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Indian fiscal federalism at cross roads: A review of the literature

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Abstract
In India, the contortions inherent in the constitutional arrangements for sharing fiscal powers between the Centre and the States necessitate inter-governmental transfers. Such transfers have always attracted in-depth debates amongst the policy makers, practitioners and researchers in the country. The paper intends to review and synthesise the research knowledge on the system of fiscal federalism India and impact of intergovernmental transfers from the centre on the state government. As an aftermath, the study reviews and examines various research articles published between 2000 and 2019. The study also presents a comprehensive literature review specifically in Indian context. The assessment of these studies reveal that there is wide economic disparity between various states and intergovernmental transfers have not been able to successfully reduce this gap. This paper may be expedient source of information to the researchers and managers who are willing to explore the concept of fiscal federalism and its various aspects in India.

Keywords: government, federalism, economic, paper

1. Introduction

India has a system of government that is "foundationally federal, but with striking unitary features" (Vithal and Sastry 2001, p. 14) [15]. India is a remarkable democracy and has a federal form of government since independence in the year 1947. An important part of its subject matter is the system of transfer payments or grants by which a central government shares its revenues with lower levels of government.

These transfers play a critical role in reducing income disparities and help in fostering the economic growth of the country. Intergovernmental transfers are the most important source of revenues of local governments in developing countries like India and China. Boadway and Shah (Boadway and Shah, 2007) [2] observed that intergovernmental fiscal transfers typically serve multiple objectives, ranging from dealing with corrections in vertical and horizontal fiscal imbalances to influencing regional and local economic stabilization. It may be noted here that the role of fiscal transfers is even more apposite in the cases of large economies characterised with varying degrees of regional outputs and inequalities besides significant divergences in their respective economic performances. This is typically so in the case of India. The prime policy hurdle for the federal transfer system in India concentrates around concurrent evaluation of economic conditions across regions and formulation of suitable mechanisms and criteria for alleviation of regional disparities.

Subsequent sections of this study discuss in detail about the prevailing debates over the issue of intergovernmental transfers and its effect on the fiscal perform ace of the states in India.

2. Existing Studies in Indian Context

Rao (2002) [10] explained the trends in finances and sources of fiscal imbalances in various states of India. According to him, the Finance Commission reforms should focus on and improving the revenue productivity of states and compressing the unproductive expenditure. He concludes that the design of the tax devolution system has been unsuccessful in improving resource base of the states. It appears quite derisive that majority of the low-income states have good bounty of natural resources but this reflects on the fact that over decades it is both physical & social infrastructure, which has proven to be a binding constraint in the requisite development of such states (Rao and Mandal, 2009) [11]. Rao (2003) [12] analysed the transfers from the Finance Commission and found out that incentive linked transfers are too less to make any significant difference in fiscal performance. Chakraborty (2003) [4] in his study concluded that the fiscal transfers by various Finance Commissions are regressive in nature, as there is a positive relationship between aggregate tax transfers per capita and the per capita income of the states. He also highlighted that while fiscal autonomy was found to be negatively related to grant transfers (implying progression in the transfer of grants), it was not successful in eliminating horizontal inequality, as the relative share of grants is much less than the tax transfers.

Nirvakar and Vashisht (2004) used panel data to examine the effect of economic and political situation of the states on the extent of fiscal transfers to the states. They concluded that states with greater bargaining power received more transfers from centre and there was a greater temporal variation in the transfers made by the erstwhile planning commission to the various states. The population or the demographic size of the state was the major variable used to determine the political weight of the state. Moreover, other explicit measures like degree of representation in the ruling party or coalition; alignment between the ruling party at the

