate and fund activities within the areas constitutionally reserved for the States. Thus, planning “... superseded the federal Constitution so far as States are concerned, but this supersession was not legal or constitutional but was by agreement and consent.”(Patil, 1995, p.118)
- NDC emerged as a body with huge powers. The procedure for finalizing the Plan was as follows. The Plan used to be created by the Planning Commission and placed before the Cabinet for its approval. After that, it used to be sent to the NDC for acceptance, which is where the process of consultation and negotiation between Centre and States used to commence in concrete terms. Decisions were taken not through voting, but by consensus. Thus, even though it was the Cabinet that actually gave approval to the Plan, it was the NDC wherein the Plan, subject to the negotiations and bargains with the stakeholders, used to assume its final shape. This is what led to the NDC earning the sobriquet of “Super Cabinet of the entire Indian federation” (Laxmikanth, 1969). However, while the above view lends to the extreme that the NDC was all powerful, there is also another view that the NDC was nothing but a “Rubber Stamp” of the Union Government. This largely was true in the period immediately post-Independence, in which the Congress was in power in the Centre as well as in most of the States and hence, the NDC meetings would have more of a reconciliatory approach rather than that of a discussion-oriented approach. This view was further strengthened in the seventies and early eighties under the Prime Ministership of Indira Gandhi (Shukla, 2008, p.87).

- Having said this, it is also equally true that NDC meetings were not as amicable as the above statements would make one believe. Minutes of the NDC meetings reveal them to be fairly stormy affairs, even under the Prime Ministership of Jawaharlal Nehru and Indira Gandhi, when the Congress was in power at the Centre as well as in most States. During discussions of the 4th Five Year Plan in 1969, Chief Ministers of West Bengal, Kerala and Tamil Nadu were vociferous in stating that the financial interests of their States were not being met. In 1977, when the Janata Dal came into power in the Centre, there were as many as 16 Chief Ministers who demanded a relook at the way Centre-State relationships were defined. These demands, frequently voiced in different fora on different occasions actually had a great impact on the corrective mechanisms that were eventually put into place; one of these was setting up of the various Committees to look into Centre-State relations (Rajamannar Committee (1969), Anandpur Sahib Resolution (1973), West Bengal Memorandum (1977), Sarkaria Commission (1983)) and the other was in terms of modifying the Gadgil formula in 1990.
- It is also naive to believe that the NDC meetings would create Congress vs. Non-Congress lobbies of States desirous of getting funds for development. Even Congress-led States have been vociferous in demanding more autonomy for their own State or in protesting against what they believed was a centralization policy in the NDC meetings. For example, when the UPA Government under Dr. Manmohan Singh raised the States share in the Sarva Shiksha Abhiyan scheme unilaterally, there were as many Congress led States that protested against this issue as there were non-Congress led States.
- Finally, the duality in terms of control over resource transfers led to obvious tensions between the Planning Commission and the Finance Commission. Some interesting insights on the uneasy existence of the Finance Commission with the setting up of the Planning Commission are found in the Supplemental Note written by Mr. P. V. Rajamannar as an Appendix to the Report of the Fourth Finance Commission, though he explains at the very beginning of the note that the views expressed in the note are his own and should not be treated as akin to recommendations of the Finance Commission (Rajamannar, 1965).
- In his legal opinion, there is nothing in the Constitution that indicates that the grants given under Article 275 should be restricted only to filling the revenue gaps of the State;

in fact, he points out to the fact that the Constitution does not even recognize the differences in the revenue and capital sides of the budget. Thus, there is no “legal warrant” to omit capital grants from the purview of the Finance Commission.

- However, “*it is the setting up of the Planning Commission that has in practice restricted the scope of the Finance Commission.*” The Third FC had recommended that the grants-in-aid given to States should be such that they would be able to cover at least 75 per cent of the revenue component of their plans. This recommendation was rejected by the Government of India; it has been one of the very few that was rejected. This was because from the perspective of the Government, there was no real practical or political advantage in the Plan expenditure being supported by way of statutory and unconditional grants in aid.
- Further, the ToRs of the next Finance Commission, unlike those of the Third, specifically mandated the Fourth Finance Commission to only consider the revenue expenditures of the State Governments in assessing the need for grants. This effectively restricted the constitutionally created Finance Commission from commenting on and potentially infringing on the recommendations of the Planning Commission, which did not derive its authority from the Constitution but was a “quasi-political body..... without constitutional or legislative sanction”. Mr. Rajamannar, in his note, comments that the Planning Commission should also be made a body independent of the Government, if it is to carry out such a huge role in influencing the funds available to the States for development.

Thus, in the Indian federal polity, there was the presence of a constitutionally supported Finance Commission that recommended only non-Plan revenue grants to the States under Article 275, apart from recommending tax devolution. Its ToRs normally included assessments of non-Plan expenditures only, thereby indicating that the Government did not really see any benefits in the States receiving their grants through a formula based approach created by a constitutional body.

Thus, a more discretionary, bargaining oriented platform for disbursing development funds to the States was the extra-constitutional Planning Commission. However, after the first three Plans, there was a lot of discussion on the arbitrary nature of transfers within the NDC. The Centre was forced to take cognizance of this and eventually, from the fourth Five Year Plan onwards, the Planning Commission too created a formulaic approach to disburse funds under the Normal

Central Assistance to State Plans. Having said that, presence of the Planning Commission to approve and sanction the State Plans continued to give the Centre an informal control, albeit financially defined, over the functions listed in the State List.

3.4 Committees to Study Centre-State Relations

These discussions on the uneasy relations between the Finance Commission and the Planning Commission serve to highlight the broader tensions between the Centre and the States, with each entity struggling to maintain and assert and enhance its own control and autonomy, in what could potentially be described as a zero sum game of power. These tensions have over a period of time given rise to debates on the need for Constitutional amendments to preserve the autonomy intended for State Governments. The Union Government appointed several Commissions over a period of time whereas several State Governments also set up Committees to study into the issue of Centre-State relations and to recommend means to protect State autonomy. It is in this light that the suggestions of the Administrative Reforms Commission (1967), the Rajamannar Committee (1969), the Anandpur Sahib Resolution (1973), West Bengal Memorandum (1977), Sarkaria Commission (1983) and the M. M. Punchhi Commission (2007) have to be seen.

It is interesting to note that while most State level Committees have suggested constitutional changes to preserve the autonomy of the States, the Sarkaria Commission, as also the Punchhi Commission, set up by the Government of India, did not favour any changes at the constitutional level to enhance autonomy.

Thus, the Rajamannar Committee recommended setting up of an Inter-State Council which would approve any Bill prior to it being presented to the Parliament. It also suggested that residual taxation powers should rest with the States. These recommendations were completely ignored by the Central Government.

The Anandpur Sahib Resolution called for making the Indian Constitution truly federal by vesting all residual powers except for foreign affairs, defence, communications and currency in the State Governments.

Perhaps the most extreme demands were made under the West Bengal Memorandum in which a repeal of Sections 356, 357 and 360 was sought. It also demanded that State consent be made

mandatory for the creation of new States, and wanted 75 per cent of the total revenue raised by the Centre to be shared with the States. Demands made under both Anandpur Sahib Resolution as well as the West Bengal Memorandum were seen to be too radical and were rejected by the Centre.

As has been said above, the Sarkaria Commission found the existing constitutional arrangements satisfactory for preserving State autonomy. However, the Commission did make several recommendations for bettering the federal health of the country. The chief recommendations in that context are setting up of a permanent Inter-State Council, Centre to consult States before making a law on the Concurrent List, residual powers of taxation to rest with the Centre but other residual powers to be given to the States, etc. Interestingly, the Commission found the dichotomous system of the Finance and Planning Commission both having powers of transferring resources to the States satisfactory. Thus, the approach taken by the Sarkaria Commission was one of removing “irritants” in the existing system without really making any structural changes to the same. In similar vein, recommendations of the Punchhi Commission may be said to be ones encouraging a consultative role between the Centre and the States, without undertaking radical Constitutional reforms to influence federal relations.

In defining the financial relations between the Centre and the States in India, cognizance is due to a third, rather interesting and discretionary mode of transferring resources from the Centre to the States, without which the dynamics of the above discussion remain incomplete. This third route of transferring resources to the States is through the Central Ministries and is discussed next.

3.5 Fund transfers by Central Ministries: Central Sector and Centrally Sponsored Schemes

Funds are also transferred by Central Ministries to the States, on recommendation of the Planning Commission, under certain schemes that are called as Central Sector and Centrally Sponsored Schemes.

All transfers approved and recommended by the Planning Commission for a particular year are included in the Gross Budgetary Support (GBS) given by the Government in the Union Budget for that year. Thus, the GBS amount indicates the total expenditure that the Central Government will carry out on Plan activities.

Now, the GBS is further split into support for the Central Plan and Central Assistance to State Plans. As has been mentioned before, Central Assistance to State Plans is given for implementing plan objectives that are relevant at a State level and are part of the State List. On the other hand, the support for the Central Plan is largely designed in the format of developmental Schemes funded by Central Ministries. These are in the nature of Central Sector or Centrally Sponsored Schemes.

3.5.1 Central Sector and Centrally Sponsored Schemes

There are important differences in the Central Sector and Centrally Sponsored Schemes. Those schemes which related to subjects in the Union List and are directly implemented by the Centre are called as Central Sector Schemes. The expenditure on these schemes is directly undertaken by the relevant Central Ministry.

Other development objectives such as Agriculture, Public Health and Sanitation etc. form a part of the State List. At the same time however, these objectives are perceived to be national priorities. Thus, the State Ministries implement the schemes for these development objectives, but the Centre, in the interest of uniformity in design and service delivery, creates the guidelines for the Scheme and also transfers additional resources to the States, over and above the Central Assistance to State Plans, for implementation of these development schemes. It is important to note that scheme guidelines for such schemes are created by the Central Ministries and funds used to be allocated to the State Governments only after approval of guidelines from the Planning Commission. Such schemes, which are implemented by the States but are part-supported financially by the Centre, are called as Centrally Sponsored Schemes (CSS).

Thus, Central Sector Schemes are directly implemented by the Central Ministries, whereas Centrally Sponsored Schemes are implemented by State Governments. This naturally leads to a difference in the way the schemes are funded.

The entire funds required for Sector Schemes are directly given by the Ministries to the implementation agencies at district or block level. However, in the case of Centrally Sponsored Schemes, funds are either transferred to the Consolidated Funds of States or are directly given to the State- or District- or Block level implementation agencies. In case they are given to the

Consolidated Funds of States, they get reflected in the state budget accounts. However, to the extent that CSS funds are directly transferred to the implementation agencies, the funds form “off-State budget” transactions. It has been observed that direct transfers to implementation agencies are the favoured route of funding the CSS. From 2006-07 to 2013-14, the proportion of funds directly transferred to implementation agencies stood at 75.36 per cent of the total funds transferred by Central Ministries (Chapter 4).

Finally, Central Sector Schemes are supported 100 per cent through central funding. In the case of CSS, however, the Centre contributes part of the funds and the States are expected to come up with a matching contribution. The percentages of Central support vary from schemes to scheme.

3.5.2 Historical Perspective: CSS

In the first 3 Five Year Plans, it was noted that the Central schemes used to cover areas such as Agriculture, Education, etc., which were State List subjects. Again, since the schemes were designed centrally, they did not have the design flexibility in terms of funds, manpower, logistics, etc. to cater to the unique problems of the States.

Hence, it was decided at the end of the third Five Year Plan that only a few schemes would be designed centrally which would be termed as “Centrally Sponsored Schemes” and the others would be transferred to the States. Thus, 36 schemes were transferred to the States and 90 CSS were included in the fourth Five Year Plan. Of these 90 schemes, very few were eligible for 100 per cent Central Assistance and thus, many States observed in the NDC meetings that CSS were leading to inequalities in fund transfers. However, the number of schemes and the funds disbursed therein proliferated; this was despite the NDC Committee on CSS capping the total support to CSS at 1/6th(17 per cent) of Central Assistance to State Plans. By the end of the fifth Five Year Plan, there were 190 CSS in existence.

In the meeting to discuss the draft of the sixth Five Year Plan, many States criticized the heavy dependence of the Centre on CSS as a mode of resource transfer. Hence, 72 CSS were transferred to State Plans. The Rs.2000 crore surplus accruing to the Centre due to devolution of schemes was then distributed amongst the States in the form of additional block assistance. However, by the end of the sixth Plan, the number of CSS increased to 201 and the scheme assistance stood at 35 per cent of the Central Assistance to State Plans.

The Central Government set up an Expert Group under Mr. K. Ramamurty to look into reducing the number of CSSs and developing a criterion for introducing a new CSS. It also was to recommend the ceiling on the funds devolved through CSS. However, the recommendations of the Group were perceived to be too broad in their scope by the NDC. In 1985, the NDC set up a Committee under Mr. P. V. Narsimha Rao, who was then the HRD Minister to look into the issue. This Committee recommended that those schemes related to issues carrying high national priority, or are pace-setters, or are inter-State in their scope should be retained as CSS and all other schemes should be transferred to State Plans. It was this Committee which further set up a Group of officials under Mr. Baijal to create guidelines for the exact modalities involved in transfer of schemes, funding etc. The Group recommended transferring 113 schemes to the States, saving the Centre Rs.800 crore in the process. Since the schemes would be covered under Central Assistance to State Plans, the resource transfer for the same would also be covered under the modified Gadgil formula. However, when the final Narsimha Rao report was considered by the NDC in 1991, it was decided that the States should be given resources to run the 113 devolved schemes outside the Central Assistance to State Plans.

This point of rationalizing the number of CSS without putting extra burden on States emerged as one of the central points in the debate on CSS devolution. The debate intensified in the late nineties, with some States asking for stopping CSS altogether and instead transferring resources to them in an unconditional format. Other States felt that CSSs could continue, albeit with 100 per cent funding.

The Varma Committee was set up in 2005 to look into these issues and submitted its report in 2006. The Varma Committee gave a number of important and relevant suggestions. Some of these were to create a new CSS only with the approval of the full Planning Commission and in consultation with the States. A new CSS should be created only if the outlay on the same exceeded Rs. 300 crores per year. The Committee recommended that the existing CSSs with an annual outlay of less than Rs.300 crores be terminated on 31st March 2007. Importantly, the Committee was in favour of a Zero-Based Budgeting approach for the CSS for every Plan. This implies that every CSS would be considered from a zero-frame anew in every Five Year Plan. The Committee also strongly stated that the funding for CSSs should be routed through the State budget. For many CSSs, the funds are directly transferred by the Central Government to the implementing agency and hence tend to bypass the Consolidated Funds of the State. We will take

up this issue for discussion in the next chapter. Some of the recommendations of the Varma Committee were adopted during the 11th Five Year Plan. In the beginning of the 11th Plan, a number of schemes were thus wound down i.e. 155 CSS were reduced and only 99 CSS were retained in the beginning of the 11th Plan. But, as with earlier Plans, and despite repeated suggestions from different Expert Groups and Committees, many new schemes were introduced during the course of the 11th Plan too. Thus, the number of schemes increased to 147 at the end of the 11th Plan.

Thus, the top-down approach in the creation of CSSs continued through the 11th Five Year Plan, as did the proliferation of schemes. There was also a new concern in keeping with the passage of the 73rd and 74th Constitutional Amendments. This was regarding securing the participation of the Panchayat Raj Institutions as well as urban local bodies in the Centrally Sponsored Schemes. The design of the CSS thus needed to look into devolution to the States and further down to the level of the local bodies. The Chaturvedi Committee was set up a view of looking into these emerging set of problems and challenges.

3.5.3 Recommendations of the Chaturvedi Committee on Restructuring of CSS

The Chaturvedi Committee (2011) observed that CSS funding as a percentage of the GBS had kept on increasing. In the ninth, tenth and eleventh Plan, the percentage of CSS to GBS was seen to be 31 per cent, 38.64 per cent and 41.59 per cent respectively. In comparison, the percentage of NCA to GBA was seen to be only 6.74 per cent and that of Central Sector Schemes and CSS under ACA was seen to be 18.28 per cent of the GBS. The Committee further observed that the categorization of transferring funds under CSS as well as under schemes included in the ACA was artificial.

On the design of the schemes, the Committee observed that many schemes did not conform to the development needs of the different States. It also observed that the accounting framework used for the schemes in the different States was vastly different, thereby preventing the Central Government from creating a central finance control design. Thus, the Committee gave recommendations to revamp the design of the schemes financially as well as logistically. It also pointed out that proliferation of schemes has led to the central resources being spread very thinly over multiple priorities and that schemes with small outlays are not very effective in driving development outcomes in States.

To this end, it was recommended that of the 147 CSS schemes existing at the beginning of the Twelfth Five Year Plan, many could be simply wound down or could be merged and restructured into 59 schemes which would fit into three categories:

1. Flagship Schemes for addressing national priorities (Education, Health, Irrigation, etc.):
According to the Committee, only 9 of the erstwhile CSS schemes would be continued as flagship schemes.
2. Major Sub-sectoral Schemes to handle sub-sector issues in the identified priority sectors:
It would be useful to have special interventions in the sub-sectors of the national priority sectors. For example, within Agriculture or Education, one can think of sub-sectors such as irrigation and primary education respectively. 99 of the earlier CSS were to be merged into 39 Sub-sectoral CSS schemes.
3. Umbrella Schemes to improve effectiveness of Plan Expenditure:
These schemes were meant for the smaller departments. The Committee had recommended that smaller schemes with an outlay of less than Rs.300 crores be wound down completely. The small schemes were merged under this component and thus, rest of the 39 CSS schemes were merged into 11 Umbrella schemes. Amongst these, the National Rural Livelihood Mission (NRLM) would function as flagship.

The Committee also recommended restructuring of the 26 existing ACA schemes in the following fashion:

1. 6 flagship schemes within the ACA were to continue as flagship. Amongst these 6 schemes, 2 schemes namely R-APRDP and RGGVY were Central Sector Schemes.
2. The other 20 schemes would be merged into 7 ACA schemes. Of these, the Backward Regional Grant Fund (BRGF) would function as a flagship.

Thus, after restructuring both CSS and ACA schemes, there would be 17 flagship schemes in existence (9 CSS continued as flagship, 6 ACA continued as flagship, BRGF formed after merging ACA schemes was considered flagship and amongst the merged Umbrella CSS schemes, the NRLM was to be flagship)

3.5.4 Centrally Sponsored Schemes: Issues

Transfers given to States under CSS are probably the most controversial of the Centre- State transfers in India.

- States were uncomfortable with the Schemes because CSSs did not offer flexibility to the States in terms of defining development objectives.
- Centrally Sponsored Schemes were also seen to widen State level inequalities due to their funding design. CSS require the States to put in matching funds for the development expenditure and hence, often, the economically backward States did not receive transfers under certain schemes since they did not have their own resources to spend into the scheme.
- Some States even diverted the transfers received under Central Assistance to State Plans to fund Centrally Sponsored Schemes, in the process reducing the expenditure on State pertinent local issues for driving centrally designed programs.
- And yet, the volume of funds disbursed through the CSS route grew rapidly throughout the Plan period in India. Section 3.5.2 shows that in the initial Plan period, the number of schemes increased rapidly, indicating that CSS were almost created as an answer to individual problems of States.
- Transfers to States through the CSS route became increasingly discretionary over a period of time. In one of their research studies, Govinda Rao and Nirvikar Singh allude to an incidence wherein the process of creating a CSS was so discretionary that a Prime Minister announced a scheme in one of his speeches and the Planning Commission was left to working out the scheme design quickly so as to conform to the speech. The authors have also pointed out to the huge political and bureaucratic influences in determining the allocation of Scheme funds to different States (Rao & Singh, 2001).
- Another issue within the CSS scope has been the route of transferring the funds to the State Governments. It has been mentioned earlier that the Centre has two options of transferring the funds for CSS. One way is to directly transfer the funds to the State Government, in which case the Consolidated Fund of the States are enhanced to the extent of the transfers. The other way, which has been increasingly resorted to by the Centre, is to directly transfer the funds to the district level implementation agency. In

such a case, the funds by-pass the Consolidated Funds of the States completely. This is associated with two major issues. The first one is that since the amount is not transferred to the Consolidated Fund of the States, the amount completely escapes audit of the CAG and to that extent, remains vulnerable to misuse. The other issue is that since the amounts do not get reflected in the State accounts, the State legislature does not take up for discussion utilization of the amounts, or implementation of the scheme at all (Das & Mitra, 2013).

- Design of CSS funds precludes State Governments from using it for employing permanent staff. Thus, the salary component within the Schemes can only be used for hiring contractual staff, and this itself has led to inefficiencies in the capacities created at the State level. Lack of qualified human resources and hence lack of implementation is then cited by the Centre for not transferring enough amounts to the States.

Despite all of the above issues, Centrally Sponsored Schemes have proliferated in India in terms of number, volume and show an increased share in the GBS. We re-iterate this point with data tables in the next chapter.

To sum up the discussion in this chapter so far, there are three ways in which fund transfers are affected from the Centre to the States in India. These are:

1. Finance Commission

State Governments access funds through the Finance Commission. The FC not only recommends percentage of taxes to be shared with the States, but also recommends inter-se allocation of the said funds. The FC also provides discretionary grants-in-aid to the states for financing non-Plan revenue expenditure. The FC does not give loans and gives funds in the form of grants only.

2. Central Assistance to State (and UT) Plans by Planning Commission (CA henceforth)

State Governments access funds given by the Planning Commission through Central Assistance to State and UT Plans. The Normal Central Assistance (NCA) was in the nature of loans and grants given to the states so as to carry out state-specific developmental programs. The amount of funds made available to different states under NCA was determined by the modified Gadgil- Mukherjee formula. Additional Central

Assistance (ACA) for financing development priorities was made available through ACA schemes. Special Central Assistance (SCA) to certain States was given for mitigation of backwardness and poverty. ACA and SCA components were discretionary i.e. they were not formula-based.

3. Central Sector and Centrally Sponsored Schemes by Central Ministries

Central Ministries transfer funds to State Governments for running development schemes. The Centre gives part funding for Centrally Sponsored Schemes whereas a matching contribution is given by the States. Percentages of central funding are different for different schemes. The funds are transferred by the Central Ministries usually to the State Government budgets, though there is an increasing number of instances in which the transfer has been directly made to the implementing agency. Despite a number of issues in the design of CSS, these schemes have proliferated and have become a popular route of funding discretionary transfers to States.

3.6 The Hypothesis: Political Economy of Centre-State Transfers

The discussions in this chapter and the earlier one serve to indicate that the nature of inter-Governmental transfers in India, as it has evolved over a period of time, is unique and complex. A few regions acceded to India under special constitutional provisions, for example, Jammu and Kashmir. Some constitutional provisions were written to give autonomy to ethnic groups (Article 351), and to people belonging to different religions (Article 44, Article 30) and castes. Linguistic considerations played a big role in terms of defining re-drawn boundaries of the States. Constitutional provisions were created and/ or amended to smooth out the process of re-grouping different identities within the linguistically organized States.

It is important to recognize that States are not just linguistic groups, but rather, they have emerged as communities with strong political identities. One route through which they assert their political weight is through the Rajya Sabha, in which members are elected by the State Legislative Assemblies. To the extent that most Parliamentary Bills are required to be passed in both Houses of the Parliament, the political party in the Centre cannot ignore the power of the States. The other way in which States might assert their identity is through the strategy of negation; schemes created at the Centre may not be implemented at State level, thereby hurting the political and economic image of the Centre at the local level. Scheme implementation within

the States is important for the Centre for two reasons. First reason is the genuine need to create a socio-economic change at the local level across all States of the country. The second, and more political reason is that the citizen at the local level also participates in the voting for the Lok Sabha. Schemes created by the Centre, often bearing the names of the leaders at the Centre, are an excellent tool to connect to the remote voter and to create a recall for the national party at the time of Lok Sabha elections. Thus, if the State Party is the same as that of the Centre, or is sympathetic to the Centre, it helps the cause of the Centre in multiple ways.

These interacting considerations lend themselves to the interpretation of the Centre-State relations as a bargaining platform, wherein the States support the passage of important Bills of the ruling party at the Centre and act as the remote implementers of central strategy. The Centre, on the other hand, wields control over the States through various means. Apart from the constitutionally defined means such as the power given to the President to appoint the Governors, or the powers to the Governor to reserve certain Bills passed by the State Legislature for the consideration of the President, there are various other tools through which the Centre asserts its power in its equation with the States. The Centre can create schemes that are relevant for specific State Governments, create better financing options for such schemes as may be relevant to favoured State Governments, offer loans at subsidized rates, waive loans for certain priority sectors, and may be more sympathetic in recognizing special economic needs of particular States or may favour States by transferring higher amount of funds to favourable States. It is on this last point that the literature on fiscal federalism in India is fairly vocal.

Fund transfers from the Centre to the States are amenable to being positioned as a means of wielding control over the States. This implies that fund transfers may be affected not necessarily according to the principles of economic equalization, but rather through strategies carrying political cognizance of the power of the particular State to whom the fund is being transferred. This brings us to the pertinent question: Are political influences obvious and discernable in Centre-State transfers in India?

The Constitution does not easily allow for discretionary transfer routes. Fund transfer, as envisaged in the Constitution of India, is affected through an independent (of the Government) Finance Commission set up by the President every 5 years. Thus, it seems to be the case that the presence of the Finance Commission would preclude political influences to creep into the design

of fund transfers. However, there have been instances of soft deviations even within the FC route. For example, appointments of Chairmen to the Commission as well as the members are decided by the Union Government and hence, have been politically motivated (Rao & Singh, 2006, p.212). Further, as has been mentioned earlier, the ToRs given to the Finance Commission might be themselves reflections of the political priorities of the Centre. Thus, despite the fact that the design of the FC transfers reflects economic considerations, political elements could matter in these transfers.

The Planning Commission, in its genesis itself, was set up as a discussion platform between stakeholders carrying different political agendas and importantly, different political weights in the Centre-State equations. Thus, there is recognition of inherent political inequalities between States in the very design of the Planning Commission. However, as one component of the Planning Commission transfers became more formulaic (Gadgil formula for NCA), Centrally Sponsored Schemes became the favoured means to drive discretionary transfers to States. These proliferated in number and in volume, and despite many design issues and objections, continued to be the popular way of affecting discretionary fund transfers from Centre to States.

This interpretation of CSS transfers as a manifestation of political economy influences has been popular in the literature on Indian fiscal federalism. Many scholars of Public Finance have tried to empirically verify the dependence of statutory and non-statutory transfers on economic as well as explicitly political variables.

Rao and Singh (2001) use data on 14 large, General Category States from 1983-84 to 1992-93 and use a panel regression to check causality of transfers on economic and political variables. The dependent variables in their specifications are Finance Commission transfers, Grants for State Plan Schemes and Discretionary transfers i.e. Central Sector and Centrally Sponsored Schemes. The independent variables in their specification include economic variables such as population of States, State GDP etc. They also create two “explicitly political” independent variables. The first one is a dummy variable measuring whether the party in power in the Centre was the same as that in the State. This variable may be termed as “political alignment.” The other variable is the proportion of ruling party’s members coming from a particular State. The former political variable is termed “Alignment” and the latter is termed “Power”. They try different specifications of the regression model to conclude that “the alignment variable always had

positive and statistically significant effect on grants to State Plan schemes”. This is interpreted to indicate the influence of political variables in Planning Commission transfers, or in at least some component thereof. However, the influence of political variables on discretionary transfers (CSS) is “positive but insignificant” which is “surprising, since one would have hypothesized that discretionary transfers were more subject to these kinds of influence”.

