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Horizontal Equity and the Thirteenth Finance Commission: Issues and Ponderables

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Abstract

Given the importance of statutory transfers through the Finance Commission awards in India, especially for the lagging states, approaches to ensure horizontal equity call for deeper examination. An attempt has been made in this paper to critically analyse the parameters/ criteria on which basis awards are finalized. With special reference to poorer states, the following aspects have been discussed: i) Basic parameters of the 13th FC; ii) Distribution neutral factors; iii) Redistributive factors; iv) Fiscal incentive factors; and v) Grants-in-aid. Scope for possible improvement in the working of fiscal federalism and policy implications thence have also been deliberated upon.

Keywords : 13th Finance Commission, Horizontal equity, Fiscal federalism

JEL Classification : H71, H73, H77 and R58

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Horizontal Equity and the Thirteenth Finance Commission:
Issues and Ponderables

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1. Introduction

As is well known, the theory of fiscal federalism owes its genesis and fascinating treatment to the writings of Musgrave (1959) and Oates (1972). It, essentially, deals with the division of public sector functions and finances in a rational manner among multiple layers of government. An important element in fiscal federalism is that "Local governments almost invariably depend in part, and sometimes very heavily, upon transfers from upper level governments to finance the services for which they are responsible. The appropriate level and design of such transfers has been an important concern in the fiscal federalism literature" (Bird, n.d.: 152).

In the Indian context, the Finance Commission (FC), as a statutory body under Article 280 of the Constitution, is constituted quinquennially to look into the issues of fiscal federalism at the policy level. It has a clear emphasis upon evaluating and correcting both the vertical and horizontal imbalances at the levels of the Centre as well as the federating units, i.e., the states. By its very nature, the actual grant-making of FC awards wade through a complex process of assessing the capacities and limitations of both the centre and the states in terms of, mainly, raising resources, making productive investments, maintaining a favourable tax-GDP and debt-GDP ratios and being susceptible to various natural and human-made calamities. Despite good intentions and detailed analyses of fiscal scenarios, often the relatively weaker states find themselves discriminated against as compared to their better-off counterparts.

So far as vertical imbalances are concerned, there exists a plethora of studies and discussions across FCs. However, the same is not the case with horizontal imbalances, which have received inadequate (in terms of their ramifications) attention from scholars as also policy makers. The tenability of such an observation may find base in the fact that there has been a general complacency regarding the universal applicability of the criteria originally suggested

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by the initial FCs; that undermines the deeply calibrated or segregated character of most of the select variables. For instance, the inherent limitations of 'population' as an important criterion, has persuaded the FCs to stick to the 1971 Census figures as the base population data instead of the subsequent Census figures as would have been appropriate for the post-1981 FCs.

This paper is an attempt to address some important issues in statutory transfers aimed at achieving horizontal equity by Indian states. While the discussions relate to the challenges expected to be faced by the 13th FC, emphasis has been placed on the implications for the income poorer states. The subsequent sections deal with the following aspects: i) Basic parameters of the 13th FC; ii) Distribution neutral factors; iii). Redistributive factors; iv) Fiscal incentive factors; and v) Grants-in-aid. The concluding remarks briefly summarise the main points made.

2. The 13th Finance Commission: Basic Parameters

In an important clarification concerning the Terms of Reference (ToR) of the 13th Finance Commission, it has been pointed out that "More importantly, the Commission is an independent constitutional authority vested with the task of dividing the fiscal resources as an important arbiter and therefore, has to take into consideration the revenue potential of the centre and the states on the one hand and genuine expenditure needs of the centre and the states on the other, *irrespective of the wording* of the ToR" (Rao *et al.*, 2008: 53, emphasis ours). Even as the FC devolutions are not the only or even the most important means to address the palpably tender issues of ensuring equity and minimizing regional disparity during the times of economic reforms, it continues to be of much relevance especially to those states lagging behind, in spite of the Central Plans, twelve FCs and numerous other statal interventions. That is reason enough to reconsider the nature and adequacy of the existing criteria/parameters at least as far as the redistributive factors are concerned.