centre and a state, and representation of different states in the cabinet were also used to measure the degree of political influence.
Singh & Vashishta (2004) performed an empirical study and found evidence that states with indications of greater bargaining power seem to receive larger per capita transfers, and that there is greater temporal variation in Planning Commission. According to them, this could be because of the fact that states with more population have greater bargaining power because they have a larger voter bank.
Singh and Srinivasan (2006) [14] have analyzed various economic and political reasons why the primary sector, by and large, is exempted from being taxed. At the aggregate level, total tax collection is found to be inversely related to total and unconditional transfers irrespective of whether they are increasing or decreasing. Imposing conditions on transfers do not seem to have any impact on total tax collection of the Indian states and the results for total transfers appear to be influenced primarily by unconditional transfer.
Bhusana & Angara (2013) [6] in their paper analysed that Indian states are reluctant to collect taxes from direct sources and they are unwilling to increase direct tax collection to replace reduced transfers. One possible reason for this behaviour could be that the direct tax policies are easier to observe and more monitored by the voters and any unpopular change in such policies might cost the governments by losing their voters. They conclude that the imposition of conditions on transfers is not associated with an increase in indirect tax revenue; whereas increasing total and unconditional transfers appear to be substituted for indirect tax collection.
Debnath, Roy., & Bhattacharjee (2013) [7] investigated the impact of central grants on the regional growth of NE states. Their analysis shows that the grants have a positive effect on growth, however the growth rate is not uniform across all states. The authors concluded that the government still needs to rely on special assistance programmes for the rapid economic development of the region rather than completely surrounding on market forces.
Rao, C. Bhujanga & Srivastava (2014) observed that the extent of dependence of states on the centre was lowest during the period covered under the Tenth Finance Commission period. It has since increased, for all states considered together, by about 3.5 percentage points, from 37.4 percent to 40.9 percent of states' revenue receipts. This increase comes both from entitlement transfers and discretionary transfers to the extent of 2.1 and 1.3 percentage points, respectively
Authors studies the different modes of IG transfers for health in order to analyse the effectiveness of these transfers in ensuring equity in various states. We need to restructure our health reforms in order to get par with other countries. States ought to take some significant reforms in order to improve health care financing and delivery. (Fan et. Al, 2018)
Chakraborty and Chakraborty, (2018) [5] in their study, empirically proved that there has been social convergence in social sector but there is still a long way to go for economic convergence of the states in our country. They used the GMM estimations to measure the impact of public spending and concluded that the capital spending has positive and significant relationship with economic growth. The authors also highlighted also observed that the quality of human capital formation is very important for economic growth, both for club and conditional convergence.
In another study by NIPFP, Chakraborty (2019) [6] concluded that the union government's revenue expenditure on state subjects has increased from 13.4 percent in 2002-03 to 16.2 percent in 2015-16. In 2008-09, union government spent 23.1 percent of revenue expenditure on State List subjects. Similarly, union government's revenue expenditure on Concurrent List subjects increased from 11.8 percent in 2002-03 to 16.4 percent in 2015-16. With rising shares of union government's revenue expenditure on State and Concurrent List, the share of expenditure on Union List subjects is falling.
Amaranth and Singh (2019) investigated the impact of higher devolution by the fourteenth finance commission, restructuring the cost sharing patterns of the Centrally Sponsored Schemes (CSS) and withdrawal of central assistance to the state plan schemes. The authors observed that the gain from increasing tax devolution was 0.71 percent of GSDP for general category states in 2015-16 although additional burden in terms of additional share in CSS and withdrawal of few CSS was 0.69 percent of GSDP. However, the difference between the gain and additional burden further declined in 2015-17. They concluded that "Higher transfers through devolution and more autonomy to States is an illusion and is offset by the fact that States contribution towards CSS expenditures increased from 25% to 40% and States had to continue committed expenditures under CSS which have been withdrawn."

3. Research Gap
Review of literature suggests that a number of studies have been carried out to study the effect of intergovernmental transfers on the development of the states. However, no such study has been carried out to study the effects of these transfers on the development of the social sector in the North Eastern States of India. This is the first comprehensive analysis of intergovernmental fiscal transfers to SCSs in India that will assist decision makers to evaluate past strategy of intergovernmental transfers in the light of fiscal and expenditure response of these states.

4. Conclusion and the way forward
The present study also gives the scope for further research in the area of fiscal federalism. The content analysis can be performed taking the literature of last two decades.
Moreover, by examining expenditure and taxation behaviour of the states in response to federal transfers will help in determining the appropriate future award strategy that ensure restraint in expenditures and increase fiscal efforts.
Thus, the analysis will bridge the gap as none of the previous study has empirically measured the individual response of these states to conditional and unconditional transfers in the Indian Context. Earlier studies scrutinized the aggregate (all federating units combined) fiscal response of federal transfers. Nonetheless, the responses of Individual states to the federal transfers are important to design effective mechanism in the context of diverse economic and other characteristics of federating units. The study also investigates the impact of conditional and unconditional grants on the health care facilities and education level in the special category States. Thus, the empirics of this study will assist in developing a new strategy by considering the nature and extent of conditional transfers to ensure certain

minimum standard of health and education across all states. In a nutshell, the study will facilitate policy makers and stakeholders in designing suitable strategies (conditional, unconditional, mixture of the two) which are acceptable to all federating units for future fiscal transfer framework of the federal government. The task is very significant in the context of SCSs given the sensitivities and discomfort attached to the determination and allocation of national fiscal awards.

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