In a similar vein, Stuti Khemani (2003), in “Partisan Politics and Intergovernmental Transfers in India” uses FC and PC data on 15 major States from 1972-95 to find “contrary effects of partisan affiliation on Plan transfers versus statutory transfers from the Finance Commission.” Khemani finds that politically aligned States receive higher level of Plan grants and loans. She further creates a proxy variable to define potential political gain. Lower the proportion of seats controlled by the Central party in the seats allotted to the State in the National Legislature, more is the relevance of that State for the Centre since it stands to gain more from that State politically. Such States are seen to receive higher Plan grants and loans. Politically aligned States with political gain potential tend to get 4 to 18 per cent higher Plan transfers than politically aligned States without potential political gain. Very interestingly, the study does not find robust evidence to show causality between CSS transfers and political alignment.

Dasgupta, Dhillon and Datta (2001) use data from 1968-69 to 1996-97 to regress per capita transfers on SDP per capita, share of Agriculture in SDP, annual rainfall and voter turnout in the last State Assembly election. Apart from Power and Alignment, they use another variable to measure political influence on transfers. This variable captures how close the next Assembly elections are. Their model specification shows statistically significant influence of all political variables on discretionary transfers.

Biswas, Marjit and Velayoudom (2008) use data on the same 14 States as Rao and Singh for the time period 1974 to 1995. Their dependent variable is discretionary transfers to a particular State as a percentage of total transfers in that year and this percentage is then divided by population of the State to get a per capita notion of the percent transfers to that State. The dependent variable so created is regressed on SDP per capita and the residual errors from this model are then regressed on the political factors. Political factors include Power and Alignment and representation of different States in the Cabinet. Their model indicates that political influences

significantly impact discretionary transfers, but the robustness of their methodology has been criticized.

Thus, the existing econometric analysis of influence of political factors on transfers creates mixed results. There could be a number of reasons for this. Firstly, it is important to understand that even though the population of the State is treated to be an “economic” variable, it also indicates the political strength of that State. Thus, the presence of this variable as an economic variable could itself render the other political variables insignificant. Second, transfers show huge heterogeneity across time and across States. Most of the empirical work quoted above takes cognizance of this heteroscedasticity by using fixed effects in the panel regressions used in the studies. Many researchers have also created logarithmic specifications within the panel regressions for this reason. However, regression as a statistical tool itself may be inadequate to take care of such heteroscedasticity effects. Thirdly, and most importantly, we feel that it would be naive to expect statistically significant impacts of explicit political variables on transfers, because there are too many implicit bargaining variables and other design variables that impact discretionary transfers and cannot be accounted for through proxy variables. As has been mentioned earlier, there are many implicit bargaining variables: Subsidized loans to States, loan waivers for priority sectors, settlement of disputes through opaque institutions (water disputes are a case in point), delay in the settlement of certain disputes, announcing new schemes that are relevant only to few States, etc.

All these discussions create a backdrop to look at the data pertaining to transfers without necessarily juxtaposing a presumptive causality structure on the same. In the next chapter, we analyze the trends in fund transfers from all three sources viz. Finance Commission, Planning Commission and the Central Ministries. We also examine if political variables and coalition arrangements impact fund transfers from Centre to the States in India.

CHAPTER - 4

ARE FISCAL TRANSFERS INFLUENCED BY POLITICAL ALIGNMENT? CLUSTER-BASED EVIDENCE

We have examined the historical context and unique framework of federalism in India in Chapters 2 and 3. In this chapter, we examine an often-repeated conjecture in the “positive” literature on fiscal federalism in India: Does political alignment between Centre and States affect the extent of fiscal transfers from Centre to States?

We first review the rationale for this argument. Why would political variables such as political alignment affect economic transfers? States cannot be ignored by the Centre because of the powers of legislation that they carry in the Rajya Sabha. Further, States also function as useful means through which the political party at the Centre can access the remote voter. On the other hand, the Centre constitutionally controls a major proportion of tax revenues. It could favour or disfavour States by controlling the permissible routes of conditioning fund transfers to States for its own political ends.

The above view considers fiscal transfers as the outcome of the political bargain between two levels of governments in a federal structure. Transfers acquire more visible political overtones when bargains occur between the National party/ coalition in power at the Centre vis-a-vis political parties at the State level.

Moreover, National level parties cannot retain their status as National Parties unless they have a certain number of seats in the Assemblies of States. They hence forge State level alliances to win State Assembly seats. This might be done through their State level units, if they have a presence in the State. Optionally, they might want to get into an alliance with a State level or regional party in a State where they are not yet present. The political parties at the State level, on the other hand, have no interest in the National Parties getting represented at the State level. There are a number of political and economic bargains that can arise from these counteracting considerations. The National Party, which depends on the State Party machinery for contesting State Assembly elections may offer representation to the State level representatives in the Cabinet (Sridharan, 2004). Potentially, the National Party through higher fiscal transfers could favour States to which it is already aligned or is seeking alignment.

The last argument is intuitively appealing and ties up the political context to fiscal transfers rather neatly. However, given the unique institutional framework in which transfers are given by the Centre to the States, we feel that such an argument requires closer examination so that its veracity is not naively presumed.

There are three different routes through which the Centre transfers funds to States. The Finance Commission (FC) transfers preclude any kind of political influence since they are formulaic in nature. The scope for political influence to prevail in fiscal transfers, if at all, would only exist within discretionary transfers. Transfers by Central Ministries to the State Governments are discretionary. These are usually project specific transfers, and are normally given for implementation of the Central Sector (CS) or Centrally Sponsored Schemes (CSS) of the Central Ministries. It would be pertinent to examine whether fund transfers by Central Ministries have been influenced by political alignment between Centre and States.

The third route of transfers is through the Planning Commission (PC). The Planning Commission recommends grants as well as loans for State-specific schemes to the Centre. PC transfers too are largely formulaic and are governed by the Gadgil-Mukherjee formula. However, given that the process of finalizing State Plan size requires approvals from the Centre, there is a component of discretion involved in the PC transfers for State Plans. Thus, political alignment with the Centre might facilitate bigger transfers from the PC to the States.

In this chapter, we examine whether political alignment of the Centre with States is associated with instances of higher transfers being given to those States through FC, PC or Central Ministries.

In order to do so, we analyze the data on fund transfers from the Centre to fourteen large General Category States for the period 1993-94 to 2013-14 from all three sources viz. FC, PC and the Central Ministries. We thus may be able to witness relation between “political alignments” and character of fund transfers, vertical as well as horizontal.

4.1 Era of Coalition Governments: A Brief History of Political Events

The analysis in this chapter is based on data pertaining to 1991-92 - 2013-14. The choice of the period is relevant to the issue at hand. This period witnessed heavy incidence of coalition Governments in India.

India had witnessed coalition Governments before too. In response to the Emergency imposed by the Congress in 1975, several political parties formed an anti-Congress alliance called the Janata Party and formed the Government under the Prime Ministership of Morarji Desai in 1977. The Government lasted for three years till 1980.

Again, in the general elections of 1989, the incumbent Congress emerged as the single largest party in terms of votes but was unable to get requisite majority to form the Government. A coalition called as the Janata Dal emerged to form the Government with outside support of the Bharatiya Janata Party (BJP). However, this arrangement could not retain all partners and in 1990, a small faction of this coalition broke away from the alliance to form the Government with the support of the Congress under the Prime Ministership of Mr. Chandra Shekhar. This coalition-like arrangement too did not last and the Congress came back to power in 1991, as a major partner (though marginally missing the majority) in a coalition, with Mr. P. V. Narsimha Rao as the Prime Minister. This Government completed its full term of 5 years till 1996.

India went through a Balance of Payments crisis episode in 1991 and had to implement economic reforms from 1991 onwards. Thus, 1989-91 was an impasse for the country from an economic perspective and needed crisis induced reforms. It was also a structural break from a political perspective, as every Government after 1991 was a coalition Government.

A number of scams marred the reputation of the incumbent Government in 1996 and the general elections of 1996 led to a hung Parliament. BJP, the party with the largest vote share, was able to form a Government which lasted only for 13 days. A coalition consisting of 14 political parties led by the Janata Dal emerged as a “United Front” and H. D. Devegowda became the Prime Minister of the Government under this alliance. However, the alliance was short-lived as the Congress withdrew support from the alliance and a new 16 party coalition was formed. This Government was headed by Mr. I. K. Gujral. But the Congress withdrew power from this alliance too and in the elections of 1998 once again, the BJP emerged as the major party. It formed the Government with support from 13 smaller regional parties including the All India Anna Dravida Munnetra Kazhagam (AIADMK). However, the AIADMK, unhappy with the Centre not meeting some of its demands, withdrew support from the coalition in 1999, and the Government lost a no-confidence motion in the Parliament. The Congress, which was the biggest party in Opposition, could not secure an

alliance with the required numbers. And hence, in 1999, the country had to go to fresh elections.

The BJP contested the 1999 elections by forging new alliances, albeit informally, with a number of regional parties. Notably, some of the smaller partners of the AIADMK came back to the alliance, though the AIADMK moved into Opposition. The chief rival of AIADMK in Tamil Nadu i.e. Dravida Munnetra Kazhagam (DMK) also supported the alliance. Parties such as the DMK, and National Conference (J&K) were initially reluctant to be a part of the formal coalition, especially due to the pro-Hindutva stance of the BJP, but eventually agreed to contest elections under a common coalition agenda. The presence of such parties into the partnership in effect created the “secular block” within the coalition. This coalition of parties, formed in May 1999, was formally called the National Democratic Alliance.

Thus, the 1999 elections were characterized by re-drawing of new regional alliances. The formal NDA alliance won 269 seats and the Telugu Desam Party (Andhra Pradesh), which was not formally within the alliance but had assured support to the NDA, won 29 seats. This was the first time that a stable coalition not supported by the INC had secured a majority in the Parliament. The BJP called early elections in 2004, believing that it would win the elections.

This belief was based on the strong show in the Assembly elections held in key states in the earlier year. One of the main reasons as to why the Congress had lost in the State Assembly elections was lack of power-sharing agreements with the regional parties in the States.

The preparation phase for the 2004 Lok Sabha elections saw the Congress (Indian National Congress or INC) prominently switching its stance from that of a single party to a party amenable to power sharing agreements at the State level. In an interesting paper on the 2004 elections, Sridharan (2004) argues that a National Party becomes “coalitionable” when one or both of the following conditions are met:

1. Where two major national parties contest the elections in the presence of a third, smaller regional or national party/coalition. In this situation, both of the major parties find great merit in partnering with the third party to win the elections.
2. Where the major national party is reduced to a third or fourth party status in a State level polity. In this situation, the major national party may support the State level party and in turn promise some power-sharing agreement with the State at the national level.

As compared to 1999, the distribution of power between the INC, NDA and smaller regional parties in many of the major States was such that the INC was much more coalitionable. In Maharashtra, Andhra Pradesh, Jharkhand and J&K, the major contest was between the INC and NDA. The INC sought partnerships with the Nationalist Congress Party (NCP), Telangana Rashtra Samiti (TRS), Jharkhand Mukti Morcha (JMM) and the People's Democratic Party (PDP), which were all potentially anti-NDA allies in the 4 States respectively. In Bihar, the scenario was quite different. The INC was reduced to a fourth party status and already was a minor partner in the ruling RJD combine. In Tamil Nadu, the major two powers were the DMK and AIADMK, and the situation was thus wherein the Congress could be coalitionable.

The Congress went about creating alliances at the local levels. These alliances were more in the nature of mere power-sharing alliances in that the parties in the coalition did not necessarily see eye-to-eye with each other on policy issues. For example, the TRS was a party formed for supporting the separation of Telangana from Andhra Pradesh, an issue on which the INC did not necessarily agree. The NCP had reservations about the "foreign origin" of Sonia Gandhi; these reservations were set aside in the interest of the potential power sharing agreements between INC and NCP. The Left parties, which mostly supported the coalition from outside, were ideologically committed to a completely different set of ideas as compared to the INC.

The partnership arrangements paid off and the Congress-led alliance won the elections in 2004. This coalition became a formal entity, viz, United Progressive Alliance (UPA), only after the elections. The UPA consisted of political parties whose alliance with the major party INC was, at best, uneasy. This uneasiness and the resultant efforts of the INC to keep the coalition intact created a huge bargaining platform between the INC and the other, mostly regional, State-level political parties. In a way, the situation was one of a federal relationship between political parties, which could expectationally cause repercussions on the financial arrangements between Centre and States.

The 2009 elections demonstrated that coalitions were here to stay. With the new delimitation of constituencies allowing the Congress to redraw their alliances, the 2009 elections again saw Congress forging State level alliances. All regional parties were approached for post-election alliances rather than at a pre-election level. Thus, alliances were again seen to be

formed from a perspective of winning power to rule, not from the perspective of having common ideologies. The UPA Government came back to power in 2009.

However, a number of scams broke out under UPA II (UPA Government from 2004-09), and economic issues such as high inflation, economic slowdown, loss in jobs etc. created an anti-incumbency mood. The NDA swept the polls, with the BJP as the major party within the coalition and formed the Government under Mr. Narendra Modi.

These episodes of coalition politics highlight the increasing dependence of the two leading political parties in India, namely Indian National Congress and the Bharatiya Janata Party, on the smaller national level or regional parties. The said period has witnessed formation of alliances or coalitions, which have existed with uneasy partners, and sometimes, with outside support. There have been episodes of a regional party withdrawing support, forcing either the formation of a new alliance with new partners, or pushing the country into fresh elections. These episodes create interesting dependencies of the major National Party within the coalition on different regional parties, which in turn create a potential to drive economic bargains.

This synoptic historical sketch serves as a useful context for examining data on fund transfers from Centre to States from 1991 to the present.

4.2 Data trends in Centre-State Transfers from 1991-92 to 2013-14

Details regarding devolution and transfer of resources from the Centre to States from 2000-01 onwards are found in the State Finances: A Study of Budgets (2015-16) published by the Reserve Bank of India. Time-series data on devolution and transfer of resources from the Centre to States from 1990-91 to 2000-01 have been published by the Economic and Political Weekly Research Foundation (EPWRF) at the behest of the Planning Commission. These datasets contain details regarding the transfer of resources from Centre to States at a disaggregated level. We aggregated the relevant variables to create data on transfers given by the Finance Commission, Planning Commission and the Central Ministries in the said time period (See Appendix A). The reporting norms for fund transfers to States were changed from 2014-15 and hence, comparable datasets are available from 1991-92 to 2013-14 only.

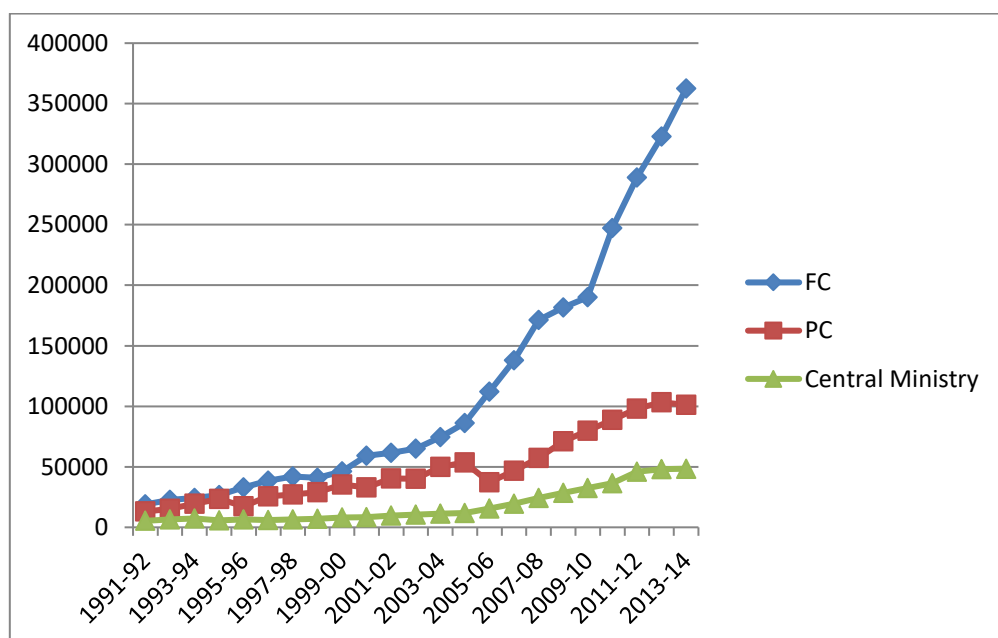
The transfers given by the different entities such as Finance Commission, Planning Commission and Central Ministries over this period are shown in the table below in absolute figures as well as in terms of percentage of the total.

Table 4.2.1: Transfers (Rs. crores) and Percentage Share in Transfers by FC, PC and Central Ministries from 1991-92 to 2013-14

Transfers by different Agencies	FC	PC	Central Ministry	Total Transfers
1991-92	18968 (50.74%)	13038 (34.88%)	5374 (14.38%)	37380 (100.00%)
1992-93	22697 (50.89%)	15381 (34.49%)	6521 (14.62%)	44599 (100.00%)
1993-94	24157 (47.36%)	19515 (38.26%)	7338 (14.39%)	51010 (100.00%)
1994-95	26725 (47.96%)	23381 (41.96%)	5620 (10.09%)	55726 (100.00%)
1995-96	33020 (58.09%)	17368 (30.56%)	6453 (11.35%)	56841 (100.00%)
1996-97	38642 (55.05%)	25461 (36.27%)	6092 (8.68%)	70195 (100.00%)
1997-98	42094 (55.43%)	27216 (35.84%)	6636 (8.74%)	75946 (100.00%)
1998-99	40841 (53.18%)	28946 (37.69%)	7010 (9.13%)	76797 (100.00%)
1999-00	46109 (51.41%)	35486 (39.57%)	8095 (9.03%)	89690 (100.00%)
2000-01	59106 (58.81%)	33079 (32.91%)	8315 (8.27%)	100500 (100.00%)
2001-02	61480 (55.10%)	40480 (36.28%)	9610 (8.61%)	111570 (100.00%)
2002-03	64860 (56.17%)	40250 (34.85%)	10370 (8.98%)	115480 (100.00%)
2003-04	74630 (54.99%)	49900 (36.77%)	11190 (8.24%)	135720 (100.00%)
2004-05	86190 (56.92%)	53520 (35.35%)	11710 (7.73%)	151420 (100.00%)
2005-06	112070 (68.02%)	37150 (22.55%)	15530 (9.43%)	164750 (100.00%)
2006-07	138010 (67.58%)	46680 (22.86%)	19530 (9.56%)	204220 (100.00%)

Transfers by different Agencies	FC	PC	Central Ministry	Total Transfers
2007-08	171190 (67.74%)	57400 (22.71%)	24140 (9.55%)	252730 (100.00%)
2008-09	181530 (64.59%)	70990 (25.26%)	28550 (10.16%)	281070 (100.00%)
2009-10	190000 (62.90%)	79760 (26.40%)	32330 (10.70%)	302090 (100.00%)
2010-11	247150 (66.39%)	88680 (23.82%)	36420 (9.78%)	372250 (100.00%)
2011-12	289070 (66.74%)	98170 (22.67%)	45860 (10.59%)	433100 (100.00%)
2012-13	322840 (68.08%)	103240 (21.77%)	48150 (10.15%)	474230 (100.00%)
2013-14	362460 (70.78%)	101230 (19.77%)	48430 (9.46%)	512120 (100.00%)

Graph No. 4.2.1: Transfers (Rs. crores) by FC, PC and Central Ministries from 1991-92 to 2013-14



Graph No. 4.2.2: Share of Transfers (Percentage) by FC, PC and Central Ministries from 1991-92 to 2013-14

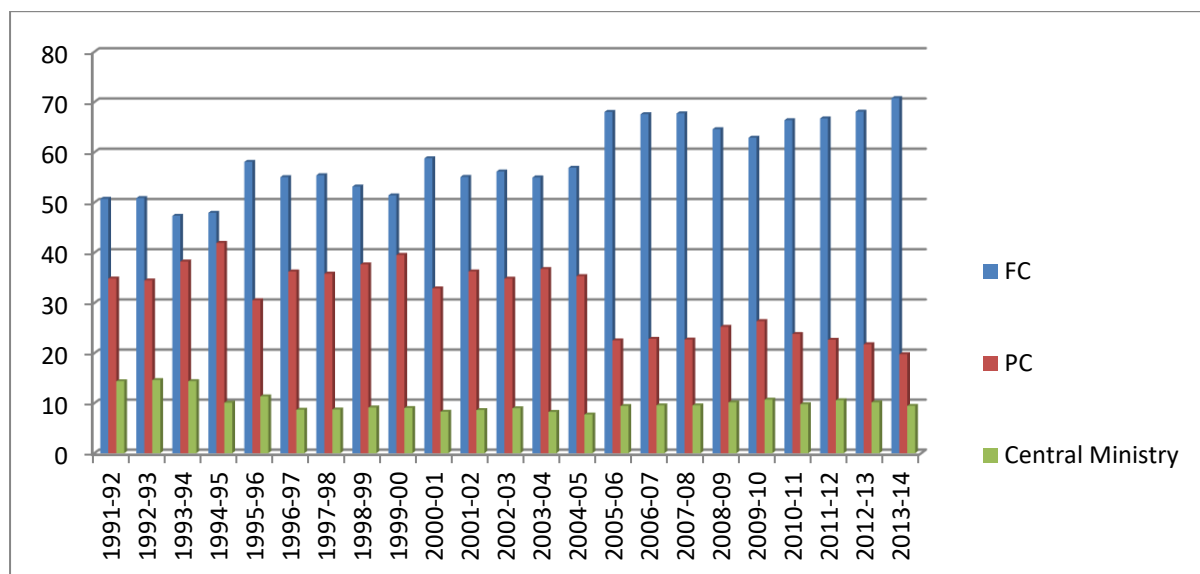


Table No. 4.2.2: Summary Statistics for Transfers (Rs. crores) by FC, PC and Central Ministries from 1991-92 to 2013-14

Transfers by different agencies	Mean	Standard Deviation	Co-efficient of Variation	Trend Growth Rate (%)	Average Share in Total Transfers (%)
FC	115384	104185	0.90	13.45	58.91
PC	48100	28822	0.60	8.94	31.02
Central Ministry	17794	14773	0.83	10.82	10.07
Total transfers	181279	146883	0.81	11.82	100.00

Table No. 4.2.3: Y-o-Y Growth rate, Trend Growth Rate and CAGR of FC, PC and Central Ministry transfers from 1992-93 to 2013-14

Transfer Agency	Y-o-Y Growth Rate of FC Transfers	Y-o-Y Growth Rate of PC Transfers	Y-o-Y Growth Rate of Central Ministry Transfers	TOTAL
1992-93	19.66	17.97	21.34	19.31
1993-94	6.43	26.88	12.53	14.37
1994-95	10.63	19.81	-23.41	9.25
1995-96	23.55	-25.72	14.82	2
1996-97	17.03	46.6	-5.59	23.49
1997-98	8.93	6.89	8.93	8.19
1998-99	-2.98	6.36	5.64	1.12
1999-00	12.9	22.59	15.48	16.79
2000-01	28.19	-6.78	2.72	12.05
2001-02	4.02	22.37	15.57	11.01
2002-03	5.5	-0.57	7.91	3.5
2003-04	15.06	23.98	7.91	17.53
2004-05	15.49	7.25	4.65	11.57
2005-06	30.03	-30.59	32.62	8.8
2006-07	23.15	25.65	25.76	23.96
2007-08	24.04	22.96	23.6	23.75
2008-09	6.04	23.68	18.27	11.21
2009-10	4.67	12.35	13.24	7.48
2010-11	30.08	11.18	12.65	23.22
2011-12	16.96	10.7	25.92	16.35
2012-13	11.68	5.16	4.99	9.5
2013-14	12.27	-1.95	0.58	7.99
Trend Growth Rate	13.45	8.94	10.82	11.82
CAGR	14.35	9.76	10.51	12.63

The above tables and graphs reveal the trends in the nature of transfers done from the Centre to the States from 1991-92 to 2013-14. The main observations from the data are:

- The FC makes the biggest transfers from Centre to States. On an average, the transfers done under the FC route account for nearly 59 per cent of the total transfers done from Centre to States in the data period (Table 4.2.2).
- However, the co-efficient of variation of FC transfers is 0.9, which implies that the standard deviation is 90 per cent of the mean. This high variability in the FC data renders the usual interpretation of the mean level of transfers irrelevant.
- The high variability in the FC transfers might be due to the change in the tax share of States recommended by the different FCs in the data period.
- We hence re-arrange the FC transfers into 5-year sub-periods under the recommendations of different FCs and give the summary statistics for these time periods.

Table No. 4.2.4: Summary Statistics for FC transfers arranged as per different Finance Commissions

Finance Commissions in the data period	Mean transfers (Rs. crores)	Standard Deviation	CV	Proportion to total transfers (%)
10th FC (1995-96 to 1999-00)	40141	4818.63	0.12	54.63
11th FC (2000-01 to 2004-05)	69253	11163.04	0.16	56.39
12th FC (2005-06 to 2009-10)	158560	32631.40	0.21	66.16
13th FC (2010-11 to 2014-15)*	305380	49056.86	0.16	67.99

*For the 13th FC, the summary statistics are based on the data upto 2013-14

- The FC transfers as a proportion of total transfers from Centre to States show a secular increase across the different Finance Commissions.
- Consistent with the above point, we see that the y-o-y growth rate of FC transfers shows a jump every 5 years. The y-o-y growth rates in 1995-96, 2000-01, 2005-06 and 2010-11 show sudden increments. This is consistent with the recommendations of a new FC coming into force every 5 years. As has been mentioned in Chapter 3, every FC has increased the percentage of taxes to be shared with the States over the recommendations of the earlier FC. This leads to the growth rate of FC transfers increasing suddenly when the recommendations of the new FC come into force.
- The variability in FC transfers can be attributed more to the variability in the grant component of transfers rather than to the tax share component.
- The Planning Commission emerges as the second biggest agency of transfers. On an average, about 31 per cent of the transfers have been recommended by the PC. However, the variability in the PC transfers is very high; the CV for PC transfers stands at 0.6 (Table 4.2.2). Re-arranging the data by the period of the Five Year Plans might be able to give a better picture of the trends in the PC transfers across time.

Table No. 4.2.5: Summary Statistics for PC transfers arranged as per different Five Year Plans

	Mean transfers (Rs. crores)	Standard Deviation	CV	Proportion to total transfers (%)
8th FYP (1992-93 to 1996-97)	20221	4168.54	0.21	36.30
9th FYP (1997-98 to 2001-02)	33041	5291.92	0.16	36.45
10th FYP (2002-03 to 2006-07)	45500	6752.00	0.15	30.47
11th FYP (2007-08 to 2011-12)	79000	15751.90	0.20	24.17
12th FYP (2012-13 and 2016-17)	102235	1421.28	0.01	20.76

*For the 12th FYP, the summary statistics are based on the data upto 2013-14

- The proportion of PC transfers to total transfers declines secularly from the 8th Five Year Plan to the 12th Five Year Plan.
- There are four years in which PC transfers show negative growth rates (Table 4.2.3). Of these four instances, 1995-96 and 2005-06 show huge reductions in transfers. In 1995-96 and in 2005-06, we see that the PC transfers decline by 25.72 per cent and 30.59 per cent respectively. These are huge reductions in PC transfers and ones, for which more investigation is needed. As compared to PC transfers, we find that the number of instances in which the FC transfers or Central Ministry transfers show a sudden and large fall are very low.
- On an average, the assistance for CS and CSS through Central Ministries accounts for only 10 per cent of the total Centre-State transfers over the entire data period. CS and CSS transfers too show a very high level of variance (CV is 0.8). This renders interpretations about the average trends meaningless. We hence arrange the CS and CSS data into sub-periods co-inciding with the Five-Year Plans. This brings out the secular trends in Central Ministry transfers in a better way.