As a prelude to the following issue-based discussion, it may be useful to have an idea about the criteria chosen by the two most recent FCs, the 11th and the 12th (Table 1).

Table 1: Formula for Allocation of Shared Taxes

Factors	Relative Weightage (percentages)	
	11th Finance Commission	12th Finance Commission
Distribution neutral:	***17.5***	***35.0***
Population	10.0	25.0
Area	7.5	10.0
Redistributive:	***70.0***	***50.0***
Income distance	62.5	50.0
Infrastructure (inverse)	7.5	0.0
Fiscal incentives:	***12.5***	***15.0***
Tax effort	5.0	7.5
Fiscal discipline	7.5	7.5
Total	***100.0***	***100.0***

Source: Twelfth Finance Commission Report, Table 7.2 and Annexure 7.4.

It has been pointed out that the 12th FC has already "reversed" the trend of assigning greater weightage to redistributive factors and reduced weightage for income-neutral factors like population and area (Rajaraman and Majumdar, 2005: 3418). Between the 11th FC and 12th FC, whereas the weightage for redistributive factors declined from 70 per cent to 50 per cent, the same for population and area had doubled to 35 per cent.

Table 2: Gain/Loss in States' Shares due to Change in Formula between 11th and 12th FCs

State	11th FC Share	12th FC Share	11th FC in 12th FC*	Gain /Loss
High Income States	***9.54***	***10.95***	***8.12***	***2.83***
Maharashtra	4.63	5.00	3.45	1.55
Gujarat	2.82	3.57	3.02	0.55
Punjab	1.15	1.30	0.89	0.41
Haryana	0.94	1.08	0.76	0.32
Middle Income States	***29.19***	***26.86***	***24.99***	***1.87***
Tamil Nadu	5.83	5.31	4.54	0.77
Karnataka	4.93	4.46	4.04	0.42
Kerala	3.06	2.67	2.26	0.41
Andhra Pradesh	7.70	7.36	7.04	0.32
West Bengal	8.12	7.06	7.11	-0.05
Low Income States	***53.77***	***54.73***	***59.41***	***-4.68***
Rajasthan	5.47	5.61	5.67	-0.06
Madhya Pradesh	8.84	9.37	9.79	-0.39
Orissa	5.06	5.16	5.57	-0.41
Uttar Pradesh	19.80	20.20	22.09	-1.89
Bihar	14.60	14.39	16.32	-1.93

Notes: Undivided MP, UP and Bihar have been taken for analysis.
* Applying 11th FC criteria for the 12th FC.

Source: Lenka and Mallick (2008: 78).

Such blatant downgrading of redistributive factors shall adversely affect the interests of poorer states and could undermine the relevance and contribution of FC awards. Similarly, consequent upon the change in formula between awards of the aforesaid FCs, the relatively richer states have managed to gain, whereas their poorer counterparts have lost in the diversion of shares from the low income states to middle and high income states" (Lenka and Mallick, 2008: 77-78). Table 2 highlights the loss of low income states including Bihar, Orissa and Madhya Pradesh.

With this brief background, in the following, three major issues, namely, distribution neutral factors, redistributive factors and fiscal incentive factors, concerning horizontal (i.e., states *inter se*) equity and fiscal performance have been discussed, with brief references to some of India's poorest states.

3. Distribution Neutral Factors

3.1. Population and Area

These apparently homogenizing criteria of population and area blur a realistic picture of the deprivation of various basic amenities and infrastructure essential for a decent living for a significant number of marginalized groups/communities in highly disadvantaged topography and agro-climatic zones. An idea regarding the intensity of poverty in states dominated by Scheduled Tribe (ST) and Scheduled Caste (SC) population can be had from Table 3. It is obvious that states with higher share of ST-SC population also have a large proportion of them in poverty, which also contributes to higher levels of poverty incidence at the state level as well. For instance, that about two-fifths (38.6 per cent) of Orissa's population include STs and SCs, mostly located in remote or poorly-endowed regions of the state makes a strong case for revision of the population criterion, in a substantive sense. The basic idea is that a simple statistic on the *density* of population is not merely inadequate, but effectively camouflages the deep schisms in the population profile of a state. Analyses have brought out that STs have been the most marginalized group amongst the total population and greater the concentration of ST population, higher is the likelihood of incidence of poverty (Shah *et al*., 2006). Further, irrespective of the 'tribal' identity *per se* of the given section of the population, spatial endowments/attributes strongly impact the poverty status of STs, even across locations within a state.

Table 3: Poverty and ST-SC Population in Select States

State	Share of ST-SC Population in Total (%)	Share of ST-SC (Households) in Total Poverty, 2004-05 (%)	Poverty Incidence in the State, 2004-05 (%)
Orissa	38.6	62.8	46.4
Madhya Pradesh	35.5	65.4	38.3
Rajasthan	29.8	67.2	22.1
West Bengal	28.5	40.6	24.7

Note: States with higher than 25 per cent ST-SC population have been considered.

Sources: Census of India 2001; *Rural Development Statistics 2007-08*, NIRD, Hyderabad; and *Poverty Estimates for 2004-05*, Press Information Bureau, Government of India, Planning Commission, New Delhi, March 2007.

It is useful to appreciate that typically tribal regions are sparsely populated. Hence, taking density of population *in general* as a criterion acts against the objective of ensuring equality, as it fails to respond to the infirmities of the spatiality. Going by both its preponderance (in terms of population size) and persisting social disadvantages, the 13th FC be requested to devise a weighted index of population, that takes into account the relative shares of at least the 'general', SCs and STs. Similarly, as far as the 'area' criterion is concerned, previous FCs have systematically overlooked the special constraints facing the *Scheduled* areas. That would lead one to suggest that the *Scheduled* areas be assigned different weightage; it would go, particularly, in the interest of relatively more backward regions within the states.

An important aspect in population profile which has received practically no attention in the discussions on horizontal equity concern what may constitute the vulnerable unemployables, who would include the old, the handicapped, widows and orphans without a support base, or whom we may categorise as the 'nonworking poor'. This section of the population suffers from multiple disadvantages including being trapped in perennial poverty and remaining socially stigmatized. Their deprivation stems from their severely restricted access to and control over economic resources and inability (physical or mental) to work. As shown in Mishra (2007: 75), the correspondence or concordance between specified dimensions of core vulnerable groups—usually non-working poor—with the incidence of extremely poor is higher than that with the HCR across the major states in India (Table 4). Most states (excepting a few like Kerala and Tamil Nadu which have comprehensive social security measures) are not only providing paltry amount of social pensions and other limited social security and welfare measures to these destitutes but also the coverage is quite limited.

Since the public spending for these measures are non-plan and committed in nature, the 13th FC should look into this demographic composition of population.

Table 4: Vulnerable Population and Poverty Indicators in Rural India, by Major States

States	Proportion of SC and ST to Total Population	Incidence of Widowhood	Proportion of Disabled to total Population	Proportion of Elderly to total Population	Proportion of Poor (2004-05) (HCR)	Proportion of Extremely Poor (2004-05)
Andhra Pradesh	26.83	9.15	1.90	8.13	10.85	2.8
Assam	20.28	6.71	2.02	5.86	23.05	4.96
Bihar*	23.08	4.12	2.14	6.55	43.06	14.65
Gujarat	28.50	6.83	2.27	7.31	19.76	5.04
Haryana	21.36	5.47	2.26	7.93	13.41	2.91
Himachal Pradesh	29.92	7.85	2.64	9.31	12.5	1.95
Jammu & Kashmir	22.16	4.07	3.01	6.76	4.81	0.64
Karnataka	26.80	9.41	1.89	8.28	23.73	3.83
Kerala	12.32	10.15	2.75	10.52	12.27	3.91
Madhya Pradesh*	43.46	6.49	2.30	7.43	38.17	14.72
Maharashtra	24.35	8.48	1.83	10.24	30.36	11.25
Orissa	41.80	7.72	2.81	8.58	47.76	25.16
Punjab	33.04	5.93	1.85	9.82	9.55	1.04
Rajasthan	33.40	5.96	2.56	6.99	18.91	3.39
Tamil Nadu	25.37	10.05	2.71	9.23	22.96	5.04
Uttar Pradesh*	23.49	4.88	2.07	6.59	34.06	11.14
West Bengal	34.05	7.98	2.35	7.35	28.49	7.41
All India	28.33	6.91	2.21	7.74	29.18	9.64
Coeff. of Var.	28.20	27.18	16.11	17.20	53.50	91.35

Notes: Extremely poor are those persons whose per capita consumption is less than 75 per cent of state-specific poverty line.
* Undivided MP, UP and Bihar are taken for analysis.