Table No. 4.2.6: Summary Statistics for Central Ministry transfers arranged as per Five Year Plans

	Mean transfers (Rs. crores)	Standard Deviation	CV	Proportion to total transfers (%)
8th FYP (1992-93 to 1996-97)	6404	632.54	0.10	11.82
9th FYP (1997-98 to 2001-02)	7933	1174.59	0.15	8.75
10th FYP (2002-03 to 2006-07)	13666	3830.18	0.28	8.79
11th FYP (2007-08 to 2011-12)	33460	8288.08	0.25	10.16
12th FYP (2012-13 and 2016-17)	48290	197.99	0.00	9.8

*For the 12th FYP, the summary statistics are based on the data upto 2013-14

- Transfers by Central Ministries as a proportion of total transfers fall from 11.82 per cent in the Eighth Five Year Plan to 8.75 per cent in the Ninth Five Year Plan. From

the Ninth Five Year Plan upto the Eleventh Five Year Plan, share of transfers by Central Ministries recovered again and increased. It falls to 9.8 per cent in the Twelfth Five Year Plan.

- However, the actual level of transfers done by Central Ministries might be higher, if one is to take into consideration the direct release of funds to implementation agencies done by the Central Ministries. As has been mentioned in Chapter 3, funds are sometimes directly given to the implementation agencies rather than transferring the funds to State Government budgets. Direct release of the funds to the implementation agencies implies that these funds are directly spent by the Centre and hence, they do not technically qualify as “transfers”. That is why these items of expenditure are not included under “Net Resources transferred to States”. Data on direct release under Central Plan to State/ District level implementation agencies are only available from 2006-07 till 2013-14¹. Direct release to implementation agencies under Central Assistance to State Plans is recommended by the Planning Commission whereas direct release of funds to implementation agencies under Central Plan is made by Central Ministries. The summation of “Net Resources transferred to States” and “Direct release of funds to implementation agencies” is henceforth referred to as “Aggregate Transfers”.
- The following table gives the details regarding components of “Aggregate transfers”. Please note that since data on direct release of funds are only available from 2006-07 to 2013-14, the following table has been constructed for that time period only.

¹ It is not clear whether direct release of funds to implementation agencies was started in 2006-07 or whether the data on the same is being made available only after 2006-07.

Table 4.2.7: Transfer of resources from Centre to States (Rs. crores), Direct release of funds to implementation agencies (Rs. crores) and proportions thereof to Aggregate Transfers from 2006-07 to 2013-14

Transfer heads	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	Average Proportion (2006-07 to 2013-14)
FC Transfers	138010 54.94%	171190 55.99%	181530 49.1%	190000 48.21%	247150 50.18%	289070 53.06%	322840 55.38%	362460 57.65%	53.06%
PC Transfers	46680 18.58%	57400 18.77%	70990 19.2%	79760 20.24%	88680 18.01%	98170 18.02%	103240 17.71%	101230 16.1%	18.33%
Central Ministry Transfers	19530 7.78%	24140 7.9%	28550 7.72%	32330 8.2%	36420 7.39%	45860 8.42%	48150 8.26%	48430 7.7%	7.92%
IN ADDITION									
Direct release of Central Assistance for State Plans to implementation agencies or departments	1795 0.71%	1754 0.57%	1580 0.43%	1532 0.39%	1533 0.31%	2508 0.46%	3722 0.64%	3937 0.63%	0.52%
Direct release under Central Plan to State/ District level implementation agencies	45166 17.98%	51260 16.77%	87054 23.55%	90521 22.97%	118740 24.11%	109173 20.04%	104971 18.01%	112708 17.93%	20.17%
AGGREGATE TRANSFERS	251181 100%	305744 100%	369704 100%	394143 100%	492523 100%	544781 100%	582923 100%	628765 100%	100%

- The following table shows the extent of total Aggregate Transfers by different agencies.

Table 4.2.8: Aggregate Transfer of funds (Rs. crores) and Proportion to Aggregate Transfer by all Agencies from 2006-07 to 2013-14

Aggregate Transfers by Different Agencies	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	Average Proportion	CAGR
FC	138010 54.94%	171190 55.99%	181530 49.10%	190000 48.21%	247150 50.18%	289070 53.06%	322840 55.38%	362460 57.65%	53.06%	14.79%
PC	48475 19.30%	59154 19.35%	72570 19.63%	81292 20.63%	90213 18.32%	100678 18.48%	106962 18.35%	105167 16.73%	18.85%	11.7%
Central Ministries	64696 25.76%	75400 24.66%	115604 31.27%	122851 31.17%	155160 31.5%	155033 28.46%	153121 26.27%	161138 25.63%	28.09%	13.92%
Total Aggregate Transfers	251181 100%	305744 100%	369704 100%	394143 100%	492523 100%	544781 100%	582923 100%	628765 100%	100.00%	14.01%

- Aggregate transfers by FC on the average stand at 53.06 per cent of Aggregate Transfers by all agencies. Aggregate transfers by Central Ministries and PC stands at 28 per cent and 18.85 per cent of Aggregate Transfers by all agencies respectively.
- Thus, the aggregate transfers by Central Ministries are actually bigger than that done by the Planning Commission for all years from 2006-07 to 2013-14.
- Aggregate transfers by Central Ministries also have a higher growth rate as compared to the Aggregate Transfers by Planning Commission.
- The following table (Table 4.2.9) shows the share of CS and CSS transfers and direct release of funds within the Aggregate Transfers by Central Ministries.

Table 4.2.9: Percentage Share of CS and CSS transfers as well as Direct release of funds to Implementation Agencies within Aggregate Transfers by Central Ministries (2006-07 to 2013-14)

Central Ministry Transfers	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	Average (2006-07 to 2013-14)
Assistance for CS and CSS	30.19	32.02	24.70	26.32	23.47	29.58	31.45	30.05	28.47
Direct release under Central Plan implementation agencies	69.81	67.98	75.30	73.68	76.53	70.42	68.55	69.95	71.53
Aggregate Transfers by Central Ministries	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

- Direct release of funds to implementation agencies are much bigger than the transfers under Assistance to CS and CSS by Central Ministries. On an average, 71.53 per cent of the Aggregate Transfers by Central Ministries is in the form of direct release of funds to implementation agencies and only 28.47 per cent is in the form of resources transferred to State Governments for CS and CSS.
- Thus, from 2006-07 to 2013-14, the FC, Central Ministries and the PC transfer funds to States, necessarily in that order. The CAGRs of the Aggregate Transfers also follow the same order, with the highest rate of growth in Aggregate Transfers being associated with FC devolutions. Within the Central Ministry Aggregate Transfers, the proportion of direct release of funds to implementation agencies is far higher as compared to the Resources transferred to State Governments by Central Ministries for CS and CSS.

Table 4.2.10: Comparison of Shares of FC, PC and Central Ministries in “Resources transferred to States” and “Aggregate Transfers”

Agencies	Proportion of “Resources Transferred to States” by different agencies	Proportion of “Aggregate Transfers” by different agencies
FC	58.91%	53.06%
PC	31.02%	18.85%
Central Ministries	10.07%	28.09%
TOTAL	100.00%	100.00%

Thus, if only “Resources transferred to the States” alone are considered, the share of discretionary transfers by Central Ministries is quite low and stands at 10 per cent of the total transfers to States. However, the actual transfer to States is more than the “Resources transferred to States”. This is because Central Ministries directly release funds to implementation agencies, thereby by-passing Consolidated Funds of States completely. If “Aggregate Transfers” from Centre to States are considered, then an altogether different picture emerges. In this case, FC transfers still account for the largest share, but Central Ministry transfers are higher than the PC transfers. Thus, if Aggregate Transfer of funds be considered agency-wise, Central Ministries as agencies of controlling movement of funds to States account for a much higher share than the Planning Commission.

4.3 Comparing the trends in transfers between NDA I, UPA I and UPA II

The period under consideration includes the terms of 4 coalition Governments that stably held power for the full term of five years. The INC, in coalition with other parties, was in power from 1991 to 1996. The NDA was in power from 1999 to 2004 (this will be termed NDA I henceforth), the UPA was in power from 2004-09 (UPA I henceforth) and again from 2009-2014 (UPA II henceforth). The regime of NDA II commenced in 2014-15 and hence is not within the period under consideration.

It would be interesting to compare the growth rates of the transfers by the three agencies, namely FC, PC and Central Ministries under the 4 coalition Governments which completed full terms at the Centre. The following table shows the devolution of funds by different agencies under the coalition formed by the INC together with other parties.

Table 4.3.1: Transfers (Rs. crores) by different agencies and Proportions thereof to Total Transfers under Coalition formed by INC with smaller partners (1991-1996)

Transfers by different Agencies	1991-92	1992-93	1993-94	1994-95	1995-96	CAGR
FC	18968 50.74%	22697 50.89%	24157 47.35%	26725 47.95%	33020 58.09%	14.87
PC	13038 34.88%	15381 34.48%	19515 38.25%	23381 41.95%	17368 30.55%	7.43
Central Ministry	5374 14.37%	6521 14.62%	7338 14.38%	5620 10.08%	6453 11.35%	4.68
TOTAL	37380 100%	44599 100%	51010 100%	55726 100%	56841 100%	11.05

From 1991 to 1996, the total transfers grew at a CAGR of 11.05 per cent. Transfers to States are given by FC, PC and Central Ministries, necessarily in that order. Even in terms of growth rates, we find that the transfers given by FC and PC have higher growth rates compared to the Central Ministry transfers. The CAGR of Central Ministry transfers stands at only 4.68 per cent over the term of this coalition. The entire transfers by Central Ministries are routed through the Consolidated Funds of States (There is no instance of direct release of funds to implementation agencies).

The following table shows the transfer of funds by different agencies under NDA I.

Table 4.3.2: Transfers (Rs. crores) by different agencies and Proportions thereof to Total Transfers under NDA I (1999-2004)

Transfer Agency (Rs.crores)	1999-00	2000-01	2001-02	2002-03	2003-04	CAGR
FC	46109 51.41%	59106 58.81%	61480 55.10%	64860 56.17%	74630 54.99%	12.79
PC	35486 39.57%	33079 32.91%	40480 36.28%	40250 34.85%	49900 36.77%	8.89
Central Ministry	8095 9.03%	8315 8.27%	9610 8.61%	10370 8.98%	11190 8.24%	8.43
Total Transfers	89690 (100%)	100500 (100%)	111570 (100%)	115480 (100%)	135720 (100%)	10.91

Under the NDA rule (1999-2004), FC, PC and Central Ministries are important in terms of making transfers, necessarily in that order. Whilst the FC and PC devolutions show a CAGR of 12.79 per cent and 8.89 per cent respectively, Central Ministry devolutions show only a 8.43 per cent CAGR. Further, all devolutions are routed through the Consolidated Funds of States and there is no direct release of funds to implementation agencies.

The following table shows the “Aggregate Transfers” done by FC, PC and Central Ministries under the UPA I regime from 2004 to 2009. Data on direct releases of funds to implementation agencies are available from 2006 onwards. The summation of Resources transferred to the States by the different agencies and “direct releases of funds to implementation agencies” gives Aggregate Transfers.

Table 4.3.3: Aggregate Transfers (Rs. crores) by different agencies and Proportions to Total Aggregate Transfers under UPA I (2004-09)

Transfer Agency	2004-05	2005-06	2006-07	2007-08	2008-09	CAGR
FC	86190 56.92%	112070 68.02%	138010 54.94%	171190 55.99%	181530 49.1%	20.46
PC	53520 35.34%	37150 22.54%	48475 19.29%	59154 19.34%	72570 19.63%	7.9
Central Ministry	11710 7.73%	15530 9.43%	64696 25.75%	75400 24.66%	115604 31.26%	77.25
<i>Of which</i>						
CS and CSS transfers	11710 7.73%	15530 9.43%	19530 7.77%	24140 7.89%	28550 7.72%	24.95
Direct release of funds to implementation agencies	NA	NA	45166 17.98%	51260 16.76%	87054 23.54%	38.83*
Total Aggregate transfers	151420 100%	164750 100%	251181 100%	305744 100%	369704 100%	10.91

*The CAGR for Direct Release of Funds to Implementation Agencies has been calculated for 3 years

Under UPA I, the data on transfers show several significant changes. After the first two years of the coalition assuming power, we find that aggregate transfers by the Central Ministry

become higher as compared to those by PC. This implies that transfers for implementing Central Plans at State level are higher than those given for implementing State Plans. The rapid change in dynamics is indicated in the CAGR of the components. The CAGR of Aggregate Transfers by Central Ministries over the UPA I period is extremely high and stands at 77.25 per cent.

The huge increase in the Aggregate Transfers by Central Ministries during the UPA I regime can be largely associated with the huge social sector spending that the UPA I Government carried out. The National Common Minimum Programme (NCMP) launched by the UPA I Government carried its vision of increasing budgetary allocations to the socially vulnerable sections of the society. It has been suggested that one of the reasons for the NDA Government losing elections in 2004 is that its pro-market stance or “India Shining” policy had failed to strike a chord with the vulnerable sections staying in “Bharat”. The NCMP partly reflected the electoral strategy of the newly elected UPA Government. In part, though, the NCMP also reflected an approach used to placate the Left Front and other left-aligned parties, which were significant members of the UPA I coalition.

Consistent with the mandates of the NCMP, the UPA I Government passed the Mahatma Gandhi National Rural Employment Guarantee Act (2005), giving 100 days of guaranteed employment to unskilled labour in the rural areas. It also consolidated the various programs for bettering rural health outcomes and launched the National Rural Health Mission (NRHM) in 2006 and National Urban Health Mission (NUHM) in 2009. The Sarva Shiksha Abhiyan was prioritized as a flagship program of the UPA Government. From 2007-08 onwards, budgetary allocations for secondary and higher education were increased significantly. Similarly, budgetary allocations for Integrated Child Development Services (ICDS), Mid-day Meal Scheme, Total Sanitation Campaign and Accelerated Rural Water Supply Program were enhanced significantly (Jha, Mishra, Das & Parvati, 2009). The priority given to social sector under UPA I and the increased spending on Central Sector and Centrally Sponsored Schemes gets reflected in the steep CAGR of the Central Ministry transfers in Table 4.3.3.

From 2006-07 onwards, the Centre started releasing funds directly to implementation agencies. One of the reasons for this is the sudden fiscal deterioration of State finances that started from 1997-98 onwards. From around 1997-98, States started competing amongst themselves for getting more investments (Planning Commission Report, 2006), and this was largely done without putting into place checks for controlling tax evasion. As a result, the

annual growth rate of tax revenue of the States declined from 15.5 per cent in the decade before 1997 to 12.9 per cent from 1997-98 to 2002-03. The increasing contribution of services to the economy and lack of a suitable tax base at the State level to tap this important source of revenue further lowered tax revenue. On the expenditure side, the salary and pension payments increased for States following the pay-hike introduced by the fifth Pay Commission. Also, there were political compulsions to spend more on investments in irrigation, agriculture and other social sectors.

This led to a deterioration in the fiscal situation of Indian States after 1997-98. The response of several States, which had received payments from the Centre for CSS in their Consolidated Funds, was to delay the flow of funds to the concerned Departments. This seriously affected the implementation of CSS between 1997-98 and 2002-03. The UPA Government, which wanted to increase the budgetary allocations on various social sector schemes, found that the most significant risk in implementing the schemes was that of interruption in fund flows by State Governments. Many of the Central Ministries responded to the problem by by-passing the State Consolidated Funds and directly releasing the funds to the implementation agencies of the State Government (Das & Mitra, 2013). This way of directly releasing the funds to the implementation agencies was used for many big-budget CSSs such as Sarva Shiksha Abhiyaan (SSA), Mahatma Gandhi National Rural Employment Guarantee Scheme (MNREGS), National Rural Health Mission (NRHM), and National Rural Drinking Water Programme (NRDWP). Hence, data show a very high CAGR associated with the direct release of funds to implementation agencies under UPA I.

Thus, transfers under UPA I became more discretionary (higher budgetary allocations for CSS) with pronounced bias in favour of Central Plan as compared to State Plans and were routed mostly through direct release of funds made directly to the State or District level implementation agencies bypassing the Consolidated Funds of States.

The practice of directly releasing funds to implementation agencies continued under UPA II, as is seen in the data in Table 4.3.3.

Table 4.3.4: Aggregate Transfers (Rs. crores) by different agencies and Proportions to Total Aggregate Transfers under UPA II (2009-14)

Transfer Agency	2009-10	2010-11	2011-12	2012-13	2013-14	CAGR
FC	190000 48.21%	247150 50.18%	289070 53.06%	322840 55.38%	362460 57.65%	17.52
PC	81292 20.62%	90213 18.31%	100678 18.48%	106962 18.34%	105167 16.72%	6.64
Central Ministry	122851 31.17%	155160 31.5%	155033 28.46%	153121 26.27%	161138 25.63%	7.01
<i>Of which</i>						
CS and CSS transfers	32330 8.2%	36420 7.39%	45860 8.42%	48150 8.26%	48430 7.70%	10.63
Direct release of funds to implementation agencies	90521 22.97%	118740 24.11%	109173 20.04%	104971 18.01%	112708 17.93%	5.63
Total Aggregate Transfers	394143 100%	492523 100%	544781 100%	582923 100%	628765 100%	

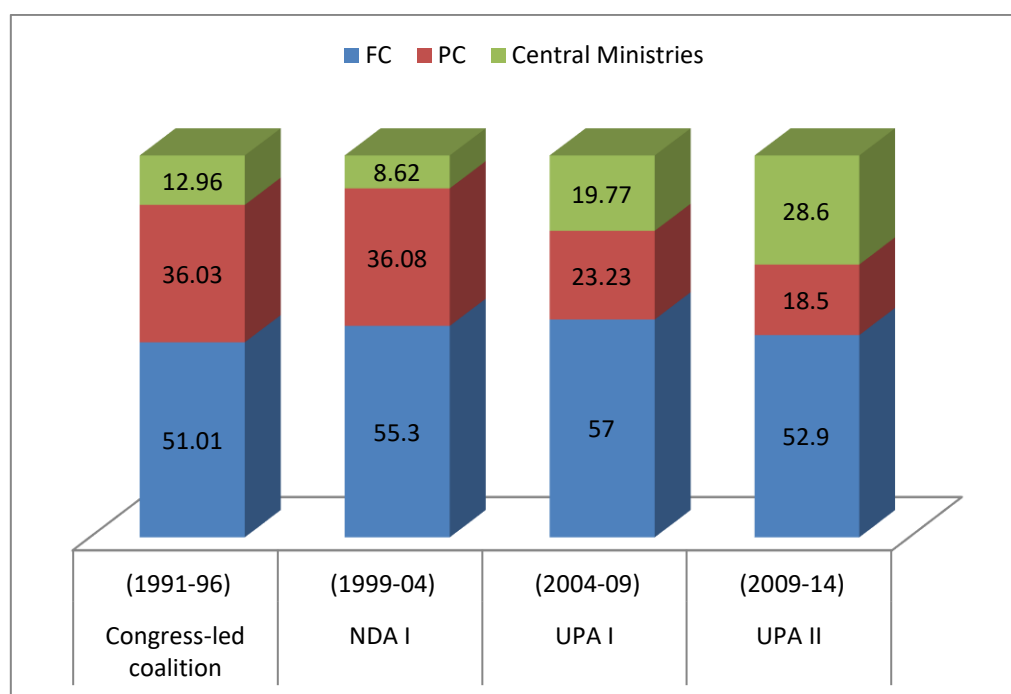
Under UPA II, some of the elements introduced in UPA I continue to be seen. A bias towards the Centre continues to be seen in that the aggregate transfers by Central Ministries are higher than those given by the PC. Direct release of funds to implementation agencies by Central Ministries is almost four times as high as the resources transferred through CS and CSS. However, while the amount as well as proportion of Aggregate Transfers by Central Ministries are high, the CAGR of the same does come down, which might be reflective of the base effect. Similarly, the CAGR of direct release of funds to implementation agencies also comes down in this period.

The following table shows a comparison of the average percentage share of the three agencies in the Aggregate Transfers in the Congress-led coalition, NDA I, UPA I and UPA II governments.

Table 4.3.5: Average Percentage Share by Agencies in the total devolution to States under Congress, NDA I, UPA I and UPA II

Agencies	Congress (1991-96)	NDA I (1999-04)	UPA I (2004-09)	UPA II (2009-14)
FC	51.01	55.30	57.00	52.90
PC	36.03	36.08	23.23	18.50
Central Ministries	12.96	8.62	19.77	28.60

Graph 4.3.1: Percentage Share by Agencies in the Aggregate Transfers to States under Congress-led Coalition, NDA I, UPA I and UPA II



Thus, it is under UPA I Government that the share of discretionary transfers by Central Ministries increases. The share of discretionary transfers is highest under UPA II. Further, it is seen that the share of transfers by the Finance Commission as well as Planning Commission fall under UPA II and a higher share of devolution takes place through the Central Ministries.

4.4 Do weaker coalitions create higher discretionary transfers?

In Section 4.3, we have already presented data on fiscal transfers by different coalition Governments. We have also shown that it was the UPA II Government under which the share of discretionary transfers was the highest. This gives us an interesting context in which to

informally examine whether composition of the ruling coalition has an effect on the nature and quantum of fiscal transfers.

A major assertion in coalition studies is that “any coalition is at best a second-best situation for every major political party” (Kailash, 2009). This implies that the major party within the coalition will be uneasy with the pressure tactics of the smaller parties and will try to enhance its own position within the coalition. If political factors actually do affect fiscal transfers, then weaker the position of the central party within the coalition, higher would be the possibility of the central party using discretionary transfers to advance its own power within the coalition.

So we next attempt to understand the composition of the NDA I, UPA I and UPA II alliances. We identify which coalition had relatively the weakest centre and which one had the strongest one.

In order to gauge the strength of the central party within the coalition in power, we construct a data table on the number of seats captured by the Central party in the coalition as a percentage of the total number of seats won by the coalition. Lower the percentage of the total number of seats won by the central party within coalition, higher is the bargaining power of the constituent units. We examine whether such a scenario creates instances of higher discretionary transfers to States.

Table 4.4.1: Coalition Governments between 1999 and 2014, Seats won by major parties within coalition, Seats won by the Coalition, No. of parties in the Coalition

Election Year	Winner	Major Party in the Winner Alliance	Seats won by Major Party within Alliance	Seats won by the Alliance	% seats won by major party within winner alliance
1999	NDA I	BJP	180	270	67
2004	UPA I	INC	145	222	65
2009	UPA II	INC	206	262	79

In terms of percentage of seats belonging to the major party within the winner alliance, the UPA I government seems to be the weakest of the three coalition governments. However,

again, there isn't a major difference between NDA I in which BJP had won 67 per cent of the seats within the alliance and UPA I in which the INC had won 65 per cent of the seats within the alliance. But there is a different vulnerability associated with UPA I; this has to do with the total number of seats won by the core alliance in the first place.

Any party or coalition which wins 272 or more seats in the Lok Sabha gets the majority and forms the Government. Now, the core NDA I electoral alliance had secured 270 seats by itself; thus, while it would need outside support or negotiations with other parties to form the Government, it would also have a higher bargaining power in any of the talks. In contrast, the UPA was itself formed after the elections. With the "post-elections" partnerships forged, UPAI as a core coalition had won only 222 seats, which implies that it would need a partner or multiple partners with control over 50 seats in order to make up the Government.

This dependency on multiple partners within the coalition and a placatory approach for the outside partners would then imply a ripe opportunity and scope for political and also economic bargains. It could be argued that the huge emphasis on discretionary transfers and the proliferation of Centrally Sponsored Schemes under UPA I was a manifestation of the weakness of the INC or the weakness of the coalition or both.

However, such compulsions do not exist under UPA II. Out of the 272 seats required for forming the Government, the UPA II coalition won 262 seats. Within the coalition, the INC controlled 79 per cent of the seats. It is obvious that the nature and the quantum of economic bargains would be significantly downsized within such a coalition affording an upper hand to the major party within the coalition.

If weakness of the coalition were indeed to be the dominant variable which explains the prevalence of discretionary transfers, then there would be no case for continuation and strengthening of the same under a much stronger INC position inside the UPA II. But we find that the share of discretionary transfers by Central Ministries under UPA II is even higher than under UPA I!

Instead of placating coalition partners, the major partner may be using transfers to consolidate its own position in States. This could be a natural second theme in coalition politics.

In any case, there must have been other variables that created conditions for continuation and proliferation of discretionary transfers even in the absence of apparent political compulsions to continue the same.

With the presence of just three coalition Governments in the data period, statistical testing alone may have limited capacity to establish association or causality between weak coalitions and discretionary transfers. However, even without running statistical models, we may claim that “strength” of the coalition does not seem to be associated with proliferation of discretionary transfers.

4.5 Does “political alignment” affect Centre-State transfers in India?

Another question that has been often debated in literature is whether discretionary transfers have favoured certain States more specifically as compared to others. Does the Centre-State relationship model itself along lines of a bargaining platform, with higher discretionary transfers per capita moving towards politically “important” states?

Existing research studies define politically important States to be those which are either “politically aligned” to the Centre or those in which the proportion of MPs belonging to the ruling party in power at the Centre are higher. In this section, we only consider political alignment of the State with the Centre as a variable which could potentially affect transfer of funds. A brief discussion on the other variable is given in Section 4.11.

It is pertinent to note that whether a particular State got higher or lower discretionary transfers from the Centre can be assessed correctly only if compared and contrasted with non-discretionary transfers from the Centre. Whereas CSS transfers by the Central Ministries can be treated to be the most discretionary transfers, transfers by the FC are the most formulaic or non-discretionary ones. PC transfers to the General Category States have been largely driven by the Gadgil-Mukherjee formula in the data period. However, owing to the framework of the NDC, PC transfers for State Plans lend themselves to be the closest to a position of a “bargain” between Centre and States.

We examine which States have got “high”, “medium” and “low” transfers from the FC, PC and Central Ministries.

We also need to define “political alignment. For our purpose, we define it as follows: If the party or coalition forming the State government is the same as, or is a coalition partner in, or supports the coalition at the Centre from outside, then we say that the State is “politically aligned” to the Centre. Dummy variables have been constructed to indicate political alignment; a value of “1” is assigned if the State is politically aligned with the Centre and a value of “0” is assigned if there is no alignment.

Data on State-wise transfers were obtained from the National Institute for Public Finance and Policy (NIPFP) for fourteen large General Category States for the period post-reforms period.

The chosen States are Andhra Pradesh, Bihar, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Odisha, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

Only the major States have been taken into consideration because they all reflect reasonably comparable strengths and status in terms of their biggest economic and political bargaining strength, namely, population and political representation in the Centre, for example, number of Members of Parliament in the Lok Sabha. Including smaller General Category States in the sample, for example Goa, Tripura or Puducherry would lead to differences in the treatment allotted to the States by the Centre due to the population criterion. Analyzing only the relatively bigger States helps us to control for the difference in treatment given by the Centre to the States based on their political representation.