Sources: Cols. 2-5, *Census of India, 2001*; Cols. 6-7 Dev and Ravi (2007). Cited in Mishra (2007: 76).

4. Redistributive Factors

4.1. Income Distance

Being the single most dominant criterion (attributed a high of 50 per cent weightage), the income distance (from higher per capita income) overwhelmingly affects the devolution outcomes. With the inherent limitations of this potent criterion, some of the poorer states,

instead of benefiting from the processes of distribution of the divisible pool, have been and shall be worse off compared to most other states. As an illustration, in Table 5 a comparison has been attempted between the gaps in per capita income and head count ratio (HCR) for two time points, 1993-94 and 2004-05 (for which relevant and usable data are available for both the variables), taking Orissa as a case. What is striking that whereas by taking the per capita income the proportion of gap between India (national average) and Orissa has *declined* by close to 10 per cent, the poverty gap has *risen* sharply by almost 15 per cent, between the aforesaid pair of time points. It appears that the per capita income criterion can decisively reverse the possibilities for receiving the due by the poorest states.

Table 5: Gaps in Per Capita Income and HCR between All India and Orissa, 1993-2005

Year	PCNNP (India) (Rs.)	PCNSDP (Orissa) (Rs.)	Gap (Value)	Gap (%)
1993-94	7731	4875	2856	58.58
2004-05	19500	13082	6418	49.06
	HCR (All India) (%)	HCR (Orissa) (%)	Gap (Value)	Gap (%)
1993-94	35.97	48.56	12.59	25.93
2004-05	27.5	46.4	18.90	40.73

Notes: PCNNP : Per capita net national product
PCNSDP : Per capita net state domestic product
HCR : Head Count Ratio
PCNNP and PCNSDP have been estimated on a 3-year moving average basis at 1993-94 prices.

Sources: For PCNNP and PCNSDP, Central Statistical Organisation and for HCRs, Planning Commission.

Hence, the substantive issue of concern is that of using per capita *income* as the key variable in deciding devolution by the FC. It is well known that income generation is subject to wide fluctuations/volatility due often to natural causes, as is common in states where majority of the population is heavily dependent upon agriculture and allied activities. From this point of view, unlike the income figures which have the undesirable characteristic of income smoothening, the per capita consumption expenditure shall be a more realistic and relevant indicator of both the standard of living and inequality.

Apart from the well known limitations of per capita income as the criterion, a close look at Table 6 would be useful. In here, states/UTs have been ranked by two alternative criteria, namely, poverty incidence and per capita income, taking Orissa as the numeraire *vis-à-vis* other states. That the rankings vary significantly between criteria is obvious. For example, by applying per capita income instead of poverty incidence, the losers include relatively poorer states as Chhattisgarh, Jharkhand and Orissa and even advanced states like Maharashtra, Karnataka, Delhi and Tamil Nadu. The rankings would have been the reverse had poverty incidence being chosen the criterion. This indicates that the relative merits of both the criteria calls for scrutiny.