The data from NIPFP were available from 1993-94. The NIPFP data is maintained in the following format:

Table 4.5.1: NIPFP data format on Total Revenue Receipts and Total Transfer from Central Government

Budget code	Budget description / years
A	Total Revenue Receipts
B	Total Transfer from Central Government (C+D)
C	Share in Central Taxes
D	Grants-in-aid from Central Government (1 to 5)
1	Non-plan Grants
2	Grants for State/Union Territory Plan Schemes
3	Grants for Central Plan Schemes
4	Grants for Centrally Sponsored Plan Scheme
5	Grants for Special Plan Scheme

We have defined “FC transfers”, “PC transfers” and “Central Ministry transfers” using data mentioned in Table 4.5.1. Following are the components used to define the variables.

1. FC transfers = Share in Central Taxes (Component C) + Non- Plan Grants (Component D1)

2. PC transfers = Grants for State Plan Schemes² (Component D2) + Plan Loans (Data obtained from State Budgets)
3. Central Ministry transfers = Grants for Central Plan Schemes + Grants for Centrally Sponsored Schemes

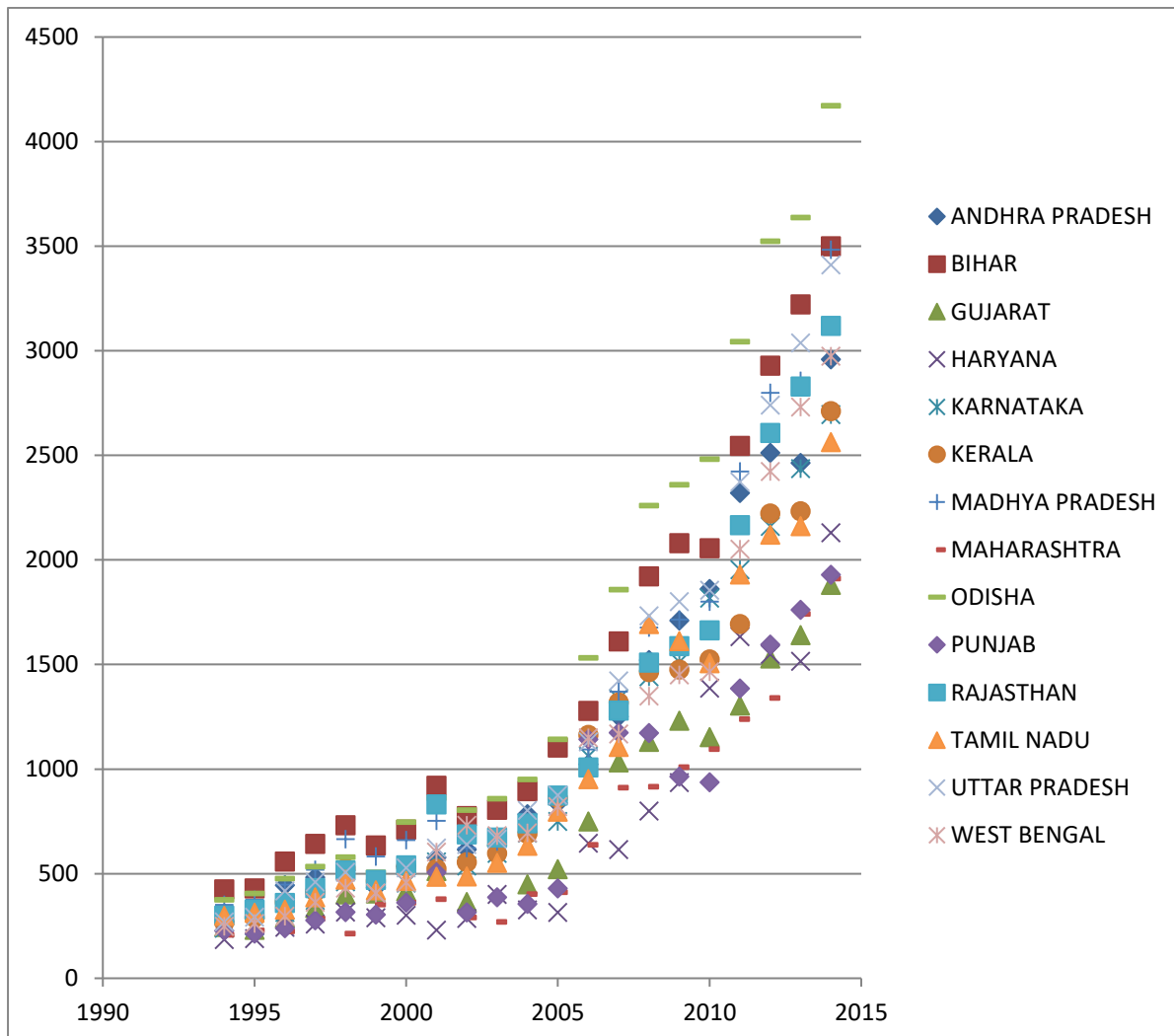
4.6 FC transfers per capita: Trends and Clusters

NIPFP data on the share of every State in Central taxes were available from 1993-94 to 2013-14. However, this panel data reflected total tax transfer amounts to different States and not tax transfers per capita. Since the population in different States is different, it would not be appropriate to compare the total taxes devolved to different States. The tax share had to be hence divided by the population of the State in that year so as to arrive at per capita transfers. The population for each of the States at a Census interval was obtained by referring to Census data and the population numbers for each year were interpolated. The State's share was then divided by the interpolated population figures in order to arrive at per capita transfers for every State in every year. Thus, a panel data on tax shares per capita to all fourteen States was created for the time period 1993-94 to 2013-14.

The trends in States' share of taxes per capita (referred to as FC transfers per capita henceforth) are shown below.

² Rao and Singh (2006) also use the State-wise Revenue Receipts data from NIPFP to construct the series for PC transfers. However, according to them, PC transfers are equal to only the grant component given by the PC. Loans only become transfers if they are waived by the Centre. However, the level of loans affect the "fund flow" availability with the States. Further, the size of loans is also sizeable. We have hence included the loan component of transfers in our analysis.

Graph 4.6.1: Distribution of FC Transfers per capita across fourteen States from 1993-94 to 2013-14



The graph shows that FC transfers per capita have increased over time. It also shows that some States consistently get lower transfers and some consistently get higher transfers. Odisha, Bihar and MP consistently seem to be in the high transfers' category. Punjab and Haryana consistently seem to be in the low transfers' category. This follows from the fact that most FCs use certain common variables such as per capita income, and income distance within the States to determine transfers to States. Hence, the States with lower per capita levels such as Bihar and Madhya Pradesh consistently get higher transfers per capita under different FCs and vice-versa.

The graph also indicates that outliers might be present in the data. We group the data by years and carry out a test to detect the presence of outliers. The non-normal distribution of the data precludes usage of standard outlier tests such as the Dixon's Q-test. We hence use the non-

parametric test of defining outliers. A point is a statistical outlier if it either exceeds the value of the third quartile by 1.5 times the Inter-Quartile Range (IQR) or is lesser than the value of the first quartile by 1.5 times the Inter-Quartile Range (IQR). The IQR is the difference between the value of the third quartile and the first quartile.

The test reveals the FC transfers per capita to following States to be outliers.

Table 4.6.1: Outliers in the per capita FC transfers data

Year	State	Whether the per capita FC transfers is high or low
1994-95	Bihar	High
1997-98	Bihar	High
1998-99	Bihar	High
	Haryana	Low
	Madhya Pradesh	High
	Punjab	Low
1999-00	Bihar	High
	Odisha	High
2002-03	Maharashtra	Low
	Odisha	High
	Punjab	Low
2005-06	Maharashtra	Low
	Odisha	High
	Haryana	Low
2006-07	Odisha	High
	Haryana	Low
2008-09	Odisha	High

Presence of outliers creates high between- State variability. We hence remove the outliers and then use a single factor ANOVA to check whether the variance of FC transfers per capita changes across time. Following are the ANOVA results.

Table 4.6.2A: ANOVA Summary for time variability in FC transfers per capita

SUMMARY				
<i>Groups</i>	<i>Count</i>	<i>Sum</i>	<i>Average</i>	<i>Variance</i>
1994	14	3918.94	279.92	4413.31
1995	13	3674.61	282.66	3933.26
1996	14	5015.30	358.24	9936.42
1997	14	5769.83	412.13	11917.85
1998	13	5928.45	456.03	14607.95
1999	10	4283.61	428.36	1871.89
2000	12	5623.98	468.66	9766.75
2001	14	8370.37	597.88	36315.70
2002	14	7719.11	551.36	31935.75
2003	12	7802.90	650.24	13324.92
2004	14	9165.51	654.68	38940.15
2005	14	10613.02	758.07	62289.12
2006	11	11757.35	1068.85	19092.73
2007	12	14986.84	1248.90	34755.75
2008	14	20594.19	1471.01	151423.07
2009	13	19092.44	1468.65	120451.52
2010	14	22610.60	1615.04	167636.87
2011	14	28065.89	2004.71	270164.28
2012	14	32058.12	2289.87	393863.34
2013	14	34275.67	2448.26	413199.72
2014	14	39444.12	2817.44	482975.02

Table 4.6.2B: ANOVA results for time variability in FC transfers per capita

ANOVA						
<i>Source of Variation</i>	<i>SS</i>	<i>df</i>	<i>MS</i>	<i>F</i>	<i>P-value</i>	<i>F crit</i>
Between Groups	1.67E+08	20	8365660	72.91	1.01E-93	1.61
Within Groups	29487147	257	114736			
Total	1.97E+08	277				

The results imply that the between-time group variance is much higher than the inter-State variance at any given point in time. This indicates that the mean level of per capita FC transfers itself keeps changing across time.

We quantify the variability of per capita FC transfers for every year by constructing the Gini co-efficient for each year. The Gini coefficients are later aggregated to understand the movement of the Gini coefficient across successive FCs.

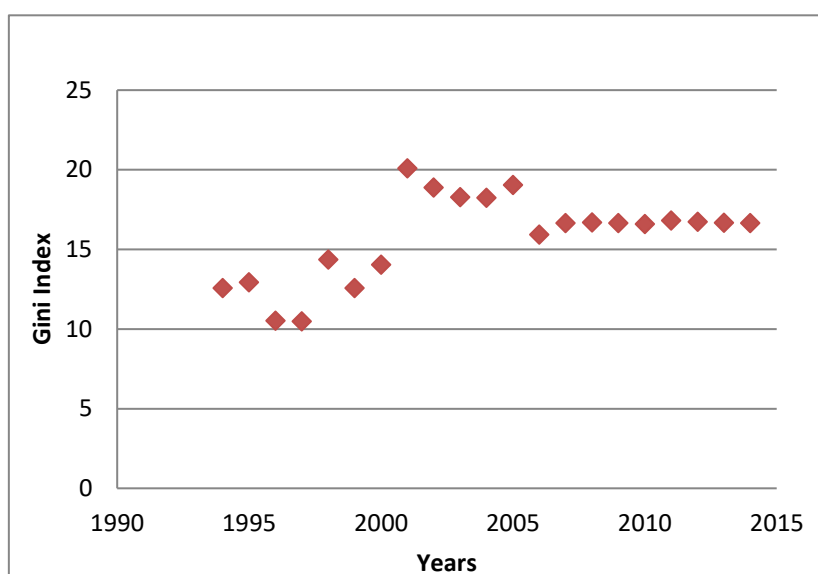
Table 4.6.3: Gini coefficients for FC transfers per capita from 1993-94 to 2013-14

Year	FC	Gini Index for FC transfers per capita
1993-1994	9th FC	12.57
1994-1995		12.93
1995-1996	10th FC	10.51
1996-1997		10.47
1997-1998		14.36
1998-1999		12.57
1999-2000		14.04
2000-2001	11th FC	20.08
2001-2002		18.87
2002-2003		18.28
2003-2004		18.24
2004-2005		19.05
2005-2006	12th FC	15.93
2006-2007		16.64
2007-2008		16.69
2008-2009		16.64
2009-2010		16.59

Year	FC	Gini Index for FC transfers per capita
2010-2011	13th FC	16.81
2011-2012		16.73
2012-2013		16.67
2013-14		16.65

Source: Calculated using the Gini calculator at <http://www.peterrosenmai.com/lorenz-curve-graphing-tool-and-gini-coefficient-calculator>

Graph 4.6.2: Gini coefficients for FC transfers per capita from 1993-94 to 2013-14



The graph shows an interesting pattern wherein the Gini coefficients belonging to the years under recommendations of each FC are seen to be similar. It might be fruitful to calculate the average Gini coefficient for 5 years under the recommendations of the different FCs to discern the broad trend in the behaviour of the Gini index.

Table 4.6.4: Gini coefficients under different FCs

FC	Gini co-efficient (Average over 5 years)
Tenth	12.39
Eleventh	18.90
Twelfth	16.49
Thirteenth	16.71

From the Tenth to the Thirteenth Finance Commission, the average Gini coefficient tends to broadly increase. Maximum variability in transfers is seen under the period of the 11th FC. The data thus indicate that there is a presence of increasing variation in the FC transfers per capita across time.

A k-means cluster analysis is next carried out on the data. For every year, the States are classified as “high”, “medium” or “low” transfer States.

Table 4.6.5A: Classification of States into Low, Medium and High FC Transfers per capita Clusters from 1993-94 to 2003-04

Cluster	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
Low Transfers	GUJARAT	GUJARAT	GUJARAT	GUJARAT	HARYANA	HARYANA	HARYANA	HARYANA	GUJARAT	HARYANA	GUJARAT
	HARYANA	HARYANA	HARYANA	HARYANA	M'TRA	M'TRA	M'TRA	M'TRA	HARYANA	M'TRA	HARYANA
	K'TAKA	K'TAKA	M'TRA	K'TAKA	PUNJAB	PUNJAB	PUNJAB		M'TRA	PUNJAB	M'TRA
	M'TRA	M'TRA	PUNJAB	M'TRA					PUNJAB		PUNJAB
	PUNJAB	PUNJAB	WB	PUNJAB							
				TN							
				WB							
Medium Transfers	AP	AP	K'TAKA	AP	AP	AP	AP	AP	AP	AP	AP
	KERALA	KERALA	KERALA	KERALA	GUJARAT	GUJARAT	GUJARAT	GUJARAT	K'TAKA	GUJARAT	K'TAKA
	R'THAN	R'THAN	R'THAN	MP	K'TAKA	K'TAKA	K'TAKA	K'TAKA	KERALA	K'TAKA	KERALA
	TN	TN	TN	ODISHA	KERALA	KERALA	KERALA	KERALA	MP	KERALA	MP
	UP	UP	UP	R'THAN	ODISHA	R'THAN	R'THAN	PUNJAB	TN	MP	R'THAN
	WB	WB		UP	R'THAN	TN	TN	TN	UP	R'THAN	TN
					TN	UP	UP	UP	WB	TN	WB
					UP	WB	WB	WB		UP	
					WB					WB	
High Transfers	BIHAR	BIHAR	AP	BIHAR	BIHAR	BIHAR	BIHAR	BIHAR	BIHAR	BIHAR	BIHAR
	MP	MP	BIHAR		MP	MP	MP	MP	ODISHA	ODISHA	ODISHA
	ODISHA	ODISHA	MP			ODISHA	ODISHA	ODISHA	R'THAN		UP
			ODISHA						WB		

Note: AP, GUJ, K'TAKA, MP, M'TRA, R'THAN, TN, UP and WB stand for Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal respectively.

Table 4.6.5B: Classification of States into Low, Medium and High FC Transfer per capita Clusters from 2004-05 to 2013-14

Cluster	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Low Transfers	GUJARAT	GUJARAT	HARYANA	GUJARAT	GUJARAT	GUJARAT	GUJARAT	GUJARAT	GUJARAT	GUJARAT
	HARYANA	HARYANA	M'TRA	HARYANA	HARYANA	M'TRA	HARYANA	HARYANA	HARYANA	HARYANA
	M'TRA	M'TRA		M'TRA	M'TRA	PUNJAB	KERALA	M'TRA	M'TRA	M'TRA
	PUNJAB			PUNJAB	PUNJAB		M'TRA	PUNJAB	PUNJAB	PUNJAB
							PUNJAB			
Medium Transfers	AP	AP	AP	AP	AP	AP	AP	AP	AP	AP
	K'TAKA	BIHAR	GUJARAT	K'TAKA	K'TAKA	BIHAR	BIHAR	BIHAR	K'TAKA	BIHAR
	KERALA	K'TAKA	K'TAKA	KERALA	KERALA	HARYANA	K'TAKA	K'TAKA	KERALA	K'TAKA
	MP	KERALA	KERALA	MP	MP	K'TAKA	MP	KERALA	MP	KERALA
	R'THAN	MP	MP	R'THAN	R'THAN	KERALA	R'THAN	MP	R'THAN	MP
	TN	PUNJAB	PUNJAB	TN	TN	MP	TN	R'THAN	TN	R'THAN
High Transfers	UP	R'THAN	R'THAN	UP	UP	R'THAN	UP	TN	UP	TN
	WB	TN	TN	WB	WB	TN	WB	UP	WB	UP
		UP	UP			UP		WB		WB
		WB	WB			WB				
		BIHAR	ODISHA	BIHAR	BIHAR	BIHAR	ODISHA	ODISHA	ODISHA	BIHAR
	ODISHA		ODISHA	ODISHA	ODISHA			ODISHA		
									UP	

Note: AP, GUJ, K'TAKA, MP, M'TRA, R'THAN, TN, UP and WB stand for Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal respectively.

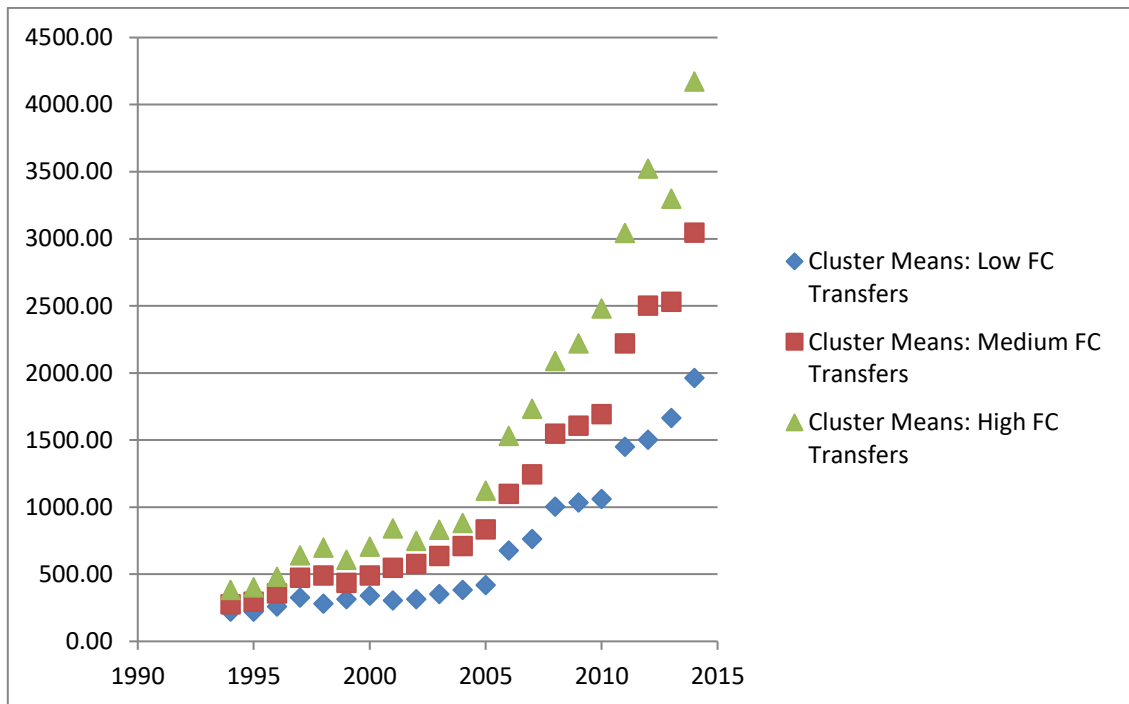
Classification of States into low, medium and high transfer (per capita) clusters entails the question: How well are the clusters defined? Are the means of the clusters clearly discernable from each other?

The means of the cluster for every year is calculated; this is termed as the cluster centroid. Centroids for all three clusters for every time period are given below.

Table 4.6.6: Centroids of Low, Medium and High FC Transfer per capita Clusters from 1993-94 to 2013-14

Time frame	Cluster Means: Low FC Transfers (1)	Cluster Means: Medium FC transfers (2)	Cluster Means: High FC Transfers (3)
1993-94	178.35	245.3	344.93
1994-95	204.37	272.83	380.27
1995-96	217.84	332.07	466
1996-97	254.63	391.57	544.76
1997-98	266.39	429.78	602.76
1998-99	287.27	404.36	583.9
1999-00	305.81	453.41	642.72
2000-01	286.67	527.24	781.83
2001-02	253.36	528.03	731.92
2002-03	277.65	555.03	761.87
2003-04	322.46	623.72	842.92
2004-05	350.99	735.48	974.14
2005-06	527.86	851.51	1201.96
2006-07	634.73	1070.53	1506.29
2007-08	780.98	1331.02	1866.81
2008-09	811.07	1384.44	1935.53
2009-10	821.19	1404	1956.59
2010-11	1050.88	1693.88	2324.82
2011-12	1203.4	1948.06	2656.38
2012-13	1351.01	2196.06	2979.15
2013-14	1452.67	2332.31	3194.49

Graph 4.6.3: Centroids of Low, Medium and High FC Transfers per capita clusters from 1993-94 to 2013-14



We carry out a single factor ANOVA test to calculate the between- cluster variance and within-cluster variance. If the between cluster variance (variance of all group means around global mean) is greater than the within cluster variance (variance of all individual transfers in a cluster around the group mean for that cluster), then it indicates that clusters are clearly discernable from each other. Following are the results of the ANOVA test.

Table 4.6.7A: ANOVA Summary for separation of clusters of FC transfers per capita

SUMMARY				
<i>Groups</i>	<i>Count</i>	<i>Sum</i>	<i>Average</i>	<i>Variance</i>
Cluster Means: Low FC Transfers	21	14876.13	708.39	296146.93
Cluster Means: Medium FC Transfers	21	23632.78	1125.37	716986.79
Cluster Means: High FC Transfers	21	32457.71	1545.61	1347182.28

Table 4.6.7B: ANOVA results for separation of clusters of FC transfers per capita

ANOVA						
<i>Source of Variation</i>	<i>SS</i>	<i>df</i>	<i>MS</i>	<i>F</i>	<i>P-value</i>	<i>F crit</i>
Between Groups	7359848.35	2.00	3679924.17	4.68	0.01	3.15
Within Groups	47206319.89	60.00	786772.00			
Total	54566168.24	62.00				

The results show that the between group variation is much higher than the within group variation. Thus, the cluster means are clearly discernable from each other and the clusters are well-defined.

This section thus brings out the trends in the data on per capita FC transfers. Firstly, the mean of per FC transfers per capita itself changes across time. Second, the FC transfers per capita to the States exhibit differential variability across time. Thirdly, there is also a cross sectional variance, albeit shown here at a cluster level. Three clusters are clearly discernable and FC transfers per capita can also be classified as low, medium and high transfers. Finally, there are outliers in the dataset which potentially impact mean as well as variance of the data.

These factors will have to be accounted for when we carry out panel regressions using this data, a point which we will take up for discussion in Section 4.11.

4.7 CSS Transfers per capita: Trends and Clusters

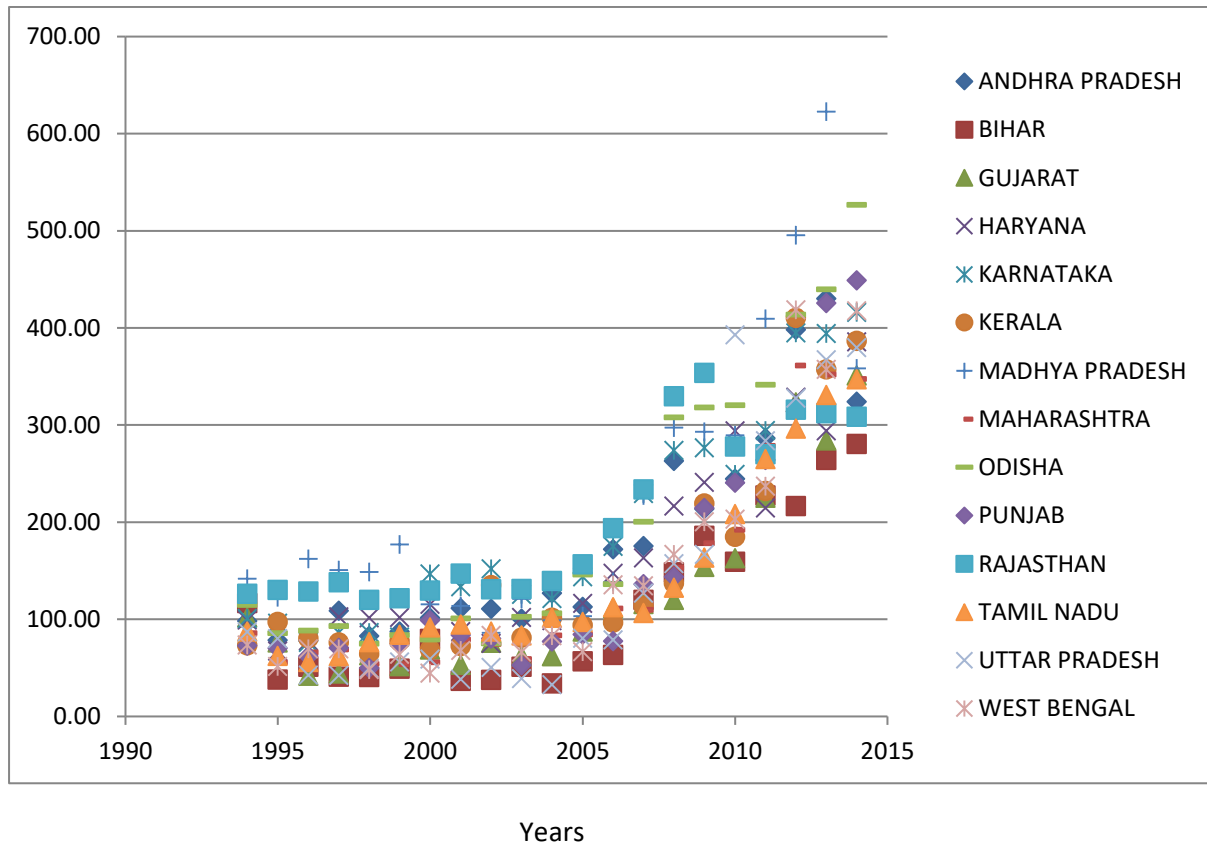
A polar extreme to the FC transfers lies in examining the trends in the transfers by Central Ministries. Whereas the FC transfers are initiated in a top-down manner, with the FC giving grants to the States, the design of CSS is such that they have to be initiated in a bottom-up manner, with the States claiming the funds provided by the Centre under CSS. Whereas FC transfers are unconditional, CSS transfers are not only conditional in the sense of the usage of funds, but they also require the states to satisfy certain other conditions such as sharing the cost of the scheme, giving administrative and manpower support for implementation of the scheme etc. Finally, whereas FC transfers are formulaic, Central Ministry transfers are discretionary.

Since Central Ministry transfers create a polar extreme to the formulaic and norm-based FC transfers, we next examine discretionary transfers by Central Ministries to understand if these show a completely different pattern from FC transfers.