Table 6: Gainers/Losers in Transfers by Alternative Criterion, States/UTs *vis-à-vis* Orissa

State / Union Territory	Poverty Incidence (POV) 2004-05	Per capita income (PCY) (average of 2002-05)		Rank		Rank Difference
	Combined	Combined	Inv. PCY	POV	PCY	
Andhra Pradesh	34.05	177.69	56.28	16	13	3
Assam	42.46	129.01	77.52	13	7	6
Bihar	89.22	61.71	162.05	2	1	1
Chhattisgarh	88.15	127.31	78.55	3	6	-3
Delhi	31.68	411.71	24.29	18	23	-5
Goa	29.74	404.41	24.73	20	22	-2
Gujarat	36.21	207.11	48.28	15	16	-1
Haryana	30.17	270.05	37.03	19	21	-2
Himachal Pradesh	21.55	232.37	43.03	21	18	3
Jammu & Kashmir	11.64	136.94	73.03	23	9	14
Jharkhand	86.85	113.74	87.92	4	5	-1
Karnataka	53.88	179.81	55.61	8	14	-6
Kerala	32.33	216.91	46.10	17	17	0
Madhya Pradesh	82.54	109.83	91.05	5	4	1
Maharashtra	66.16	240.51	41.58	7	19	-12
Orissa	100.00	100.00	100.00	1	3	-2
Punjab	18.10	255.11	39.20	22	20	2
Rajasthan	47.63	134.78	74.19	11	8	3
Sikkim	43.32	172.10	58.11	12	10	2
Tamil Nadu	48.49	199.16	50.21	10	15	-5
Tripura	40.73	177.06	56.48	14	12	2
Uttar Pradesh	70.69	94.98	105.28	6	2	4
West Bengal	53.23	173.30	57.70	9	11	-2
All-India	59.27					

Sources: Poverty Estimates for 2004-05, Press Information Bureau, Government of India, New Delhi, March 2007, at http://planningcommission.nic.in/news/prmar07.pdf and *State Analysis Service*, Centre for Monitoring Indian Economy, at http://www.cmie.com/

5. Fiscal Incentive Factors

5.1. Tax Efforts and Fiscal Discipline

It is important to observe that since the 10th FC (1995 onwards), there is a distinct change (*paradigm shift?*) in the choice of criteria. The downright discarding of the 'Index of Backwardness', 'Inverse per capita Income' and the 'Poverty Ratio' and bringing in new criteria of fiscal performance ('Tax efforts' and 'Fiscal discipline') have to be viewed with concern. Such a move emphasizing fiscal performance defeats the very basic objective of equity. Especially, for about four decades since the 1st Plan, with draconic policies like freight equalization, non-revision of royalties on minerals exploited, and a grave siphoning off of the central investment subsidy by the relatively advanced states, poorer states like Orissa, Bihar, Assam, Madhya Pradesh, Jharkhand and Chhattisgarh have emerged net losers in the spheres of infrastructure and productive activities, especially, industrialization (Das, 1993 and 1997).

Consequently, these policy instruments "have left them starved of investible funds for basic social and economic infrastructure, forcing desperate migration to far-flung firms and fields for a pittance. Income from mining royalty for these mineral-rich states have remained abysmally low, as the mineral cess has improved meekly and rarely" (Das, 2007). Excepting for atomic and specific strategic minerals in the First Schedule (including petroleum and gold), the centrally-decided royalty provisions have often been irrational, not to mention that royalty rates remained meagre and were hardly revised upwards even beyond the 1980s. In fact, with newer rates for key minerals as iron ore, coal, bauxite, manganese and chromium, and those listed in the Second Schedule, international rates are far sensibly designed, with local interests in focus.

Depending upon whether the value addition occurs at and contributes to the local state, fixing royalty rates across minerals as also regions/states assumes significance and is not an uncommon practice around the world. "While the Centre's practice of using ad valorem and unit-based rates have been weak on revisions and a degree of arbitrariness, states can explore royalty based on net income, broadly defined to include the gross income received or receivable as the product of capital, labour, land and skill. Even between states, for inter-governmental transfers, a competitive surcharge provision would help" (Das, 2007). Uniformity in the central royalty structure and legislative authority need deeper scrutiny as regional disparities in growth has not only risen over the decades, but has kept mineral-rich states in a state of desperation, severely depressing their non-tax revenue base.