NIPFP data specifies the grants for CS and CSS given to each State across the selected time period 1993-94 to 2013-14. We normalize the Central Ministry transfers to States to adjust

for population sizes of the States. State-wise Central Ministry transfers per capita so obtained from 1993-94 to 2013-14 are shown below.

Graph 4.7.1: Distribution of CSS Grants per capita across fourteen States from 1993-94 to 2013-14



This graph shows more complexity in patterns, as compared to the FC transfers. For example, Rajasthan, which is a high transfer State for most part of the time period, becomes medium or low transfer State towards the end of the time period under consideration. Tamil Nadu alternates between being a low transfers State to a medium transfers State.

Some trends completely reverse as compared to FC transfers per capita. For example Bihar and UP, which were decidedly "high transfer" states under FC rules, are seen to be at in the "low transfer" cluster almost throughout the data period. Madhya Pradesh is interesting, because it gets high revenues under both statutory as well as discretionary transfers. Rajasthan and Karnataka consistently get higher discretionary transfers per capita, whereas under FC transfers per capita, they are both medium transfer States.

We group the data by years and carry out a test to detect the presence of outliers. The non-normal distribution of the data precludes usage of standard outlier tests such as the Dixon's Q-test. We hence use the non-parametric test of defining outliers. A point is a statistical outlier if it either exceeds the value of the third quartile by 1.5 times the Inter-Quartile Range (IQR) or is lesser than the value of the first quartile by 1.5 times the Inter-Quartile Range (IQR). The IQR is the difference between the value of the third quartile and the first quartile.

The test reveals the discretionary transfers per capita to following States to be outliers.

Table 4.7.1: Outliers in the CSS data

Year	State	Whether the CSS transfer per capita is high or low
1995-1996	MP	High
1995-1996	Rajasthan	High
1997-1998	MP	High
1998-1999	MP	High
2001-02	Karnataka	High
2003-2004	Bihar	Low
2003-2004	UP	Low
2010-11	MP	High
2012-2013	MP	High
2013-2014	Odisha	High

We calculate the within- and between- groups variance for the data. However, given that the presence of outliers affects the mean of the distribution as also its variance, we calculate the variance for this exercise after removing the outliers. Following are the ANOVA results.

Table 4.7.2A: ANOVA Summary for time variability in discretionary transfers per capita

SUMMARY				
<i>Groups</i>	<i>Count</i>	<i>Sum</i>	<i>Average</i>	<i>Variance</i>
1994	14	1382.54	98.75	429.82
1995	14	1114.26	79.59	669.71
1996	12	791.90	65.99	234.76
1997	14	1156.50	82.61	1134.58
1998	13	913.05	70.23	541.92
1999	13	990.04	76.16	448.72
2000	14	1257.89	89.85	890.50
2001	14	1223.00	87.36	1079.62
2002	13	1104.93	84.99	760.96
2003	14	1180.45	84.32	905.82
2004	12	1202.56	100.21	483.51
2005	14	1432.45	102.32	897.70
2006	14	1752.25	125.16	1531.06
2007	14	2195.73	156.84	2300.22
2008	14	2849.53	203.54	5645.46
2009	14	3181.70	227.26	3804.60
2010	14	3422.61	244.47	4357.90
2011	13	3422.36	263.26	1256.70
2012	14	5017.49	358.39	4765.00
2013	13	4611.61	354.74	3243.44
2014	13	4754.25	365.71	2200.34

Table 4.7.2B: ANOVA Results for time variability in discretionary transfers per capita

ANOVA						
<i>Source of Variation</i>	<i>SS</i>	<i>df</i>	<i>MS</i>	<i>F</i>	<i>P-value</i>	<i>F crit</i>
Between Groups	2853513.84	20	142675.69	78.39	0.00	1.61
Within Groups	478681.50	263	1820.08			
Total	3332195.34	283				

The above test results indicate that even after removing the outliers, the between group variance (i.e. between time periods) is greater than the within group variance (between all States at a point in time). This indicates that the mean of per capita discretionary transfers changes across time.

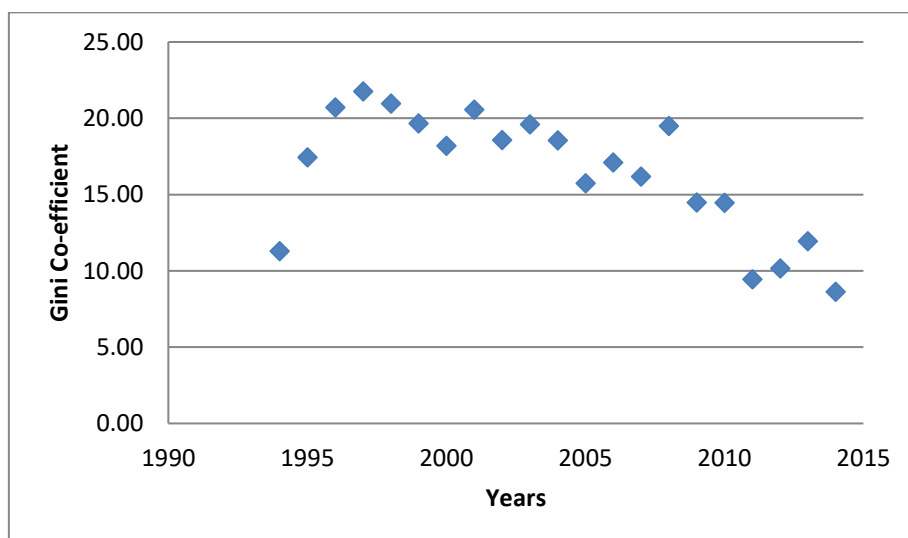
How much is the inequality between States in per capita Central Ministry transfers every year? We construct the Gini Index in order to assess the variability in per capita Central Ministry transfers every year. Please note that the Gini coefficients have been created for the data inclusive of outliers.

Table 4.7.3: Gini Index for Central Ministry transfers per capita from 1993-94 to 2013-14

CSS transfers per capita	Gini
1994	11.29
1995	17.45
1996	20.72
1997	21.77
1998	20.97
1999	19.66
2000	18.20
2001	20.58
2002	18.57
2003	19.61
2004	18.55
2005	15.75
2006	17.11
2007	16.18
2008	19.51
2009	14.48
2010	14.47
2011	9.46
2012	10.16
2013	11.94
2014	8.64

Source: Calculated using the Gini calculator at <http://www.peterrosenmai.com/lorenz-curve-graphing-tool-and-gini-coefficient-calculator>

Graph 4.7.2: Gini Index for Central Ministry transfers per capita from 1993-94 to 2013-14



Broadly, the Gini Index indicates that the variability in CSS transfers per capita has fallen across time.

We next carry out a cluster analysis is carried out on the data to create high, medium and low transfer clusters of States for every year. It may be noted that even though CSS transfers per capita to certain States in certain years are in some sense statistical outliers, we do not attempt to remove these outliers from the data because of the information that these points contain. The basic objective in carrying out the data analysis in this chapter is to compare and contrast the FC transfers per capita which are statutory and largely formulaic with the CSS transfers per capita which are negotiated and discretionary. The presence of outliers is interesting because it suggests that there could be economic or political forces, or administrative issues that possibly affect the quantum of discretionary transfers to certain States in certain time-periods.

A k-means cluster analysis is carried out on the data. For every year, the States are classified as high, medium or low transfer states.

Table 4.7.4A: Classification of States into Low, Medium and High Central Ministry Transfers per capita Clusters from 1993-94 to 2003-04

Central Ministry transfer	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04
Low Transfers		BIHAR	BIHAR	BIHAR	BIHAR	BIHAR	GUJARAT	BIHAR	BIHAR	BIHAR	BIHAR
	KERALA	M'TRA	GUJARAT	GUJARAT	GUJARAT	GUJARAT	KERALA	GUJARAT	UP	GUJARAT	UP
	M'TRA	TN	PUNJAB	TN	KERALA	K'TAKA	M'TRA	UP		M'TRA	
	PUNJAB	WB	TN	UP	M'TRA	KERALA	UP			PUNJAB	
	TN		UP		PUNJAB	M'TRA	WB			UP	
	UP				UP	ODISHA				WB	
	WB				WB	PUNJAB					
						TN					
						UP					
						WB					
Medium Transfers	AP	AP	AP	AP	AP	AP	AP	AP	AP	AP	GUJARAT
	BIHAR	GUJARAT	HARYANA	HARYANA	HARYANA	HARYANA	BIHAR	HARYANA	GUJARAT	HARYANA	HARYANA
	GUJARAT	HARYANA	K'TAKA	K'TAKA	K'TAKA	R'THAN	HARYANA	KERALA	HARYANA	KERALA	KERALA
	HARYANA	K'TAKA	KERALA	KERALA	ODISHA		MP	MP	MP	ODISHA	MP
	K'TAKA	KERALA	M'TRA	M'TRA	TN		ODISHA	M'TRA	M'TRA	TN	M'TRA
	ODISHA	ODISHA	ODISHA	ODISHA			PUNJAB	ODISHA	ODISHA		ODISHA
		PUNJAB	WB	PUNJAB			TN	PUNJAB	PUNJAB		PUNJAB
		UP		WB			TN		TN		TN
									WB		WB
High Transfers	MP	MP	MP	MP	MP	MP	K'TAKA	K'TAKA	K'TAKA	K'TAKA	AP
	R'THAN	R'THAN	R'THAN	R'THAN	R'THAN		R'THAN	R'THAN	KERALA	MP	K'TAKA
									R'THAN	R'THAN	R'THAN

Note: AP, GUJ, K'TAKA, MP, M'TRA, R'THAN, TN, UP and WB stand for Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal respectively.

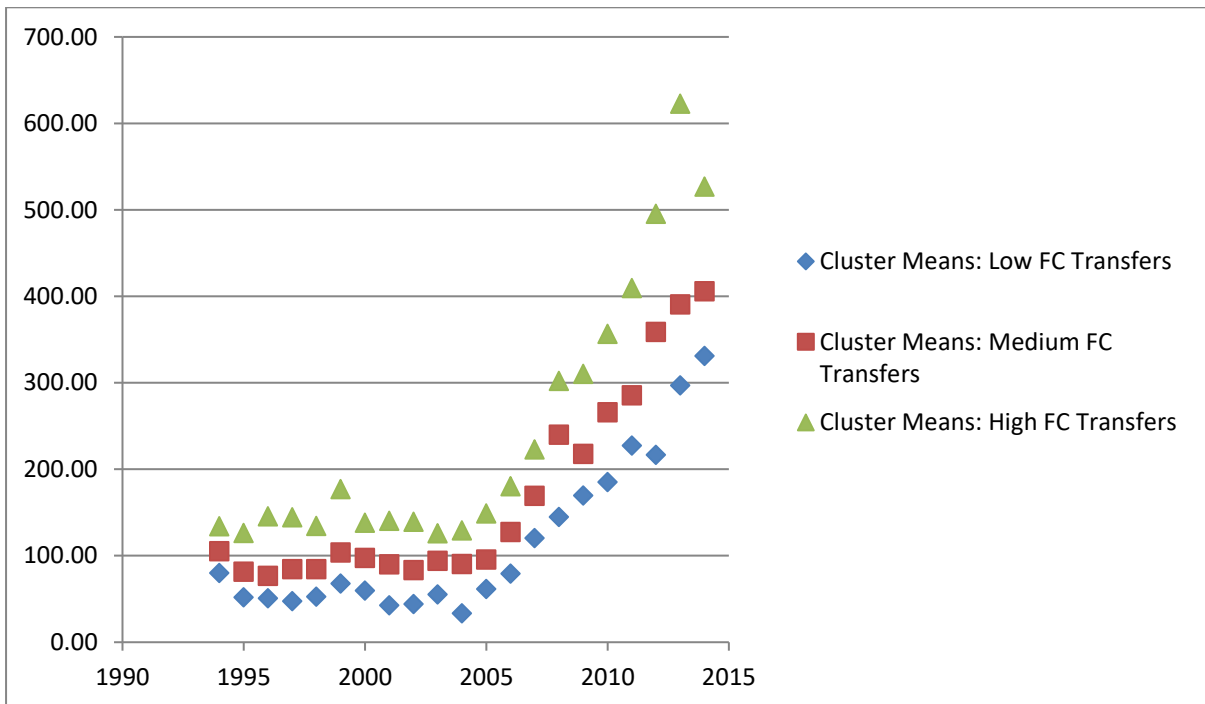
Classification of States into low, medium and high transfer (per capita) clusters entails the question: How well are the clusters defined? Are the means of the clusters clearly discernable from each other?

The means of the cluster for every year is calculated; this is termed as the cluster centroid. Centroids for all three clusters for every time period are given below.

Table 4.7.5: Centroids of Low, Medium and High Central Ministry Transfers per capita Clusters from 1993-94 to 2013-14

Years	Cluster Means: Low Central Ministry Transfers	Cluster Means: Medium Central Ministry Transfers	Cluster Means: High Central Ministry Transfers
1994	80.21	105.47	134.25
1995	51.95	81.65	126.62
1996	50.86	76.80	145.68
1997	47.53	84.65	144.60
1998	52.87	84.58	134.46
1999	67.85	103.83	177.22
2000	59.64	97.60	138.27
2001	42.93	90.33	140.60
2002	44.24	83.34	139.57
2003	55.23	94.17	126.07
2004	33.50	90.47	129.43
2005	61.84	95.76	148.97
2006	79.29	127.64	180.54
2007	120.63	169.50	222.93
2008	145.01	239.92	302.40
2009	169.94	218.00	310.51
2010	185.29	266.20	356.84
2011	227.47	285.63	409.50
2012	216.62	358.77	495.69
2013	297.26	390.66	622.81
2014	331.20	405.98	526.96

Graph 4.7.3: Behaviour of Centroids of Low, Medium and High CSS Transfer Clusters from 1993-94 to 2013-14



We now carry out a single factor ANOVA test to calculate the between- cluster variance and within-cluster variance for centroids. If the between cluster variance (variance of all group means around global mean) is greater than the within cluster variance (variance of all individual transfers in a cluster around the group mean for that cluster), then it indicates that the means of clusters are clearly discernable from each other. Following are the results of the ANOVA test.

Table 4.7.6A: ANOVA Summary for separation of clusters of Central Ministry transfers per capita

SUMMARY				
<i>Groups</i>	<i>Count</i>	<i>Sum</i>	<i>Average</i>	<i>Variance</i>
Cluster Means: Low FC Transfers	21	2421.34	115.30	7967.15
Cluster Means: Medium FC Transfers	21	3550.95	169.09	12395.14
Cluster Means: High FC Transfers	21	5113.90	243.52	23500.32

Table 4.7.6B: ANOVA Summary for separation of clusters of Central Ministry transfers per capita

ANOVA						
<i>Source of Variation</i>	<i>SS</i>	<i>df</i>	<i>MS</i>	<i>F</i>	<i>P-value</i>	<i>F crit</i>
Between Groups	174106.55	2	87053.28	5.95	0.00	3.15
Within Groups	877252.09	60	14620.87			
Total	1051358.65	62				

The results show that the between group variation is much higher than the within group variation. Thus, the cluster means are clearly discernable from each other and the clusters are well-defined.

The above analysis brings out a number of peculiar features of the per capita Central Ministry transfers to States. Firstly, there is a presence of outliers i.e. certain States have received very high or very low levels of Central Ministry transfers per capita in certain years. The Gini coefficients indicate that variability in the transfers changes across time. The presence and persistence of discernable clusters in every year implies that the data also contains “strata” among States. These trends in the data make running regressions more complex. We will revisit this point in Section 4.11 when we run panel data regressions using CSS transfers per capita.

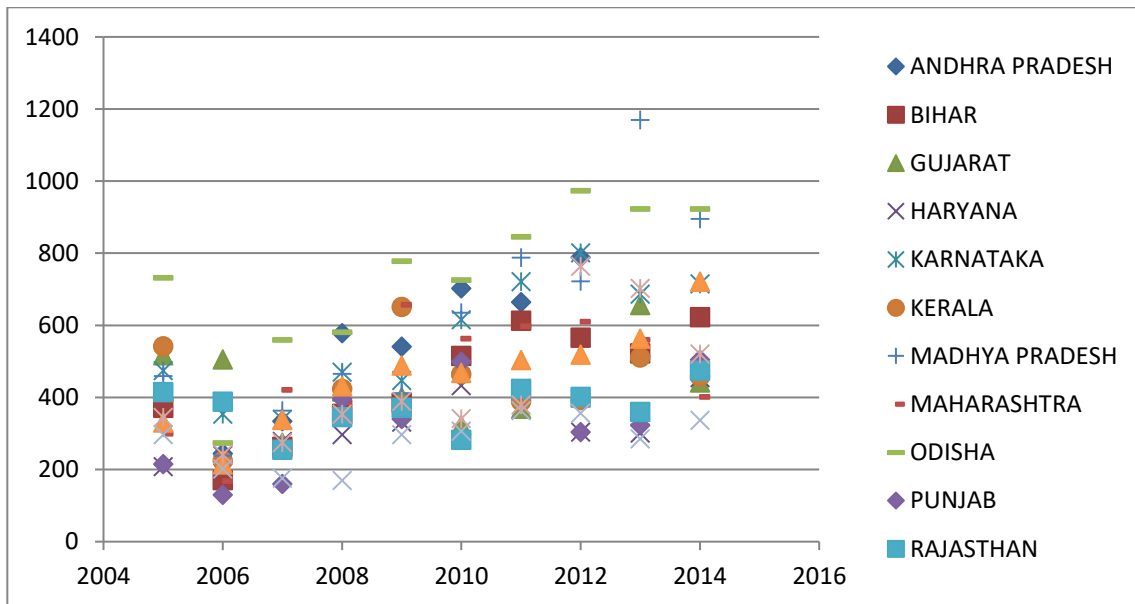
4.8: PC Transfers per capita: Trends and Clusters

In this section, we examine the trends in per capita PC transfers.

We used the data on grants given to each State by the Planning Commission from 1993-94 to 2013-14 maintained by NIPFP. However, data on Plan loans to the Centre was not available with NIPFP. We got State-wise data on Loans and Advances from the Centre for State Plan Schemes from the “RBI State Finances: A Study of Budgets”. But, these data are available only from 1999-00. Further, the data on 2003-04 are not available in the RBI reports. Thus, a continuous time-series data on all States i.e. complete panel data are only available from 2004-05 to 2013-14. Hence, the data exercises of examining trends and creating clusters on PC transfers data have been carried out only for 2004-05 to 2013-14.

We normalized the PC transfers to States to adjust for population sizes of the States. State-wise PC transfers per capita so obtained from 2004-05 to 2013-14 are shown below.

Graph 4.8.1: Distribution of PC transfers per capita across fourteen States from 2004-05 to 2013-14



Visual inspection of the graph suggests existence of outliers within the sample data. Presence of outliers affects both the mean as well as the variance of a dataset, and hence, we run formal tests to detect presence of outliers. The non-normal distribution of the data precludes usage of standard outlier tests such as the Dixon's Q-test. We hence use the non-parametric test of defining outliers. A point is a statistical outlier if it either exceeds the value of the third quartile by 1.5 times the Inter-Quartile Range (IQR) or is lesser than the value of the first quartile by 1.5 times the Inter-Quartile Range (IQR). The IQR is the difference between the value of the third quartile and the first quartile.

The test reveals the PC transfers per capita to following States to be outliers.

Table 4.8.1: Outliers in the data on per capita PC transfers

Year	State	Whether the PC transfer per capita is high or low
2004-05	Odisha	High
2005-06	Gujarat	High
	Rajasthan	High
2006-07	Odisha	High
2007-08	Uttar Pradesh	Low
2008-09	Odisha	High
2012-13	Madhya Pradesh	High

We carry out the ANOVA test to examine the within- and between-group variances for the dataset, grouped as per time-period. Before doing so however, we remove the outliers from the data. The results of the ANOVA test are shown below.

Table 4.8.2A: ANOVA Summary for time variability in PC transfers per capita

SUMMARY				
<i>Groups</i>	<i>Count</i>	<i>Sum</i>	<i>Average</i>	<i>Variance</i>
2005	13	4866.52	374.35	11256.16
2006	12	2700.57	225.05	3273.33
2007	13	3733.05	287.16	5233.01
2008	13	5498.91	422.99	7220.23
2009	13	5712.25	439.40	13285.25
2010	14	6876.58	491.18	21164.33
2011	14	7504.46	536.03	27938.52
2012	14	7903.59	564.54	46512.06
2013	13	6910.67	531.59	34287.08
2014	14	7945.97	567.57	32839.52

Table 4.8.2B: ANOVA Results for time variability in PC transfers per capita

ANOVA						
<i>Source of Variation</i>	<i>SS</i>	<i>df</i>	<i>MS</i>	<i>F</i>	<i>P-value</i>	<i>F crit</i>
Between Groups	1628124	9	180902.7	8.68	5.13E-10	1.95
Within Groups	2561295	123	20823.54			
Total	4189419	132				

The between group variance (i.e. between time periods) is greater than the within group variance (between all States at a point in time) for PC transfers per capita. This indicates a variability in the PC transfers per capita across time.

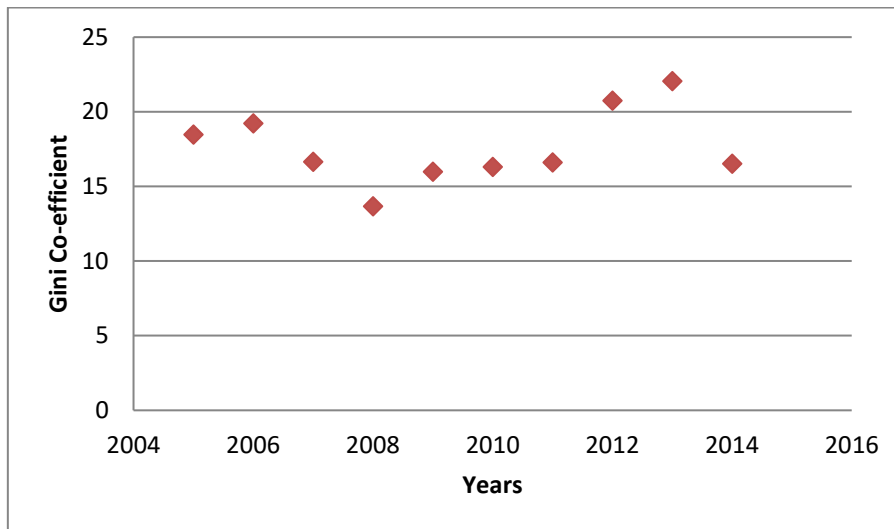
We move from a measure of variance to a measure of inequality. A quantifiable measure of inequality is the Gini coefficient. We construct the Gini Index for PC transfers per capita for every year. Please note that the Gini coefficients have been created for the data inclusive of outliers.

Table 4.8.3: Gini Index for PC transfers per capita from 2004-05 to 2013-14

PC transfers per capita	Gini
2005	18.48
2006	19.22
2007	16.66
2008	13.68
2009	15.99
2010	16.30
2011	16.61
2012	20.74
2013	22.06
2014	16.52

Source: Calculated using the Gini calculator at <http://www.peterrosenmai.com/lorenz-curve-graphing-tool-and-gini-coefficient-calculator>

Graph 4.8.2: Gini Index for PC transfers per capita from 2004-05 to 2013-14



The Gini coefficients indicate variability in inequality of PC transfers per capita across time.

A cluster analysis is carried out on the data to create clusters of States receiving high, medium and low PC transfers per capita for every year. A k-means cluster analysis is carried out on the data.

Table 4.8.4: Classification of States into Low, Medium and High PC Transfers per capita Clusters from 2004-05 to 2013-14

CSS transfer	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	
Low Transfers	HARYANA	AP	PUNJAB	UP	BIHAR	GUJARAT	GUJARAT	GUJARAT	HARYANA	AP	
	M'TRA	BIHAR	UP		GUJARAT	R'THAN	HARYANA	HARYANA	PUNJAB	GUJARAT	
	PUNJAB	HARYANA			HARYANA	UP	KERALA	KERALA	R'THAN	HARYANA	
	TN	KERALA			MP	WB	PUNJAB	PUNJAB	UP	KERALA	
	UP	MP			PUNJAB		R'THAN	R'THAN		M'TRA	
	WB	M'TRA			R'THAN		TN	UP		PUNJAB	
		PUNJAB			UP		UP			R'THAN	
		TN			WB		WB			UP	
		UP								WB	
		WB									
		AP	K'TAKA	AP	BIHAR	AP	BIHAR	AP	BIHAR	AP	BIHAR
		BIHAR	ODISHA	BIHAR	GUJARAT	K'TAKA	HARYANA	BIHAR	M'TRA	BIHAR	K'TAKA
	Medium Transfers	GUJARAT	R'THAN	GUJARAT	HARYANA	TN	KERALA	M'TRA	TN	GUJARAT	TN
K'TAKA			HARYANA	KERALA		M'TRA			K'TAKA		
KERALA			K'TAKA	M'TRA		PUNJAB			KERALA		
MP			KERALA	PUNJAB		TN			M'TRA		
R'THAN			MP	R'THAN					TN		
			M'TRA	TN					WB		
			R'THAN	WB							
			TN								
			WB								
		ODISHA	GUJARAT	ODISHA	AP	KERALA	AP	K'TAKA	AP	MP	MP
					K'TAKA	M'TRA	K'TAKA	MP	K'TAKA	ODISHA	ODISHA
					MP	ODISHA	MP	ODISHA	MP		
					ODISHA		ODISHA		ODISHA		
								WB			

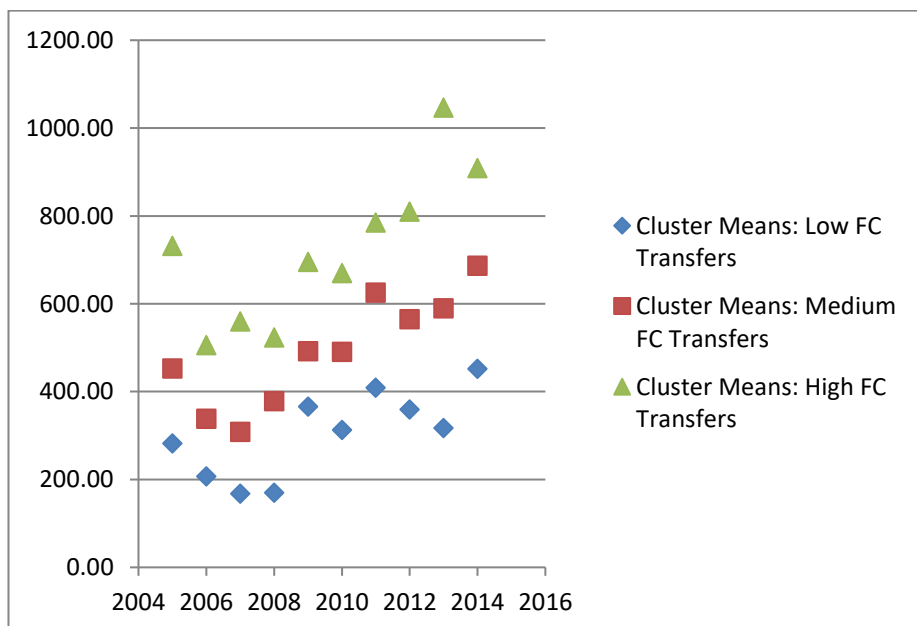
Note: AP, GUJ, K'TAKA, MP, M'TRA, R'THAN, TN, UP and WB stand for Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal respectively.

The cluster centroids show the mean value of the high, medium and low transfers for every year in the data period. The following table shows the values.

Table 4.8.5: Centroids of Low, Medium and High PC Transfers per capita Clusters from 2004-05 to 2013-14

Years	Cluster Means: Low FC Transfers	Cluster Means: Medium FC Transfers	Cluster Means: High FC Transfers
2005	282.47	453.10	731.82
2006	207.28	338.73	505.79
2007	167.91	308.84	559.84
2008	169.71	378.29	523.58
2009	365.79	492.39	695.55
2010	313.23	490.69	669.89
2011	409.21	625.31	784.94
2012	359.79	564.92	810.01
2013	317.44	589.70	1046.71
2014	451.96	686.78	908.97

Graph 4.8.3: Behaviour of Centroids of Low, Medium and High PC Transfer Clusters from 1993-94 to 2013-14



We carry out an ANOVA test to examine if the cluster means are clearly discernable from each other. Following are the results.

Table 4.8.6A: ANOVA Summary for separation of clusters of PC transfers per capita

SUMMARY				
<i>Groups</i>	<i>Count</i>	<i>Sum</i>	<i>Average</i>	<i>Variance</i>
Cluster Means: Low FC Transfers	10	3044.80	304.48	9614.32
Cluster Means: Medium FC Transfers	10	4928.75	492.87	15783.58
Cluster Means: High FC Transfers	10	7237.10	723.71	29777.62

Table 4.8.6B: ANOVA Summary for separation of clusters of PC transfers per capita

ANOVA						
<i>Source of Variation</i>	<i>SS</i>	<i>df</i>	<i>MS</i>	<i>F</i>	<i>P-value</i>	<i>F crit</i>
Between Groups	881769.67	2	440884.83	23.97	1.03E-06	3.35
Within Groups	496579.67	27	18391.84			
Total	1378349.34	29				

The results show that the between group variation is much higher than the within group variation. The cluster means are clearly different from each other and the clusters are well-defined.

Thus, some interesting points emerge from inspection of the per capita PC transfers. Obviously, the mean of the transfers itself changes across time. Further, the variability in the transfers also changes across time. Data show cross-sectional variance as well as time variance. Finally, the dataset contains outliers i.e. there are instances of certain States having received very high or very low per capita transfers from the Planning Commission in the given data-period. Running regressions using data with high variance is complex; these analysis points will be re-visited in Section 4.11 when we attempt a panel regression using data on PC transfers per capita.

4.9: Defining Political Alignment

We create a dummy variable “POL” to indicate the political alignment for every State in every year in the data. If the party or coalition forming the State government is the same as, or is a coalition partner in, or supports the coalition at the Centre from outside, then we say that the State is “politically aligned” to the Centre. Dummy variables have been constructed to indicate political alignment; a value of “1” is assigned if the State is politically aligned with the Centre and a value of “0” is assigned if there is no alignment.

The names of the political parties in power at the State level for every time period are given in the Appendix B. The following table carrying the values of POL was constructed based on the data given in Appendix B.

Table 4.9.1: Dummy Variable Values indicating Political Alignment (POL) for 14 Major General Category States from 1993-94 to 2013-14

POL	AP	BIHAR	GUJ	HARYANA	K'TAKA	KERALA	MP	M'TRA	ODISHA	PUNJAB	R'THAN	TN	UP	WB
1993-1994	0	0	1	1	1	1	1	1	1	1	0	1	1	0
1994-1995	0	0	1	1	1	1	1	1	1	1	0	1	1	0
1995-1996	0	0	0	1	1	1	1	0	1	1	0	1	1	0
1996-1997	1	1	1	0	1	0	1	0	1	1	0	0	1	0
1997-1998	1	1	1	0	1	0	1	0	1	0	0	0	1	0
1998-1999	1	1	0	0	1	0	1	0	1	0	1	0	0	0
1999-2000	1	0	1	1	0	0	0	0	0	1	0	1	1	0
2000-2001	1	0	1	1	0	0	0	0	1	1	0	1	1	0
2001-2002	1	0	1	1	0	0	0	0	1	1	0	0	1	0
2002-2003	1	0	1	1	0	0	0	0	1	0	0	0	0	0
2003-2004	1	0	1	1	0	0	1	0	1	0	1	0	0	0
2004-2005	1	0	0	0	1	1	0	1	0	1	0	0	1	1
2005-2006	1	0	0	1	1	1	0	1	0	1	0	0	1	1
2006-2007	1	0	0	1	0	0	0	1	0	1	0	1	1	0
2007-2008	1	0	0	1	1	0	0	1	0	0	0	1	1	0
2008-2009	1	0	0	1	0	0	0	1	0	0	1	1	1	0
2009-2010	1	0	0	1	0	0	0	1	0	0	1	1	1	0
2010-2011	1	0	0	1	0	0	0	1	0	0	1	1	1	0
2011-2012	1	0	0	1	0	1	0	1	0	0	1	0	1	0
2012-2013	1	0	0	1	0	1	0	1	0	0	1	0	1	0
2013-2014	1	0	0	1	1	1	0	1	0	0	0	0	1	0

Note: AP, GUJ, K'TAKA, MP, M'TRA, R'THAN, TN, UP and WB stand for Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal respectively.

4.10: Do clusters of high transfer States coincide with clusters of politically aligned States?

One of the objectives of the thesis is to examine the relationship between “political alignments” and extent of fund transfers.

4.10.1 Methodology

Sections 4.6 and 4.7 have demonstrated that for the time period 1992-93 to 2013-14, the FC transfers per capita as well as Central Ministry transfers per capita are subject to time variability as well as cross sectional variability. While we have carried out a panel regression to check for the effect of political alignment on both of the transfers separately (See Section 4.12), we feel that presence of high variability within the data could complicate the use of regressions. We hence use a simple cluster comparison approach to examine whether cluster membership of the “high transfers” cluster coincides with cluster membership of the “politically aligned” cluster.

This is done by using the chi-square test based on binary classification of variables. Since the test requires binary classification, we re-classify the clusters as “low transfer” clusters and the “medium and high transfers” clusters. We arrange data into columns indicating POL and rows indicating cluster membership of the state, in the following manner.

Table 4.10.1.1: Representation format of Cluster data and POL data

	Politically Aligned	Not Politically Aligned
High or Medium transfers	HA	HNA
Low transfers	LA	LNA

Note: HA, HNA, LA and LNA denote co-occurrence of High transfers and political alignment, High transfers and political non-alignment, Low transfers and political alignment, Low transfers and political non-alignment respectively.

If the politically aligned States indeed get preferential treatment, then the number of cases in which politically aligned States are also “high or medium transfer” States will be higher. Similarly, if political alignment matters, then the number of cases in which politically not aligned States are also low transfer States will also be higher. In other words, if the political alignment indeed affects transfers, then the number of cases in the North-West and South-East corners of the binary classification table will be high.

4.10.2 Examination of association between FC transfers per capita and POL

The following table shows data classification under FC transfers per capita.

Table 4.10.2.1: Actual Number of Cases Using Binary Classification of Data for POL and FC transfers per capita

Actual no. of cases	POL		
FC transfers per capita	Aligned	Not Aligned	TOTAL
High and Medium	101	112	213
Low	43	38	81
TOTAL	144	150	294

If FC transfers and political alignment are independent of each other, then, $P(\text{High transfers and Aligned}) = P(\text{High transfers}) * P(\text{Aligned})$.

We set up the null of independence between the two variables (FC transfers per capita and POL) in the following manner.

H_0 : Political alignment and level of FC transfers per capita are independent of each other

H_A : Political alignment and level of FC transfers per capita are not independent of each other

We calculate the “expected” probability of occurrences under the null of independence. These probabilities, when multiplied by 294, which is the total number of occurrences, will give the “expected” number of cases for each classification, in contrast to the “actual” number of cases that have been shown above.

Following table shows the expected number of cases, calculated using the methodology indicated above.

Table 4.10.2.2: Expected Number of Cases Using Binary Classification of Data for POL and FC transfers per capita

Expected no. of cases	POL		
FC transfers per capita	Aligned	Not Aligned	TOTAL
High	104.32	108.67	
Low	39.67	41.32	
TOTAL			294

Since we now have the actual number of cases as well as the expected number of cases under each of the 4 scenarios, we now check for independence of variables using the chi-square test. The relevant test statistic is

$$\frac{\sum(\text{Actual number} - \text{Expected number})^2}{\text{Expected number}}$$

which follows the chi-square distribution with 1 d.f.

The computed test statistic value 0.75 is less than 3.84, which is the critical chi-square value for 1 d.f. We hence do not reject the null of independence, indicating that FC transfers are independent of political alignment.

This confirms that FC transfers, which are formulaic in nature and are given based on development indicators, seem to be independent of political influences. Would this also hold true for discretionary transfers per capita given by the Central Ministries?

4.10.3 Examination of association between Central Ministry transfers per capita and POL

The same exercise is carried out using Central Ministry transfers per capita. Since the Central Ministry transfers are completely discretionary, they offer a polar opposite to the FC transfers. The following table shows data classification (actual number of cases under different scenarios) under Central Ministry transfers per capita.

Table 4.10.3.1: Actual Number of Cases Using Binary Classification of Data for POL and Central Ministry transfers per capita

Actual no. of cases	POL		
CSS transfers per capita	Aligned	Not Aligned	TOTAL
High	99	90	189
Low	45	60	105
TOTAL	144	150	294

We calculate the expected number of cases for each of the variable combinations.

Table 4.10.3.2: Expected Number of Cases Using Binary Classification of Data for POL and Central Ministry transfers per capita

Expected no. of cases	POL		
CSS transfers per capita	Aligned	Not Aligned	TOTAL
High	92.57	96.42	
Low	51.42	53.57	
TOTAL			294

We set up the null of independence between the two variables (Central Ministry transfers per capita and POL) in the following manner.

H₀: Political alignment and level of Central Ministry transfers per capita are independent of each other

H_A: Political alignment and level of Central Ministry transfers per capita are not independent of each other

We check for independence of variables using the chi-square test. The computed test statistic value 2.45 is less than 3.84, which is the critical chi-square value for 1 d.f. We hence do not reject the null of independence, indicating that Central Ministry transfers are also independent of political alignment.

Thus, we have a surprising result based on the chi-square test. Not only are the formulaic transfers per capita independent of political alignment, but so are the discretionary transfers per capita.

Thus, whilst the Central Ministry transfers may be “discretionary” in that there is no set rule to determine the extent of transfers to different States, they do not seem to be decisively led by political alignment between Centre and States. If political alignments cannot explain the differentials in discretionary transfers, then what is the explanation for the differential? Chapter 5 carries a detailed analysis of the different design-based elements of Central Ministry schemes that could potentially explain the differentials in discretionary transfers between States.

4.10.4 Examination of association between PC transfers per capita and POL

We finally examine the clusters on PC transfers per capita and POL for association between the two variables. The following table shows data classification (actual number of cases under different scenarios) under PC transfers per capita.

Table 4.10.4.1: Actual Number of Cases Using Binary Classification of Data for POL and PC transfers per capita

Actual no. of cases	POL		
CSS transfers per capita	Aligned	Not Aligned	TOTAL
High	30	52	82
Low	36	22	58
TOTAL	66	74	140

We calculate the expected number of cases for each of the variable combinations.

Table 4.10.4.2: Expected Number of Cases Using Binary Classification of Data for POL and PC transfers per capita

Expected no. of cases	POL		
CSS transfers per capita	Aligned	Not Aligned	TOTAL
High	38.66	43.34	
Low	27.34	30.66	
TOTAL			140

We set up the null of independence between the two variables (PC transfers per capita and POL) in the following manner.

H0: Political alignment and level of PC transfers per capita are independent of each other

HA: Political alignment and level of PC transfers per capita are not independent of each other

We check for independence of variables using the chi-square test. The computed test statistic value 8.85 is more than 3.84, which is the critical chi-square value for 1 d.f. We hence reject the null of independence, indicating that PC transfers are associated with political alignment.

Thus, interestingly, in complete contrast with FC and Central Ministry transfers per capita, we find that higher per capita PC transfers seem to be associated with political alignment³.

4.11 Panel Data Regressions

In this section, we explore a formal panel data regression as an alternative way of looking at the data. We have data on FC transfers per capita data, CSS transfers per capita, and political alignment for fourteen States across twenty-one years. We regress FC transfers per capita and CSS transfers per capita separately on the dummy variable created to represent political alignment (POL). Given that the cluster analysis found no evidence of association between transfers and political alignment, we expect that the panel data regression would also show that political alignment is not statistically significant in explaining the transfers.

Another variable that has been used in existing research studies as a proxy for political importance of a State is the proportion of MPs in the ruling party belonging to a particular State. Using available data (Election Commission of India, 1999, 2004, 2009), we calculated the proportion of MPs in each of the fourteen States belonging to the ruling party or coalition. States were ranked in a descending order as per the proportion of MPs belonging to the ruling party in the State. We also calculated the transfers to the States in the five-year period under every coalition and ranked States accordingly. Assuming that the composition of the coalition

³ A discriminant function analysis was also tried out on the dataset to examine if categories of political alignment and non-alignment can be distinguished based on FC, PC and CSS transfers. We find that only 65 per cent of the aligned cases and 47 per cent of the non-aligned cases could be explained by the analysis. The results again go to show the weak nature of relationship between political alignment and Central transfers to States.

remained the same for the entire five year period, we calculated the rank correlation coefficient between the proportion of MPs of the ruling party in the States and the CSS transfers to the State. We found that the rank correlation coefficient was either insignificant or had a negative sign. Hence, this variable has not been used in the panel regressions to proxy political importance. One of the reasons for insignificance of the variable could be that whilst a higher proportion of MPs in the ruling party belonging to a State might create higher political importance for that State, such may not always be the case. Even if the proportion of MPs in the ruling party belonging to a State is low, the political importance given to that State might be quite high if the MPs help the ruling party to maintain majority at the margin. The other reason is our contention that political forces may not be able to explain economic variables such as transfer of funds well.

4.11.1 Regression of FC transfers per capita on Political Alignment

We first carry out a panel data regression of FC transfers per capita (fcpc) for fourteen States across twenty-one years on political alignment (POL).

The between and within groups ANOVA tests carried out on the data in Section 4.6 indicate that the means of high, medium and low transfers clusters are clearly discernable in the per capita FC transfers. This implies that there are State-specific effects in the dataset. Unobserved, State-specific effects that are time invariant can be internalized in the panel regression by using a fixed effects (FE) regression. Data analysis in Section 4.6 also indicates that the mean of transfers varies across time. Time-dummies are introduced in the fixed effects regression model to take into account the time-effects. Since there are 21 time periods, we introduce 20 dummy variables for time (dt_2, dt_3, dt_4,....dt_19, dt_20).

It is pertinent here to recall the presence of time variance and cross-sectional variance in the FC transfers per capita (Section 4.6). In the presence of time and cross-sectional variance, robust standard errors are used in estimation.

The specification of the model is as follows:

$$fcpc_{it} = a_1 + a_2dt_2 + a_3dt_3 + \dots + a_{20} dt_{20} + b_2POL_{it} + u_{it}$$

Following are the results of the regression.

Table 4.11.1.1: Fixed-effects (FC transfers per capita) using 294 observations

Included 14 cross-sectional units

Time-series length = 21

Dependent variable: FC_transfers_pc

Robust (HAC) standard errors

	<i>Coefficient</i>	<i>Std. Error</i>	<i>t-ratio</i>	<i>p-value</i>	
const	291.49	65.71	4.43	0.00001	***
POL	-54.87	68.02	-0.80	0.4206	
dt_2	23.99	2.57	9.32	<0.00001	***
dt_3	58.42	16.47	3.54	0.00046	***
dt_4	114.18	21.36	5.34	<0.00001	***
dt_5	155.41	30.80	5.04	<0.00001	***
dt_6	136.94	25.29	5.41	<0.00001	***
dt_7	170.30	29.39	5.79	<0.00001	***
dt_8	249.00	37.44	6.64	<0.00001	***
dt_9	210.70	36.43	5.78	<0.00001	***
dt_10	229.51	40.08	5.72	<0.00001	***
dt_11	316.63	42.00	7.53	<0.00001	***
dt_12	412.70	52.95	7.79	<0.00001	***
dt_13	548.96	45.90	11.95	<0.00001	***
dt_14	740.28	63.11	11.72	<0.00001	***
dt_15	982.42	82.41	11.92	<0.00001	***
dt_16	1031.37	86.56	11.91	<0.00001	***
dt_17	1048.44	87.59	11.96	<0.00001	***
dt_18	1422.45	117.74	12.08	<0.00001	***
dt_19	1673.62	137.28	12.19	<0.00001	***
dt_20	1918.22	156.32	12.27	<0.00001	***
dt_21	2059.34	164.93	12.48	<0.00001	***

Significance at 1% level is indicated by ***

Mean dependent var	907.6170	S.D. dependent var	719.9099
Sum squared resid	11326932	S.E. of regression	209.1252
LSDV R-squared	0.925409	Within R-squared	0.914050
LSDV F(34, 259)	94.50744	P-value(F)	2.5e-126
Log-likelihood	-1969.358	Akaike criterion	4008.715
Schwarz criterion	4137.641	Hannan-Quinn	4060.346

Joint test on named regressors -

Test statistic: $F(21, 259) = 131.162$

with p-value = $P(F(21, 259) > 131.162) = 6.19662e-125$

Test for differing group intercepts -

Null hypothesis: The groups have a common intercept

Test statistic: $F(13, 259) = 34.1509$

with p-value = $P(F(13, 259) > 34.1509) = 9.4418e-049$

Distribution free Wald test for heteroskedasticity -

Null hypothesis: the units have a common error variance

Asymptotic test statistic: $\text{Chi-square}(14) = 3921.34$

with p-value = 0

Test for normality of residual -

Null hypothesis: error is normally distributed

Test statistic: $\text{Chi-square}(2) = 20.4677$

with p-value = $3.59333e-005$

The overall model is significant, as indicated by the joint test on named regressors. The null of a common intercept is rejected, indicating the presence of State-specific effects in the per capita FC transfers. Time dummies are significant, indicating that means of FC transfers change with time. As is expected, political alignment (POL) is seen to be insignificant in terms of explaining per capita FC transfers.

Thus, the results show what the cluster analysis had already indicated: Political alignment does not exert a statistically significant influence on FC transfers per capita.

4.11.2 Regression of Central Ministry transfers per capita on Political Alignment

We carry out a panel data regression of Central Ministry transfers per capita (cmpc) for fourteen States across twenty-one years. The between and within groups ANOVA tests carried out on the data in Section 4.7 indicate that the means of high, medium and low transfers clusters are clearly discernable in the per capita Central Ministry transfers. This implies that there are State-specific effects in the dataset. Unobserved, State-specific effects that are time invariant can be internalized in the panel regression by using a fixed effects (FE) regression. Data analysis in Section 4.7 also indicates that the mean of discretionary transfers varies across time. Time-dummies are introduced in the fixed effects regression model to take into account the time-effects. Since there are 21 time periods, we introduce 20 dummy variables for time (dt_2, dt_3, dt_4,....dt_19, dt_21).

It is pertinent here to recall the presence of time variance and cross-sectional variance in the Central Ministry transfers per capita (Section 4.7). In the presence of time and cross-sectional variance, robust standard errors are used in estimation.

The specification of the model is as follows:

$$\text{cmpc}_{it} = a_1 + a_2\text{dt}_2 + a_3\text{dt}_3 + \dots + a_{20} \text{dt}_{20} + b_2\text{POL}_{it} + u_{it}$$

Following are the results of the regression.

Table 4.11.2.1: Fixed-effects (CSS transfers per capita) using 294 observations

Included 14 cross-sectional units

Time-series length = 21

Dependent variable: CSS_transfers_pc

Robust (HAC) standard errors

	<i>Coefficient</i>	<i>Std. Error</i>	<i>t-ratio</i>	<i>p-value</i>	
const	85.28	6.31	13.52	<0.00001	***
POL	-3.73	5.55	-0.67	0.50181	
dt_2	-17.70	5.23	-3.39	0.00082	***
dt_3	-20.49	6.12	-3.35	0.00094	***
dt_4	-15.88	6.61	-2.40	0.01703	**
dt_5	-18.32	5.27	-3.48	0.00059	***
dt_6	-11.73	6.30	-1.86	0.06392	*
dt_7	-3.15	7.02	-0.45	0.65387	
dt_8	-6.97	7.58	-0.92	0.35879	
dt_9	-4.03	9.51	-0.42	0.67212	
dt_10	-10.49	7.18	-1.46	0.14544	
dt_11	-2.25	8.48	-0.27	0.791	
dt_12	11.72	7.32	1.60	0.11038	
dt_13	31.60	10.15	3.11	0.00206	***
dt_14	63.85	10.32	6.19	<0.00001	***
dt_15	107.13	15.81	6.78	<0.00001	***
dt_16	128.26	13.58	9.45	<0.00001	***
dt_17	127.98	10.96	11.68	<0.00001	***
dt_18	162.68	8.11	20.05	<0.00001	***
dt_19	256.47	16.82	15.24	<0.00001	***
dt_20	269.29	18.89	14.26	<0.00001	***
dt_21	266.02	16.91	15.73	<0.00001	***

Significance at 1%, 5% and 10% level is indicated by ***, ** and * respectively

Mean dependent var	146.0208	S.D. dependent var	107.0255
Sum squared resid	274443.3	S.E. of regression	32.55191
LSDV R-squared	0.918227	Within R-squared	0.912624
LSDV F(34, 259)	85.53821	P-value(F)	3.2e-121
Log-likelihood	-1422.489	Akaike criterion	2914.978
Schwarz criterion	3043.904	Hannan-Quinn	2966.609
rho	0.434671	Durbin-Watson	1.071261

Joint test on named regressors -

Test statistic: $F(21, 259) = 128.819$

with p-value = $P(F(21, 259) > 128.819) = 5.14524e-124$

Test for differing group intercepts -

Null hypothesis: The groups have a common intercept

Test statistic: $F(13, 259) = 15.6568$

with p-value = $P(F(13, 259) > 15.6568) = 4.63373e-026$

The joint test on named regressors posits a null of all regressors being together insignificant. Rejection of the null implies that the model is overall significant. The groups i.e. the States are seen to have State-specific intercepts. The analysis of within and between group variance of per capita Central Ministry transfers (Section 4.7) had already indicated that the mean of the transfers changes with time. This effect is seen in the dummy variables for time becoming significant.

The results again show what the cluster analysis had already indicated: Political alignment does not exert a statistically significant influence on per capita Central Ministry transfers. Thus, FE panel regression of FC transfers per capita and CSS transfers per capita to fourteen major States from 1991-94 to 2013-14 indicates that political alignment does not significantly affect transfers, statutory as well as discretionary.

4.11.3 Regression of PC transfers per capita on Political Alignment

We carry out a panel data regression of Planning Commission transfers per capita (PCpc) for fourteen States across twenty-one years. The between and within groups ANOVA tests carried out on the data in Section 4.8 indicate that the means of high, medium and low transfers clusters are clearly discernable in the per capita PC transfers. This implies that there

are State-specific effects in the dataset. We use the Fixed Effects (FE) regression model to account for State-specific effects. The ANOVA test carried out in Section 4.8 also indicates that the mean of PC transfers varies across time. Time-dummies are introduced in the fixed effects regression model to take into account the time-effects. Since there are 21 time periods, we introduce 20 dummy variables for time (dt_2, dt_3, dt_4,....dt_19, dt_21).

It is pertinent here to recall the presence of time variance and cross-sectional variance in the per capita Planning Commission transfers (Section 4.8). In the presence of time and cross-sectional variance, robust standard errors are used in estimation.

The specification of the model is as follows:

$$PC_{c_{it}} = a_1 + a_2dt_2 + a_3dt_3 + \dots + a_{20} dt_{20} + b_2POL_{it} + u_{it}$$

Following are the results of the regression.

Table 4.11.3.1: Fixed-effects (PC transfers per capita) using 140 observations

Included 14 cross-sectional units

Time-series length = 10

Dependent variable: PCpc

Robust (HAC) standard errors

	<i>Coefficient</i>	<i>Std. Error</i>	<i>t-ratio</i>	<i>p-value</i>	
const	512.15	45.74	11.20	<0.00001	***
POL	-79.53	19.37	-4.11	0.00	***
dt_2	-50.90	62.95	-0.81	0.42	
dt_3	2.65	66.49	0.04	0.97	
dt_4	-82.84	51.61	-1.61	0.11	
dt_5	31.01	71.87	0.43	0.67	
dt_6	-41.02	54.50	-0.75	0.45	
dt_7	28.08	69.25	0.41	0.69	
dt_8	-54.77	45.14	-1.21	0.23	
dt_9	52.25	78.28	0.67	0.51	
dt_10	-62.77	48.55	-1.29	0.20	

Mean dependent var	456.8293	S.D. dependent var	189.3981
Sum squared resid	2785372	S.E. of regression	154.9575
LSDV R-squared	0.441379	Within R-squared	0.161122
LSDV F(23, 116)	3.984967	P-value(F)	3.77e-07
Log-likelihood	-891.5289	Akaike criterion	1831.058
Schwarz criterion	1901.657	Hannan-Quinn	1859.747
rho	-0.178040	Durbin-Watson	2.189609

Joint test on named regressors -

Test statistic: $F(10, 116) = 2.22799$

with p-value = $P(F(10, 116) > 2.22799) = 0.0206336$

Test for differing group intercepts -

Null hypothesis: The groups have a common intercept

Test statistic: $F(13, 116) = 5.30576$

with p-value = $P(F(13, 116) > 5.30576) = 2.13874e-007$

Wald test for joint significance of time dummies

Asymptotic test statistic: Chi-square(9) = 33.426

with p-value = 0.000112557

4.12 Interpretation of the Results

We use cluster analysis as well as panel data regressions to show the effect of political alignment on per capita FC transfers, per capita Central Ministry transfers as well as per capita Planning Commission transfers.

Our analysis shows that FC transfers per capita are independent of political alignment. Given the formulaic nature of FC transfers, they would preclude any kind of political interference. Political alignments could exert influence, if at all, only through the discretionary part of transfers. Central Ministry and Planning Commission transfers have elements of discretion built into the transfer mechanism.

Planning Commission transfers were potentially more prone to the use of discretion upto 1969. However, with the Gadgil formula devised in 1969, PC transfers too became largely

formula-driven. In the data period under consideration, PC transfers have been made under the framework of the Gadgil-Mukherjee formula. However, to the extent that the schemes and size of the State Plans need approval of the Centre within the framework of the Planning Commission, it could be well be the case that approvals are given to politically aligned States. Analysis of per capita PC transfers from 2004-05 to 2013-14 indicates that higher per capita PC transfers are given to politically aligned States. Thus, PC transfers seem to be significantly influenced by political alignment considerations.

Central Ministry transfers are discretionary. Given that Central Ministry transfers are not governed by any rule or formula, it is intuitively appealing to conjecture that political variables could influence the quantum of transfers to States. However, interestingly, it is seen that just like FC transfers, discretionary transfers given by Central Ministries also are completely independent of political alignment!

Why is it that political alignments do not influence the fund transfers made by Central Ministries? Central Ministries transfer funds to States for implementing schemes that are Central priorities. In order to provide ease of administration to the Central Ministries, uniform administrative, financial and implementation processes are required at the level of the States getting the funds. If a State is not able to comply with any of these processes, further transfers to that State normally stand suspended. Thus, to a large extent, fund transfers from Central Ministries would depend on administrative alignment of the State machinery with the Central processes rather than political alignment of the State party with the party in power at the Centre. However, factors such as administrative capacities, ease of compliance, design of fund flow etc. preclude quantification. It might be thus, quite fruitless to try and prove the statistical significance of such factors in explaining the differentials in Central Ministry transfers to States.