In order to draw its relevance for the 13th FC, any decision on inclusion or weightage to be assigned for 'tax efforts' and 'fiscal discipline' must be with reference to the strength of the tax base of a state. The weak tax base is a reflection of the poor state of the manufacturing sector and industrial infrastructure. Decades of neglect of the key infrastructure (railways, ports, roads, aviation and electricity, importantly) have reduced the capacity of these states to take off with value added industrialization. Instead, the opening of the economy, since the early 1990s has led to a mad rush for unfettered exploitation of state's valuable mineral resources, with little *in situ* processing and cess revision. While competitive politics of federalism had taken away opportunities for early industrialization in these states, the reforms process has suddenly exposed the states' natural resources to be extracted without much scope for improving statal income.

It is common knowledge that the poorer states are also poorer in terms of infrastructure – physical, social and economic. As some of the poorest states in India are mineral-rich (their dynamic competitive advantage), industrialization requires massive investment in various infrastructure. Additionally, even from the point of enhancing the social sectors, infrastructure promotion assumes urgency. As Padhi (2008: 9) observes:

> "Creating a healthy 'investment climate' should therefore mean proper planning of public investments to minimise social and environmental costs of industrialisation. From this angle, the infrastructure gaps are likely to be more substantial, per unit cost of creation and maintenance of infrastructure relatively higher, and composition of public investments different from, as compared to a narrower view of public investments based on return to private investments in industrialisation. Public investments in infrastructure which help maximise social return are the best means of promoting and sustaining a healthy investment climate. This would require significant public resources for financing balanced infrastructural development."

Fiscal discipline as an incentive factor could be quite ambiguous, as it involves subjectivity on the part of the FC to reward states based upon discrete fiscal correction measures adopted by them. A recent study shows that more than half of the 14 major states have achieved significant fiscal correction during 2000-06. While some states (namely, Karnataka and Tamil Nadu) have relied more on enhancing their own revenues than on contracting expenditures, some other states as Gujarat and West Bengal have resorted to achieving the same by the other way round. Quite differently, states like Haryana and Orissa have displayed their commitment for fiscal correction by raising their own revenue as well as by containing their expenditure (as evidenced from lower levels of debt/revenue ratio) during the recent fiscal years. (Ravishankar *et al.*, 2008). Given these variations in fiscal correction measures across states, the manner the FC assays the eligibility for support could be subject of detailed analysis.

In light of the aforesaid discussion, the 13th FC may consider a reduction in the weightage, for tax effort may be to well below 7.5 per cent. The 'Index of Infrastructure' and 'Poverty Ratio' need to be revived/modified to effectively address the issue of equity, especially as inter-state disparity in growth has worsened during the post-reform period.

6. Grants-in-Aid for Critical Expenditure Sectors

In keeping with the Article 275 of the Constitution, the award of grants-in-aid by the FC assumes importance as it purports to cover the assessed deficit in the non-plan revenue account following the devolution of taxes and duties. Eventually, this involves a careful assessment of the 'need' for such assistance by the states considering their expenditure requirements and resources available with them. Grants-in-aid being an *unconditional* transfer, determined exclusively at the discretion of the FC, there always remains space for *interpreting* the need (Rao and Singh, 2005: 187). As candidly put by Rao and Sen (1996: 144-145),

> "in spite of the attempts by the successive commissions to ensure larger flow of resources to poorer states by assigning greater weight to the backwardness factor in the tax devolution formula, the methodology adopted by the successive commissions has had an inherent bias against poorer states. As the projections were made by taking the existing revenues and non-plan expenditures with some minor modifications as bases, the standards of services in the states with lower tax bases could not be enhanced as the budgetary gaps projected on the basis of existing low levels of services in these states were small."

The required estimation of trend growth rates of non-plan revenue expenditure, argues Sreedevi (2008: 63-64), suffers from the dual deficiencies of presenting such trend only in the *past* and fails to indicate if a particular expenditure is *productive* or not. Further, with the dwindling share (8.13 per cent and 7.52 per cent for the 11th and 12th FCs, respectively) of grants on account of non-plan revenue gap, the relevance of the prevalent estimation procedure has come to be questioned. Table 7 gives an impression regarding the relative shares of the 12th FC grants-in-aid to states; between the poorer states as well as between poorer and better-off states, the discrepancies are notable.