We hence use a case-study approach to highlight the role and impact that less tangibly measurable factors such as administrative capabilities and fund flow mechanisms play in determining the quantum of scheme transfers to States. The next chapter carries out a study of three major Centrally Sponsored Schemes and attempts to identify qualitative factors that influence discretionary transfers.

CHAPTER 5

EXPLAINING THE DIFFERENTIALS IN DISCRETIONARY TRANSFERS: DESIGN ELEMENTS IN CSS

From 1991 onwards, coalition Governments have been more the rule than the exception at the Centre in India, and this has created political dependencies of the party at the Centre on its regional allies. On the other hand, State Governments, entrusted with many functions but incommensurate taxation powers, find themselves to be financially dependent on the Centre. These forces create interesting bargains between the power-hungry Centre and the fund-starved States.

There is an observed differential in the funds transferred to different States under the Centrally Sponsored Schemes (CSS). The backdrop of political bargains serves as a tempting answer to explain the differentials in fund transfers. However, in Chapter 4, we show that no significant association exists between CSS transfers to States and political alignment between Centre and States. Thus, discretionary transfers to States may not be necessarily led by the political alignment of the State with the Centre or other political influences.

The question still remains: If not political influences, then what explains the differentials in fund transfers across States? Why is it that discretionary transfers to States show a high level of variability?

The answer perhaps, lies in the design of discretionary transfers. The Centre, for ease of administering the scheme, normally creates a common set of rules or a scheme “design” regarding compliance, financial declarations, sharing of funds between Centre and States, administrative processes and implementation of the program. Hence, the approach of the Centre could be generally described to be a “one-size-fits-all” approach. Given that capacities (to adhere to these rules) are vastly different across States, some States could find it cumbersome to fit into the design of the scheme. Some States may not have the fiscal capacity to support the part funding that the CSSs demand. Even though a State is politically aligned to the Centre, bureaucratic paperwork entailed by the design of the scheme may stall the movement of funds to such a State. Similarly, inabilities of the local Government may create non-utilization of funds, thereby affecting fund transfers in the next time-period. These factors thus lend “rigidities” to

scheme transfers, and create situations in which States normally gravitate to what could be called as an “equilibrium” fund-position for that State within a particular scheme.

Thus, design related aspects may be helpful to distinguish why specific schemes result in differential transfers.

In this chapter, we study three major Centrally Sponsored Schemes, namely, Mahatma Gandhi National Rural Employment Guarantee Act (2005) or MNREGA, Pradhan Mantri Gram Sadak Yojana (2000) or PMGSY and National Health Mission or NHM to identify those design related aspects that lead to differential CSS transfers to States.

5.1. Mahatma Gandhi National Rural Employment Guarantee Act (2005)

5.1.1 Introduction

There is a long precedence of schemes oriented towards rural welfare and creation of rural employment in India. The Scarcity and Relief Works (1914) Act in British India seems to be the forerunner of schemes oriented towards creating employment in times of famines. The Employment Guarantee Scheme (1972) introduced in Maharashtra was unique in that it recognized the right of the rural unemployed to get unskilled manual work on demand (Bagchi, 1984). Later, Central Schemes such as the Food for Work Scheme (1977), the National Rural Employment Program (1980), the Rural Landless Employment Guarantee Program (RLEGP), the Jawahar Rozgar Yojana (1989), the Sampoorna Grameen Rozgar Yojana (2001) and the National Food for Work Program (2004) were variants of the same model. However, barring the Employment Guarantee Scheme in Maharashtra, none of the other schemes recognized the right to work as a fundamental right of the rural citizenry.

The National Rural Employment Guarantee Scheme (NREGS) was brought in through the National Rural Employment Guarantee Act passed in 2005 and hence provided a “legal guarantee of at least 100 days of employment on asset creating public works programs every year at minimum wages for at least one able-bodied person in every rural, urban poor and lower middle class household.” (MNREGA Act, 2005). After an amendment in 2009, the Act was renamed Mahatma Gandhi National Rural Employment Guarantee Act, 2005 (MNREGA

henceforth).MNREGA was largely modelled on the lines of the Employment Guarantee Scheme introduced in Maharashtra in 1972.

In 2017-18, MNREGA covered 685 districts, 6883 blocks and 262381 Gram Panchayats. The Centre released Rs.55704 crores under the scheme and 232.79 crore man-days of employment were generated under different works in 2017-18. Utilization of funds by States stood at 97.83 per cent of the total funds released by the Centre. 96.15 per cent of the total expenditure undertaken by States was routed through e-FMS i.e. electronic Fund-transfer Management System.

However, the State-level data on the scheme are available very sporadically. Most of the data are available in the form of ready-made tables created by researchers for specific studies. However, such data defy compilation into a time-series from 2005-06 (start of the scheme) till date. Appendix D gives the details of transfers and utilization under MNREGA only from 2006-07 to 2010-11.

An interesting event is that MNREGA was passed in 2005 shortly after the passage of the Rights to Information (RTI) Act, 2005 and has been termed as a “sister legislation to the RTI³”. In her book titled “Paper Tiger”, author Nayanika Mathur (2016) suggests that MNREGA differentiated itself from other schemes in that it endeavoured to create transparency and accountability, both largely influences drawn from the prevalent discussion on the RTI Act 2005. The RTI entails creation of transparency through documentation of Governmental processes and the right of any citizen to access these records. Similar intents and provisions are seen in the MNREGA framework, with the scheme entailing huge amount of paperwork to be created for supporting transparency and accountability under the scheme. This very feature of the scheme, wherein every process has to be supported with documentation, is an inherent design-related procedural aspect of MNREGA and one that has great potential to create differential behavioural responses in States and get reflected in differential utilization of available funds.

In order to assess the rigidities within scheme design, it is firstly important to look at the main procedures mentioned within the Act.

5.1.2 Procedural Aspects of the Act¹

1. Adult members of a rural household, willing to do unskilled manual work, may apply for registration under MNREGA. This application is to be made in writing or orally to the local Gram Panchayat
2. Once the due verification of the applicants is processed, the Gram Panchayat will issue a “Job Card” bearing the photograph of all adult members of the household willing to work under MGNREGA. The Job card is issued free of cost and is to be maintained by the household and not by the Gram Panchayat.
3. The Job Card should be issued within 15 days of application.
4. The Job cardholder may submit a application for employment. The Gram Panchayat will issue a dated receipt of the written application and will guarantee employment within 15 days of the date on the receipt.
5. If employment is not given within 15 days of application for work, then a daily unemployment allowance is to be given to the applicants as per the Act. The liability of paying unemployment allowance is on the States.
6. Work has to be ordinarily provided within 5 km radius of the village. In case work is provided beyond 5 km, extra wages of 10% are payable to meet additional transportation and living expenses
7. Wages are to be paid according to the Minimum Wages Act 1948 for agricultural labourers in the State, unless the Centre notifies a wage rate which will not be less than Rs. 60/ per day. Equal wages will be provided to both men and women.
8. Wages will be disbursed on a weekly basis and not beyond a fortnight in any case.
9. At least one-third beneficiaries shall be women who have registered and requested work under the scheme.
10. Work site facilities such as crèche, drinking water, shade have to be provided

1. ¹ Details about Procedural Aspects of the Act are sourced from <http://vikaspedia.in/social-welfare/rural-poverty-alleviation-1/schemes/faqs-on-mgnrega/mahatma-gandhi-national-rural-employment-guarantee-act>

11. Each district Zilla Parishad is to prepare a “shelf of projects” which are permissible under MNREGA. These have to be prioritized as per recommendations of the Gram Sabhas. At least 50% of works will be allotted to Gram Panchayats for execution.
12. Permissible works predominantly include water and soil conservation, afforestation and land development works.
13. A 60:40 ratio for wage and material expenditure has to be maintained. No contractors and labour displacing machinery is allowed for execution of the works.
14. Social Audit has to be done by the Gram Sabha.
15. Grievance redressal mechanisms have to be put in place for ensuring a responsive implementation process
16. All accounts and records relating to the Scheme should be available for public scrutiny.
17. The Centre bears 100 per cent of the cost of unskilled labour and 75 per cent of the cost of skilled labour and machinery. 25 per cent of the cost of skilled and semi-skilled labour and machinery is borne by the State Government.

5.1.3 Rigidities as Evident in the Design of the Scheme

Careful scrutiny of the procedural aspects of the Act help us to identify the peculiarities with the scheme design, which themselves could and do create differentials in the transfer of funds from the Centre to the States. These are as follows.

- The factor which differentiates MNREGA from other wage employment schemes is its bottom-up approach to the problem of providing rural poor with employment. Earlier schemes used a top-down approach for implementing small rural infrastructure projects to create employment. Under MNREGA, the rural household itself assesses its own need for employment and accordingly applies for a Job Card to the Gram Panchayat (GP). The GP then records the application and issues a Job Card to that household. Herein lies the first design issue of the scheme.

Can we assume that all Gram Panchayats across different States would be equally responsive in issuing Job Cards to the households on time? The level of existing capacities across Gram Panchayats in different States is vastly different. MNREGA, in its schematic design of creating a bottom-up approach to rural employment, puts the onus of

creating the basic document for entry into the scheme on Gram Panchayats with differential capacities.

- The scheme provides that the work should be provided within 5 kms of the radius of the village. This is an attempt to utilize local labour for local work-programs. However, the main challenge is the availability of works at the level of the Gram Panchayat. This prompted the practice of dovetailing other schemes with MNREGA. The rural roads to be constructed under Pradhan Mantri Gram Sadak Yojana (PMGSY) or small bunds to be constructed under the Integrated Water Management Program (IWMP) are converged with the employment to be created under MNREGA. However, convergence too comes with its own set of peculiar challenges.

To begin with, data requirements for convergence programs are huge. Baseline data or micro-planning data for different schemes are rarely available at the Gram Panchayat level. This causes delays for projects to commence under PMGSY or IWMP; on the other hand, there is tremendous pressure to provide jobs within 15 days of the applications being made by the MNREGA Job Card holders. One of the outcomes of such contrary pulls is that Gram Panchayats have started delaying acceptance of applications until project work is notified in the area. To complicate matters further, the envisaged co-operation between different departments may not exist since different departments have different financial norms and time-tables for the sanctioned projects (Bhanumurthy, Amarnath, Verma & Gupta, 2014, p.18).

- We have noted that at least one third of the beneficiaries under the scheme should be women. In Uttar Pradesh, women in the villages are not forthcoming for a wage employment program for cultural reasons (Bhanumurthy et. al., 2014, p.18). Thus, even if the work is available, reluctance of women to participate in the local works creates a delay in starting the works. This has an impact on the utilization of funds under the scheme. This is an example of how the “one-size-fits-all” approach can hamper implementation of schemes in some States.
- Another scheme design issue that is relevant here is the design of fund disbursement. The fund release under MNREGA is done in two tranches. The first tranche released by the Centre can maximally equal 50 per cent of the total transfers to that State and is to be

utilized for 6 months. The second tranche is released subject to the State utilizing at least 60 per cent of the funds released under the first tranche.

In Uttar Pradesh, low participation by women causes delays in the implementation of the scheme. This leads to under-utilization of the sanctioned funds, and hence leads to delays in the second payment done by the Centre.

- As has been mentioned under procedural aspects of the Act, the scheme requires that at least 50 per cent of the works should be implemented by the Gram Panchayats. Again we come to the moot issue of how well equipped the Gram Panchayats are to implement the works on time. One of the stated objectives of MNREGA was to do away with “Contractor Raj” (Mathur, 2012). The nexus between the elected representatives and local contractors not only encouraged rent-seeking behaviour and corruption, but also led to labour contractors getting the works implemented using labour from outside the region or State.

With the Gram Panchayat itself designated as an implementation agency, rules were created to document the various processes within the implementation of the project to ensure transparency. Thus, for every project, a daily muster roll would be maintained at the project site carrying the names of the labourers who worked on the site for that day. The muster roll was to be accessible to anyone who had a query regarding the jobs created for the project. Muster roll entries had to be identically entered into the Job Card issued to the households. The Job Cards were to be maintained by the household and not on site. Thus, the scheme created a documentation system that could tally the employment created at the site with the employment details entered on the Job Card. This, it was hoped, would act as a deterrent to (wrongly) claiming higher expenditure for wages, or to inflating the actual employment data created under different works.

What happened in the wake of the scheme being launched was a huge requirement of documentation, which more than the corruption, helped in slowing down works implementation. This led to slower utilization of funds, causing delay in the release of the next tranche of funds.

Over a period of time, these factors created a “Job Card economy”, wherein fraudulent entries in muster rolls with corresponding entries in Job Cards became a norm. Instances of corrupt practices in issuing Job Cards, or of delaying issue of Job Cards till funds were

sanctioned have been recorded in all States. Thus, those States in which the administrative, bureaucratic and business systems were smart enough to adjust to the “new normal” of higher documentation requirements under MNREGA were the ones who continued to get higher transfers under the scheme.

- Another associated problem lies in computerizing the fund transfers. MNREGA introduced the e-FMS i.e. e-Fund Transfer Management System which would facilitate the transfer of the fund from the State Government account directly into the account of the final beneficiary (Bhanumurty et. al., 2014, p.20). While this led to the intended consequences of reducing the leakage of funds, it also created a huge requirement for training the administrative machinery. Many of the administrative staff for Centrally Sponsored Schemes are contractually hired and did not have the required skill sets to carry out transactions under e-FMS. Further complications were created from the frequent changes in the technology designed for e-FMS.

Again, here, it would not be wrong to claim that the Southern States, with higher literacy levels in general and higher exposure to IT management systems in particular could adjust better and more quickly to this “new normal”. This partly helps to explain why the performance of Southern States in terms of fund utilization tends to be stronger than other States. In particular, Andhra Pradesh used the e-FMS aggressively. Following table compares the data on unspent balances as a proportion of the funds transferred to the States in 2011-12 in Andhra Pradesh to other northern States.

Table 5.1.1: State-wise comparison of percentage of Unspent Funds to Total Fund Transfers in 2011-12

State	Unspent funds as a percentage of total transfers in 2011-12
Andhra Pradesh	5
Rajasthan	14
Bihar	17
UP	20.29
Madhya Pradesh	25.35

Source: Bhanumurtyet.al.,2014, Pg 18

Rajasthan actually is a State with a good record in fund utilization. However, even in Rajasthan, one of the main deterrents to fund utilization was seen to be the delay in entering the utilization data into the MIS, which was itself caused by the IT-unpreparedness of the contractual staff.

- MNREGA mandates a social audit by the Gram Sabha of the work completed under the scheme. Different States have taken different routes to comply with this particular rule. In Rajasthan, NGOs and other stakeholders in participatory political movements took the lead in conducting social audits under MNREGA. On the other hand, the State Government itself took a lead in Odisha to make sure that social audits were carried out. However, it is important to note that in both the States, social audits were carried out experimentally and sporadically.

However, in Andhra Pradesh, the State Government institutionalized the social audit mechanism (Aiyar, Mehta & Samji, n.d.). Thus, the State Government created a team of social auditors who were given the responsibility of carrying out social audits. Studies reveal that the public meetings at which the social audits were undertaken were exceptionally well-attended and created huge understanding for the State Government on the positive as well as negative aspects of the scheme. It also fostered a milieu of continuous engagement of the State Government with the local bodies. This, in turn, has led to a better understanding of the issues connected to fund transfers from the State to the local bodies.

In most States, once the Gram Sabha creates a list of the projects it wants to implement in the village, the list is sent to the district level Zilla Parishad, where the district authorities modify the projects arbitrarily without consulting the local bodies. The financial estimates are also changed without consultation. The lack of dialogue between the State, district and local bodies implies that funds are transferred to the district level bodies, which then transfer the funds almost arbitrarily to the local bodies. The funds transferred are, at times, much higher than the requirement and tend to lie idle at the Gram Panchayat accounts. There is no reverse mechanism of moving unused funds back to the States. Thus, the funds remain unutilized and the State Government is not given the next tranche of funds by the Centre.

Social audits are helpful in revealing precisely such types of issues and facilitate dialogue between the different levels of administrative machinery. One of the reasons for the strong performance of the Andhra Pradesh Government in fund utilization has been the institutionalization of social audits.

This also creates the question of why only Andhra Pradesh could institutionalize the audit processes mandated under MNREGA. In an interesting paper based on political, economic and policy observations of schemes in the TDP-dominated (1996-2002) Andhra Pradesh, senior civil servant Naresh Saxena (2002) suggests that institutionalization of processes for implementation of CSSs, of which MNREGA is a major example, has been a hallmark of TDP politics wishing to create coalition partners at the grassroots. It is to be noted that this observation is from 2002, three years before MNREGA was passed by an Act. Saxena suggests that the TDP created several lower rung bodies and committees manned by their own party workers who shared caste-affiliations with the electorate in those areas. Scheme funds were often disbursed through these bodies and committees, guaranteeing economic and political connections with the electorate at the same time. TDP thus managed to create a mechanism and milieu of efficient movement of funds from the State to the lower tiers of governments over a period of time. Effective utilization of funds made Andhra Pradesh a forerunner in performance related to many CSSs over a period of time. It is also a State known for a conscious effort to draw funds under different schemes from the Government of India.

This commentary suggests that Andhra Pradesh created and enjoyed administrative mechanisms and environmental milieu that gave it an advantage over other States in terms of drawing funds from the Centre.

Having said that, it is important to again note that MNREGA only mandates carrying out social audits. How the audit process is to be streamlined is left to the States. States' perspective and design of implementation of the social audit creates a differential in the most important aspect of enforcement of the Act, and is manifested in differential performances of the States in receiving and absorbing fund transfers.

- There are State-specific issues that contribute to varying levels of fund utilization. MNREGA mandates no more than 6 per cent of the total expenditure to be earmarked for

the administrative support for the scheme. In States such as UP and Bihar, in which (a) the number of Gram Panchayats is high and (b) the geographical area to be physically covered by works proposed under the scheme is huge, more number of scheme administration units are required within a block as compared to other States (Aiyar et. al., n.d.). Correspondingly, the administrative expenses of running the scheme are higher. Ability of the State Governments to implement the scheme in such cases is constrained by the mandate of restricting administration expenses to 6 per cent of the overall expenditure of the scheme. Shortage of staff leads to deficiencies in planning and under-utilization of funds.

Another related issue is that social audits are a part of administrative expenditure. In most States, the 6 per cent administrative expenditure limit is seen to be inadequate and hence, social audits become a “residual item of expenditure”. The problem is acute, more so in the geographically bigger States such as UP. Lack of funds to drive the social audits leads to stalling of assessments, further leading to under-utilization of resources. In Bihar, stalling of payments of second instalment by the Centre led to the contractual staff not being paid. The staff went on strike, which affected planning and utilization of funds under MNREGA.

- In Rajasthan, wage payments for the scheme have been routed through the Post Offices (Aiyar et. al., n.d.), which are mostly not computerized. This affects the speed and transparency of fund transfers to the ultimate beneficiaries. Pending end-to-end digitization, the MIS does not fully reflect the funds actually utilized and the State does not receive the second tranche of payments on time.

There is a huge variation in transfers under MNREGA to different States. Rather than any political influence, this variation is simply explained by understanding the design elements of the scheme. In this section, we have highlighted several issues pertaining to design of administrative mechanisms and procedures inherent to MNREGA. It is such design elements that cause variability in the probability of States begetting the MNREGA funds.

5.2. Pradhan Mantri Gram Sadak Yojana

5.2.1 Introduction

The Pradhan Mantri Gram Sadak Yojana was announced in the year 2000 under the Ministry of Road Development (MoRD) with an objective of (a) creating all weather roads to connect every village with a population of more than 1000 in 3 years and (b) with a population of more than 500 (250 in the case of hilly, tribal or scheduled areas) in 7 years. Both new construction as well as upgradation of existing roads is approved under PMGSY.

Absence of roads in the rural areas is known to have positive associations with high incidence of poverty and illiteracy. Thus, the PMGSY was also envisaged as an integral part of the overall poverty reduction program of the Central Government in 2000.

The expenditure earmarked for the scheme increased sharply from 2004-05 to 2010-11, when the scheme was included under Bharat Nirman, the flagship scheme of the UPA Government. Allocations for the scheme reached a peak of Rs.19886 crores in the Budget of 2010-11, after which the allocations reduced sharply. The Union Budget of 2015-16 again raised the allocation under the scheme to Rs.19000 crores. Between 2001 and 2017, 1.54 lakh new projects were approved under the scheme and 4.87 lakh km of roads were constructed. Thus, 80 km of roads per day were constructed in the said period under PMGSY (GOI Budget Brief, 2018).

5.2.2 Procedural Aspects of PMGSY

1. The National Rural Road Development Agency (NRRDA) was set up as an agency under the MoRD in 2002 along with a State level counterpart in each State called as the State Rural Road Development Agency (SRRDA). While the NRRDA creates the design and gives technical support and funding to the States implementing the scheme, the execution of the work plan is done by the SRRDAs within the respective States with the help of Project Implementation Units (PIUs) (Srivastava, n.d.). The Public Works Department (PWD), Rural Development Department (RDD), etc. implement the scheme (Jain, Raghuram & Morris, 2017).

2. There are fairly detailed guidelines for project selection, approval, selection of agencies of implementation and for the process of implementation itself. These are encapsulated in the Rural

Road Manual, Book of Specification and the Standard Data Book, Standard Bidding Document, and the Online Management Monitoring and Accounting System (OMMAS).

There are guidelines to mitigate the impact of the project on the people who might lose their land, standing crops, and livelihood or standing structures due to the construction of the road. This set of guidelines involves the community participation at the level of Panchayat Raj Institutions to help devise impact mitigation and grievance redressal strategies (GOI document, 2014).

Presence of formal and complex guidelines differentiates the works executed under PMGSY from that done under earlier schemes such as Minimum Need Program (MNP), Rural Landless Employment Guarantee Program (RLEGP) or Jawahar Rozgar Yojana (JRY).

3. The Ministry of Rural Development undertakes Monitoring and Evaluation (M&E) of the roads constructed under the scheme. There is also a three-tier Quality Control (QC) system mandated by the scheme. The first QC is enforced by the PIU at the time of the construction. Apart from this, State Quality Monitors and National Quality Monitors are deployed for independent quality inspection of roads.

4. Maintenance of roads would be done for a period of five years by works contractors identified as per scheme guidelines. The maintenance fund would be budgeted for by the State Governments. After five years, the State Governments would budget for the maintenance of the assets by putting them under zonal maintenance contracts.

5. The Centre would fully finance the scheme. Inter-se allocations between States are governed by a formula, with 25 per cent weight given to the number of villages with a population of more than 1000 and 75 per cent weight given to the number of villages with population of less than 1000 not connected by roads.

6. Penalty clauses for non-adherence to scheme guidelines by States are normally in the format of delaying the next release of funds.

5.2.3 Design Elements within PMGSY

As in the case of MNREGA, there are huge variations in the fund transfers under PMGSY to different States. Other PMGSY parameters such as roads constructed, habitations connected etc. also show a huge variation across different States. For example, the six States of Madhya Pradesh, Rajasthan, Uttar Pradesh, Bihar, Odisha and Chattisgarh account for 58 per cent of the total road length constructed under PMGSY. Between 2000 and 2017, PMGSY construction accounted for 41 per cent of the total habitations connected to roads in Bihar, whereas in Uttar Pradesh, PMGSY accounted for only 5 per cent of the total habitations connected by roads.

Let us examine some of the design level issues within PMGSY to understand the source of these variations.

- Unlike MNREGA which is demand driven, PMGSY funds are allocated on basis of a formula, as has been explained above. If a particular State has a high number of villages, and further if such villages are unconnected by roads, then the PMGSY formula automatically provides for higher transfers to such States. Thus, States with poorer rural infrastructure get higher transfers under the scheme. The following table shows a comparison between MNREGA and PMGSY transfers to Bihar and Tamil Nadu. It is interesting to note that Bihar has six times as many rural poor as Tamil Nadu, but yet it is Tamil Nadu that receives higher funds under MNREGA (Saxena, 2016). But since the PMGSY design of transfers accounts for the inherent variability in the availability of rural infrastructure within States, higher PMGSY transfers go to Bihar (Saxena, 2016).

Table 5.2.1: Comparison of Expenditure on MNREGA and PMGSY in Bihar and Tamil Nadu from 2012-13 to 2014-15

Year	Expenditure on MGNREGS (Rs. crore)			Expenditure on PMGSY (Rs. crore)		
	Bihar	Tamil Nadu	All India	Bihar	Tamil Nadu	All India
2012-13	1,891	4,121	39,268	1,992	21	8,387
2013-14	1,990	3,876	37,847	1,845	383	13,095
2014-15	1,073	3,908	35,780	2,259	581	16,538

Source: [Saxena, 2016](#)

- However, there is another side to the same argument too. Since rural roads are a State-subject, the State Governments ought to have provided for the same even before the

launch of PMGSY in 2000. In this sense, higher transfers to infrastructure deficit States also imply a perverse situation of giving higher transfers to historically inefficient States as well.

- There is another interesting point of comparison between the design of PMGSY and that of MNREGA. An automatic three-tier Quality Control mechanism is institutionalized under PMGSY. Whereas the actual implementation of the project may be done by the PWD or RDD, the PIU conducts the first QC at the level of construction of the road. Thus, there are two distinct entities which work within the aegis of the scheme; the implementing agency is different from the agency in charge of monitoring the quality of the work. This design works far more efficiently than the design implicit in MNREGA. In MNREGA, the implementation of works as well as social audits are both done by the Panchayat Raj Institutions, which by design creates challenges in quality management (Saxena, 2016).

The above discussion indicates that the procedural and selection elements within PMGSY have been designed carefully. The main factor that causes differential transfers under PMGSY is simply the differential in the basic gap in rural infrastructure across different States in India.

5.3 National Health Mission

5.3.1 Introduction

In 2006, the Central Government consolidated all programs focussed on the objective of providing better health outcomes in the rural areas into the National Rural Health Mission (NRHM). In 2013, the scheme objectives were expanded to give health coverage for the urban poor too and thus, a new consolidated scheme named the National Health Mission (NHM) emerged (Rao, 2015).

The objectives of the programme are (GOI Press Release, 2017):

- i. Reduction in child and maternal mortality
- ii. Prevention and control of communicable and non-communicable diseases, including locally endemic diseases.

- iii. Access to integrated comprehensive primary health care.
- iv. Population stabilisation, gender and demographic balance.
- v. Revitalize local health traditions & mainstream AYUSH.
- vi. Universal access to public services for food and nutrition, sanitation and hygiene and universal access to public health care services with emphasis on services addressing women's and children's health and universal immunisation.
- vii. Promotion of healthy life styles.

The NHM focuses on achievements in following indicators (GOI Press Release, 2017):

1. Reduce Maternal Mortality Rate (MMR) to 1/1000 live births
2. Reduce Infant Mortality Rate (IMR) to 25/1000 live births
3. Reduce Total Fertility Rate (TFR) to 2.1
4. Prevention and reduction of anemia in women aged 15–49 years
5. Prevent and reduce mortality & morbidity from communicable, non-communicable; injuries and emerging diseases
6. Reduce household out-of-pocket expenditure on total health care expenditure
7. Reduce annual incidence and mortality from Tuberculosis by half
8. Reduce prevalence of Leprosy to <1/10000 population and incidence to zero in all districts
9. Annual Malaria Incidence to be <1/1000
10. Less than 1 per cent microfilaria prevalence in all districts
11. Kala-azar Elimination by 2015, <1 case per 10000 population in all blocks

5.3.2 Procedural Aspects of the Scheme

1. The NHM support to States/UTs has five key financing components (GOI Press Release, 2017).
 - (i) Health Systems Strengthening including infrastructure, human resource, drugs & equipment, ambulances, MMUs, ASHAs etc under National Rural Health Mission (NRHM) and National Urban Health Mission (NUHM).
 - (ii) Reproductive, Maternal, Newborn, Child and Adolescent Health Services (RMNCH + A)
 - (iii) Communicable Disease Control Programmes
 - (iv) Non-Communicable Diseases Control Programme interventions upto District Hospital level
 - (v) Infrastructure Maintenance- to support salary of ANMs and LHVs etc.
2. The scheme is currently funded by the Centre and States in a ratio of 60:40.
3. The implementation of the scheme is done at the State, district and block level by “State Health Societies (SHS)”. Both the National and State share of funds are released to the State treasury. The State treasury then releases funds to districts and lower level SHS units for actual implementation.
4. It is interesting to note that the ratio of funds contributed by Centre and States as well as the procedure for transfer of funds under NHM has undergone many changes since its inception. During the eleventh Five Year Plan (2007-08 to 2011-12), the ratio of funds contributed by Centre and States was in the ratio 85:15. In the first three years of the twelfth Five Year Plan, the ratio of Centre-State expenditure for the General Category States was fixed at 75:25 and that for Special Category States was decided to be 90:10. In 2014, the Fourteenth Finance Commission gave its recommendations to increase the tax share of the States from 32 per cent to 42 per cent of the Central divisible pool of taxes. With this, it was decided to reduce the Central share of expenditure in certain schemes; the Central share in NHM expenditure for General Category States was reduced from 75 per cent to 60 per cent. However, the ratio of Centre-State spending for the Special Category States continued to be 90:10.
5. Upto 2010, the Central Government used to directly transfer the NHM funds to the implementation agencies. However, in 2010, the High-Level Expert Group to recommend

reforms on the mode of fund transfers suggested that direct releases to implementation agencies by-pass the State budgets completely and hence could create accountability problems. Since April 2014, the Central funds are released to the SHSs through the State treasuries. This has led to addition of an additional layer of administration in the NHM fund transfers mechanism (Choudhary, Mohanty & Garg, 2017).

6. In order to distribute the funds between States, the Ministry of Health and Family Welfare works out “resource envelope” for the State for that year. Resource envelope is the maximum amount of financial resources that can be transferred to the States for that year. Resource envelopes take into consideration the area of the State as well as the population weighted by health lag and socio-economic backwardness in the State. Based on their needs and assessments, the States prepare their own Project Implementation Plans within the overall resource envelope communicated to them. The States receive first tranche of payments once the budget is approved and the second tranche is released once the utilization certificates are issued by the State.

5.3.3 Design Elements within NHM

There are design elements within the NHM that cause differentials in the actual funds transferred to States within the scheme. Some of the design related inadequacies of the NHM are highlighted below.

- The first problem associated with the design of NHM is the multiplicity of objectives and the indicators of the scheme, as have been indicated above. The scheme creates a separate funding head for each of the six financing components (See 5.3.2) under the scheme. For example, the third financing component is Flexible Pool for Communicable Diseases. Now, there are separate budget heads for each different communicable disease covered under the scheme.

A report by Niti Aayog (The Action Agenda Report, 2017) claims that there are as many as 2000 budget heads under NHM under which funds are released after due diligence.

Thus, though States have the freedom to prioritize their expenditures on relevant health problems, the process implies disaggregation of the budget item-by-item. Such micro-management leads to a huge increase in transaction costs on part of State Governments, leading to delays by the States in issuing utilization certificates (Rao, 2015). This in itself

leads to the second tranche of funds not being released by the Centre. Hence, it is often seen under NHM that the amount of funds released by the Centre are lesser as compared to the funds allocated by the Centre towards the scheme.

- The above point creates a similar problem to the one observed under MNREGA: Rather than the State with poor health indicators, it is the State with more capable and paperwork-savvy administrative machinery that gets higher grants under NHM. In 2014-15, Kerala, with the lowest Infant Mortality Rate (IMR) statistics, received the third highest grant allocations as well as actual funds received in per capita terms. In contrast, Uttar Pradesh, the State with the highest IMR statistics received, grants allocated as well as released per capita were much lower than other States with better IMR statistics (Rao, 2015).
- As has been mentioned above, since 2014, the Centre transfers funds into State treasuries from where it is further released to the SHS. This creates an additional layer into an already complex administrative architecture. An NIPFP study states that a file carrying demand for funds from implementation agency moves through as many as 25 desks in Maharashtra to 32 desks in Bihar before the funds are released (Choudhary et.al., 2017). Hence, most of the releases get “lumped” in the last quarter of the financial year. Thus, the additional administrative layer implies delays in the funds moving to the decentralized implementation agencies, delays in issuing utilization certificates and ultimately, reductions in grants transferred from the Centre within the financial year.
- There are also State-specific transfer mechanisms which cause differentials in the release of funds to States. For example, in Bihar, we have already mentioned the large number of desks through which the file carrying demand for funds moves. Apart from this, the State Government has created a Personal Ledger Account into which the funds are moved from the Consolidated Fund before they can be claimed by the implementation agencies (Choudhary et.al., 2017). The Finance Department has also put limits on the maximum funds that the SHS can withdraw from the Personal Ledger Account and additional paperwork that needs to be submitted for withdrawal.
- In Maharashtra, the SHS has to make two separate demands for funds released from the Central Government and for matching grants released by the State Governments (Choudhary et.al., 2017). The SHS makes an initial demand only for the funds released

by the Centre. Once that instalment is released, only then does the SHS claim the corresponding matching grant from the State. This increases the number of times that the file carrying demand for grants moves through the 25 approval authority desks in Maharashtra.

To conclude, positioning State-wise variations in scheme transfers as being dependent only on the political alignment of the State with the Centre is to neglect the entire administrative, social and institutional framework within which the scheme operates. State-wise variations could be manifestations of extremely active or extremely lethargic administration. Variations could be driven by rigidities driven in the way that financial accounts are maintained at the local, State and Central Governments. It might have to do with paucity of manpower to update the MIS. It could be a manifestation of differential capacities of the local bodies, which are often expected to be the planning and/or implementation agencies under many schemes. The examples given above demonstrate that State level variations might be an outcome of design elements of different schemes.

CHAPTER 6

CONCLUSIONS

This thesis studies the nuances of fiscal federalism in India. The federal polity of a country cannot be dissociated from the unique historical and political circumstances that prevailed when the rules of federalism were written for the country. Fiscal federalism is a manifestation of the historically written rules of federalism as well as of the nature of contemporary political relationships between Centre and the State.

The various political forces at play at the time of Independence, the bargains driven between the Centre and the various Princely States, the need to ensure social equality through legal means and the demands for autonomy by regional interest groups were instrumental in shaping the design of the Constitution of India. Holding together a heterogeneous mix of people with different religions, castes, sects, languages and ethnicities was a challenge since every of these variables created a “group identity”. Group identities were especially prominent where there was a concentration of the population belonging to a particular language or ethnicity within an area. Thus, group identities started manifesting themselves as regional identities and with these came the demand for more autonomy or safeguards. The Constitution again re-organized the country on a linguistic basis and in case of North-East India, on the basis of ethnicities. Each of these constituent units now represented a regional grouping, had unique developmental issues and interestingly, hosted political parties that shared regional, caste and ethnic characteristics with the electorate of the State.

At the same time, the economic logic within the Constitution created a set of different issues. The Constitution of India assigns the most productive taxes to the Centre and allocates development expenditures to the States, leading to a vertical imbalance between Centre and States. The Constitution also creates a mechanism to correct for the vertical imbalance, namely the Finance Commission (FC). The FC recommends the percentage of Central taxes to be shared with the States. It also recommends the inter-se distribution of the tax proceeds between the States and thereby corrects the horizontal imbalance between the States too. FC transfers to States are driven by distribution formulae, and hence could not accommodate political demands made by the constituent State units on the Centre.

It is here that another parallel, non-Constitutional body to recommend transfers to States enters the design of fiscal federalism of India. This body was the Planning Commission (PC).

The PC was created in 1950 through a Government Resolution in order to assess the country's resources and to create a Plan that would facilitate development through optimal utilization of the same. However, execution of the Central Plan would require the co-operation of the States. Further, optimization also required integration of State Plan targets with the Central targets. In order to facilitate the process of integrating planned development across Centre and States, the National Development Council (NDC) was set up in 1952.

By its design, the NDC was a federal institution. It was a platform to assess States' resources and to recommend to the Centre the quantum of assistance that each State would require for fulfilment of its Plan targets. The meetings of the NDC used to be presided over by the Prime Minister of India and States would be represented by respective Chief Ministers. The platform soon became one associated with hard economic bargains being driven as a result of political relations.

There have been several instances of States alleging that not enough funds were granted to them for planned objectives or that the NDC was using political criteria to recommend fund disbursement to the States. Having said that, it is important to note that PC transfers too became formulaic over a period of time and were driven by the Gadgil-Mukherjee formula.

Whilst the PC used to recommend fund transfers for assisting the State Plan objectives, fund disbursements for executing the Central Plans were given by Central Ministries through Central Sector and Centrally Sponsored Schemes. The discretionary nature of the Central Ministry transfers, especially when viewed against the backdrop of the formulaic transfers affected by the FC and the increasing voracity of States at the PC, lend themselves to the interpretation that these would be affected by political variables.

The thesis carries out an in-depth analysis of whether discretionary transfers from Centre to States are affected by political variables.

We first review the rationale for this argument. Why would political variables affect economic transfers? The States are important for the Centre because of the powers of legislation that they

carry in the Rajya Sabha. Further, States also function as useful means through which the political party at the Centre can access the remote voter. On the other hand, the Centre controls the funds in a constitutionally tax-centralized federal structure and wields control over the States by controlling the routes through which transfers to States can be affected.

States and the regional parties in power are also important for the Centre particularly if there exists a coalition rule at the Centre, wherein a major National Party forms a coalition with State-level or regional or local parties. In India, the period after 1990 has been particularly associated with coalition politics. Weaker the position (in terms of number of seats held) of the major National Party within a coalition, higher would be the possibility of using discretionary transfers to advance its own power within the coalition.

The presence of possible political bargains could thus drive the possibility of higher transfers to politically relevant States, especially when the transfers are discretionary in nature.

We examined data on transfers done by the Finance Commission, Planning Commission and Central Ministries from 1993-94 to 2013-14 to fourteen large, General Category States.

In order to check whether discretionary transfers are at all impacted by “political alignment” of the State with the Centre, we created “clusters” of politically aligned and non-aligned States for each year within the dataset. We also created clusters of States having high, medium and low transfers under FC, PC and Central Ministries for every year.

We juxtaposed the clusters to find out instances of those States which simultaneously belong to the “high transfers” cluster as well as the “politically aligned” cluster. This exercise was done for FC, PC as well as Central Ministry transfers separately. The results are interesting.

We find that there is no significant simultaneity of being politically aligned as well as being a high transfers State under the FC route. In other words, political alignment does not matter for receiving transfers under the FC route. This was an expected result, given that FC transfers are formulaic.

However, using the same diagnostics for discretionary transfers, we get a very surprising result. We find that political alignment does not matter for receiving transfers under the discretionary

route either! Thus, it is not political alignment that is causing the variation in the fund transfers to States under the Central Sector and Centrally Sponsored Schemes.

If it is not political variables, then what really explains the differential discretionary scheme transfers to States?

We go on to examine three main Centrally Sponsored Schemes in India, namely, Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA), Pradhan Mantri Gram Sadak Yojana (PMGSY) and National Health Mission (NHM) in order to identify why different States receive different levels of transfers under the aegis of these schemes. We find that the explanation to the differential levels of transfers to States lies in the design peculiarities of the schemes!

The Centre, for ease of administering the schemes, normally uses a “one-size-fits-all” approach and creates a common set of rules regarding compliance, financial declarations, sharing of funds between Centre and States, administrative processes and implementation of the program. Given that financial, administrative and implementation capacities are vastly different across States, at least a few of the States could find it cumbersome to fit into the design of the scheme. Some States may not have the fiscal capacity to support the part funding that the scheme demands. Even though a State is politically aligned to the Centre, bureaucratic paperwork entailed by the design of the scheme may stall the movement of funds to such a State. Similarly, inefficiencies of the local Government may create non-utilization of funds, thereby affecting fund transfers in the next time-period. These factors thus lend “rigidities” to scheme transfers, and create situations in which States normally gravitate to what could be called as an “equilibrium” fund-position for that State within a particular scheme.

Consider the case of MNREGA. MNREGA provides a “legal guarantee of at least 100 days of employment on asset creating public works programs every year at minimum wages for at least one able-bodied person in every rural, urban poor and lower middle class household”. In order to introduce transparency and accountability at the level of local governments, electronic Fund Management System (e-FMS) was introduced for financial accountability. How did this impact fund transfers across States?

While introduction of e-FMS led to the intended consequences of reducing the leakage of funds, it also created a huge requirement for training the administrative machinery. Many of the administrative staff for running CSS are contractually hired and did not have the required skill sets to carry out transactions under e-FMS.

Here, it would not be wrong to claim that the Southern States, with higher literacy levels in general and higher exposure to IT management systems in particular could adjust better and more quickly to this “new normal”. This partly helps to explain why the performance of Southern States in terms of fund utilization tends to be stronger than other States for all CSSs in general and MNREGA in particular.

Andhra Pradesh used the e-FMS aggressively. It is seen to be one of the success stories under MNREGA. Interestingly, Andhra Pradesh was politically aligned to the UPA Government from 2005-06 to 2013-14. Statistically, the higher grants received by Andhra Pradesh from the Centre for MNREGA and political alignment would show up as a positive correlation between transfers and political alignment. However, what is perceived to be a politically driven transfer is actually a design issue under MNREGA.

There are many such instances, which actually are design issues, but are perceived as being a part of the political nexus between Centre and States. It is interesting to compare two large States, Uttar Pradesh and Bihar, in this context. Uttar Pradesh was politically aligned to the UPA Government right from the launch of MNREGA in 2005-06 upto 2013-14, whereas Bihar shows non-alignment for the same years. Both States have recorded lacklustre performance in terms of fund utilization under MNREGA. What causes this poor performance?

MNREGA mandates no more than 6 per cent of the total expenditure to be earmarked for the administrative support for the scheme. In States such as UP and Bihar, in which the number of Gram Panchayats is high and in which the geographical area to be physically covered by works proposed under the scheme is huge, the administrative expenses are high. State Governments are curtailed by the 6 per cent administration expense norms. Shortage of staff leads to planning issues and under-utilization of funds. Further, the scheme mandates that 33 per cent of the works be reserved for women workers. However, women culturally have been unwilling to apply for jobs under MNREGA in UP as well as Bihar and hence there are delays in commencing the

works. These are again design issues. The one-size-fits-all approach of the scheme is a design problem that cannot adjust for size of the administrative staff or cultural issues. This design problem then manifests itself in terms of differences in State performances under MNREGA.

The Pradhan Mantri Gram Sadak Yojana (PMGSY) shows better design elements as compared to MNREGA. Unlike MNREGA which is demand driven, PMGSY funds are allocated on basis of the identified gaps in rural infrastructure within a State. If a particular State has a high number of villages, and further if such villages are unconnected by roads, then the PMGSY formula automatically provides for higher transfers to such States. Thus, States with poorer rural infrastructure get higher transfers under the scheme.

It is interesting to compare scheme transfers to Bihar and Tamil Nadu under MNREGA and PMGSY from 2012-13 to 2014-15. Bihar has six times as many rural poor as Tamil Nadu, but yet it is Tamil Nadu which receives higher funds under MNREGA. But since the PMGSY design of transfers accounts for the inherent variability in the availability of rural infrastructure within States, higher PMGSY transfers go to Bihar.

Under NHM, transfers are given to State for expanding health cover to the rural and urban poor within the State. Now, the definition of “health” is governed by multiple indicators and the coverage of the scheme extends to several communicable diseases. There are 2000 separate budget heads for each of the indicators and diseases under which funds are transferred, leading to administrative delays. Rather than States with poor health status, states with paperwork-savvy administrative capacities emerge as winners in this story.

Thus, the explanation to the differentials in discretionary transfers to State does not lie so much in political alignments as it lies in the design of the transfers. This does not mean that political bargains and negotiations do not play a role in influencing transfers. They do, but the role of such bargains might manifest itself more in terms of implicit transfers rather than explicit ones. Implicit transfers could be in the nature of the Centre giving loans to States at lower interest rates, changing compliances for certain schemes at the behest of States or declaring certain development objectives perceived important by States as immediate priorities.

There is a limited role that political influences can play in explicit scheme transfers. It is true that transfers given by the Central Ministries are discretionary, but that discretion is also subject to various administrative, financial, manpower, and design conditions.

Thus, differentials in fiscal transfers from Centre to States need not only be the result of political nexus between them. More often than not, the differentials are driven by flawed and rigid designs of the Centrally Sponsored Schemes, rather than by political factors.

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Appendix A

Table A.1: Devolution and Transfer of Resources from Centre to States (Rs. crores) from 1991-92 to 2013-14: Actuals

S. No.	Transfer Heads (Rs. Crores)	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00
I	State's share in Central Taxes and Duties	16848	20580	22395	24885	29048	35038	40411	39421	44121
II	Grants from Centre (1+2+3+4+5)	15226	17759	21176	20004	20996	23154	24223	23863	30623
1	State Plan Schemes	6574	7843	10770	10845	8134	11693	12008	13267	16316
2	Central Plan Schemes	750	1035	1066	1079	1586	857	1141	1081	1078
3	CSS	4624	5486	6272	4541	4867	5235	5495	5929	7017
4	Special Plan Schemes	0	32	70	965	432	111	120	110	110
5	Non-Plan Grants (a to c)	3278	3363	2998	2574	5977	5258	5458	3477	6102
a	Statutory Grants	2120	2117	1762	1840	3972	3604	1683	1420	1988
b	Grants for Natural Calamities	348	522	307	182	284	525	476	608	409
c	Non-Plan Non-Statutory Grants	810	724	929	553	1722	1129	3299	1449	3705
III	Gross Loans from Centre (1+2+3)	13069	13099	14410	19253	19600	23782	30771	40342	48005
1	Plan Loans	6464	7506	8675	11571	8802	13657	15088	15569	19060
2	Non-Plan Loans	6605	5593	5735	7681	10797	10125	15684	24773	2529
IV	Gross Transfers	45143	51438	57981	64142	69643	81974	95405	103626	122749
V	Net Transfer of Resources from Centre	34925	39430	43590	50094	51808	60585	70796	73449	88130

Table A.1 (contd.): Devolution and Transfer of Resources from Centre to States (Rs. crores) from 1991-92 to 2013-14: Actuals

S. No.	Transfer Heads (Rs. Crores)	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
I	State's share in Central Taxes and Duties	50734	52220	56660	67080	78550	94020	120290	151400	161050	165010	219490	255590	291530	318270
II	Grants from Centre (1+2+3+4+5)	37784	42600	45170	50830	56320	76750	94450	108620	129920	150970	163500	186420	188680	205950
1	State Plan Schemes	16200	19320	19670	25450	29760	28750	40210	49550	63480	70850	77640	87670	91620	89970
2	Central Plan Schemes	1133	1270	1720	1350	1320	2220	2100	2270	2660	6450	3590	2740	2670	3430
3	CSS	7182	8340	8650	9840	10390	13310	17430	21870	25890	25880	32830	43120	45480	45000
4	Special Plan Schemes	127	210	220	290	290	340	310	620	520	700	540	680	520	420
5	Non-Plan Grants (a to c)	13141	13460	14920	13900	14570	32130	34410	34310	37380	47090	48910	52200	48400	67130
a	Statutory Grants	8372	9260	8200	7550	7640	18050	17720	19790	20480	24990	27660	33480	31310	44190
b	Grants for Natural Calamities	500	590	3230	1770	2170	3270	3600	2640	2910	3500	5220	3210	5560	6160
c	Non-Plan Non-Statutory Grants	4269	3610	3480	4580	4770	10810	13080	11880	13990	18600	16030	15500	11530	16790
III	Gross Loans from Centre (1+2+3)	51572	24400	26830	25870	25880	8100	5720	7250	7000	8110	9480	9900	11200	10870
1	Plan Loans	16752	20950	20360	24160	23470	8060	6160	7230	6990	8210	10500	9820	11100	10840
2	Non-Plan Loans	2214	3440	6470	1720	2410	30	-440	20	100	-100	-1020	80	100	30
IV	Gross Transfers	140090	119210	128660	143780	160750	178870	220460	267280	297980	324090	392460	451910	491420	535100
V	Net Transfer of Resources from Centre	102120	77180	71710	102980	101030	57580	192680	247300	279120	303010	373810	432540	472180	515970

The data given above has been aggregated in the following manner to derive the transfers made by Finance Commission, Planning Commission and Central Ministries.

1. Transfers by Finance Commission = States' Share in Central Taxes and Duties (I) + Statutory Grants given under Non-Plan Grants (II.5.a)
2. Transfers by Planning Commission = Grants given under State Plan Schemes (II.1) + Grants given under Special Plan Schemes (II.4) + Plan Loans (III.1)
3. Transfers by Central Ministries = Grants given under Central Plan Schemes (II.2) + Grants given under Centrally Sponsored Schemes (II.3)

APPENDIX B

POLITICAL PARTIES IN POWER AND POLITICAL ALIGNMENT DUMMIES IN FOURTEEN MAJOR STATES IN INDIA

Table B.1A: Political parties in power in fourteen major States in India from 1993-94 to 2003-04

Which party in power	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Centre	UPA	UPA	UPA	UPA	UPA	UPA	NDA	NDA	NDA	NDA	NDA
ANDHRA PRADESH	TDP	TDP	TDP	TDP	TDP	TDP	TDP	TDP	TDP	TDP	TDP
BIHAR	JD	JD	JD, RJD	JD, RJD	RJD	RJD	RJD, JD(U)	RJD	RJD	RJD	RJD
GUJARAT	JD	INC	BJP	RJP	RJP	BJP	BJP	BJP	BJP	BJP	BJP
HARYANA	INC	INC	INC	HVP+ BJP- Haryana Vikas Party	HVP	HVP	INLD	INLD	INLD	INLD	INLD
KARNATAKA	INC	JD	JD	JD	JD	JD	INC	INC	INC	INC	INC
KERALA	INC	INC	INC	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)	INC	INC	INC
MADHYA PRADESH	INC	INC	INC	INC	INC	INC	INC	INC	INC	INC	BJP
MAHARASHTRA	INC	INC	SHS	SHS	SHS	SHS	INC	INC	INC	INC	INC
ODISHA	JD	JD	INC	INC	INC	INC	INC	BJD	BJD	BJD	BJD
PUNJAB	INC	INC	INC	INC	SAD	SAD	SAD	SAD	SAD	INC	INC
RAJASTHAN	BJP	BJP	BJP	BJP	BJP	INC	INC	INC	INC	INC	BJP
TAMIL NADU	AIADMK	AIADMK	AIADMK	DMK	DMK	DMK	DMK	DMK	AIADMK	AIADMK	AIADMK
UTTAR PRADESH	SP	SP, BSP	President's Rule	President's Rule	BSP, BJP	BJP	BJP	BJP	BJP	BSP	SP
WEST BENGAL	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)

Table B.1B: Political parties in power in fourteen major States in India from 2004-05 to 2013-14

Which party in power	2004-2005	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Centre	UPA	UPA	UPA	UPA	UPA	UPA	UPA	UPA	UPA	UPA
ANDHRA PRADESH	INC	INC	INC	INC	INC	INC	INC	INC	INC	INC, TDP
BIHAR	RJD	JD(U)	JD(U)	JD(U)	JD(U)	JD(U)	JD(U)	JD(U)	JD(U)	JD(U)
GUJARAT	BJP	BJP	BJP	BJP	BJP	BJP	BJP	BJP	BJP	BJP
HARYANA	INLD	INC	INC	INC	INC	INC	INC	INC	INC	INC
KARNATAKA	INC	INC	JD(S)	President's Rule	BJP	BJP	BJP	BJP	BJP	INC
KERALA	INC	INC	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)	INC	INC	INC
MADHYA PRADESH	BJP	BJP	BJP	BJP	BJP	BJP	BJP	BJP	BJP	BJP
MAHARASHTRA	INC	INC	INC	INC	INC	INC	INC	INC	INC	INC
ODISHA	BJD	BJD	BJD	BJD	BJD	BJD	BJD	BJD	BJD	BJD
PUNJAB	INC	INC	INC	SAD	SAD	SAD	SAD	SAD	SAD	SAD
RAJASTHAN	BJP	BJP	BJP	BJP	INC	INC	INC	INC	INC	BJP
TAMIL NADU	AIADMK	AIADMK	DMK	DMK	DMK	DMK	DMK	AIDMK	AIDMK	AIDMK
UTTAR PRADESH	SP	SP	SP	BSP	BSP	BSP	BSP	BSP	SP	SP
WEST BENGAL	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)	CPI(M)	AITC	AITC	AITC

Table B.2A: Constructed dummy variable values to indicate Political Alignment (POL) in fourteen major States in India from 1993-94 to 2003-04

Is it politically aligned to the Centre?	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
ANDHRA PRADESH	0	0	0	1	1	1	1	1	1	1	1
BIHAR	0	0	0	1	1	1	0	0	0	0	0
GUJARAT	1	1	0	1	1	0	1	1	1	1	1
HARYANA	1	1	1	0	0	0	1	1	1	1	1
KARNATAKA	1	1	1	1	1	1	0	0	0	0	0
KERALA	1	1	1	0	0	0	0	0	0	0	0
MADHYA PRADESH	1	1	1	1	1	1	0	0	0	0	1
MAHARASHTRA	1	1	0	0	0	0	0	0	0	0	0
ODISHA	1	1	1	1	1	1	0	1	1	1	1
PUNJAB	1	1	1	1	0	0	1	1	1	0	0
RAJASTHAN	0	0	0	0	0	1	0	0	0	0	1
TAMIL NADU	1	1	1	0	0	0	1	1	0	0	0
UTTAR PRADESH	1	1	1	1	1	0	1	1	1	0	0
WEST BENGAL	0	0	0	0	0	0	0	0	0	0	0

Table B.2B: Constructed dummy variable values to indicate Political Alignment (POL) in fourteen major States in India from 2004-05 to 2013-14

Is it politically aligned to the Centre?	2004-2005	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
ANDHRA PRADESH	1	1	1	1	1	1	1	1	1	1
BIHAR	0	0	0	0	0	0	0	0	0	0
GUJARAT	0	0	0	0	0	0	0	0	0	0
HARYANA	0	1	1	1	1	1	1	1	1	1
KARNATAKA	1	1	0	1	0	0	0	0	0	1
KERALA	1	1	0	0	0	0	0	1	1	1
MADHYA PRADESH	0	0	0	0	0	0	0	0	0	0
MAHARASHTRA	1	1	1	1	1	1	1	1	1	1
ODISHA	0	0	0	0	0	0	0	0	0	0
PUNJAB	1	1	1	0	0	0	0	0	0	0
RAJASTHAN	0	0	0	0	1	1	1	1	1	0
TAMIL NADU	0	0	1	1	1	1	1	0	0	0
UTTAR PRADESH	1	1	1	1	1	1	1	1	1	1
WEST BENGAL	1	1	0	0	0	0	0	0	0	0