The additional burden in such an assessment becomes the complex issue of appreciating the manner in which utilization of funds has been made by eligible states. In an interesting observation, Government of Orissa (2008: 7) points out that the 12th FC has identified two sectors, namely, health and education needing financial assistance, as certain states with lower fiscal capacity would be spending less on these sectors. The Commission's recommendation provides for grants for covering 15 per cent and 30 per cent of the distance,

respectively, of the education and health sectors by which a state would be lagging behind in comparison to the average of per capita expenditure of the relevant group of states. However, this seems to be regressive for those ‘forward-looking’ states where a large part of their public expenditure is accounted for by these two vital social sectors, even when their fiscal capacity was low. For instance, despite their low fiscal capacity, poorer states like Madhya Pradesh and Orissa have managed to spend impressively well on education and health sectors, as compared to other income-poor states like Bihar and Uttar Pradesh with similar low fiscal capacity. Strangely enough, the latter couple of states have been offered disproportionately higher grant as recommended by the 12th FC. This anomaly needs to be addressed as there is scope for claiming grants for these two sectors on the principle of equalisation, by considering existing estimated gaps in these sectors.

Table 7: Share of 12th Finance Commission Grants-in-Aid Transfers to States

States	Share	Grants-in-aid								Total
	in Central Taxes & Duties (2005-10)	Non -Plan Revenue Deficit (2005-10)	Health Sector (2005-10)	Education (2005-10)	Maintenance of Roads & Bridges (2006-10)	Local Bodies (2005-10)	Calamity Relief (2005-10)	Others*	Total Grants-in -Aid	Transfers
Andhra Pradesh	7.36			0.00	6.53	7.84	8.91	6.18	3.66	6.66
Bihar	11.04		30.91	26.38	2.06	7.06	3.70	5.86	5.59	10.01
Chhattisgarh	2.66				1.75	2.81	2.78	4.21	1.39	2.42
Goa	0.26				0.26	0.12	0.05	0.42	0.09	0.23
Gujarat	3.57				5.97	5.38	6.37	3.27	2.60	3.39
Haryana	1.08				1.22	1.92	3.22	1.96	1.01	1.06
Jharkhand	3.36		6.13	6.41	2.73	2.32	3.13	3.86	2.13	3.13
Karnataka	4.46				9.72	4.84	2.97	6.63	2.84	4.16
Kerala	2.67	0.83			4.28	4.54	2.21	4.76	2.28	2.59
Madhya Pradesh	6.72		3.09	4.52	3.91	8.10	6.32	6.40	3.60	6.13
Maharashtra	5.00				7.93	11.10	5.77	4.69	3.88	4.79
Orissa	5.17	0.86	3.34	3.18	9.83	3.63	7.50	4.98	3.70	4.89
Punjab	1.30	5.51			2.81	1.98	3.78	1.89	3.44	1.70
Rajasthan	5.61			0.98	4.22	5.80	10.77	5.38	3.26	5.17
Tamil Nadu	5.31				8.10	5.77	5.42	4.46	2.90	4.85
Uttar Pradesh	19.28		39.28	43.79	16.02	13.78	7.36	10.71	10.70	17.66
West Bengal	7.06	5.36		3.85	2.75	6.66	5.84	8.21	5.31	6.73
Special Category States**	8.09	87.45	17.26	10.89	9.90	6.36	13.90	16.13	41.61	14.42
Total (Rs. Crores)	100.00 (613112.02)	100.00 (56855.87)	100.00 (5887.08)	100.00 (10171.65)	100.00 (15000)	100.00 (25000)	100.00 (16000)	100.00 (13725)	100.00 (142639.6)	100.00 (755751.62)

Notes: * ‘Others’ is an aggregation of the following heads: ‘Maintenance of buildings (2006-10)’, ‘Maintenance of forests (2005-10)’, ‘Heritage conservation (2006-10)’ and ‘State specific needs (2006-10)’

** Special Category States include Arunachal Pradesh, Assam, Himachal Pradesh, Jammu & Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura and Uttaranchal

Source: Government of Orissa (2008: 21)

In yet another criticism of the manner in which grants-in-aid were provided for under the 12th FC, observers have expressed concern over 'increasing conditionalities' imposed in a denial of the basic spirit of the FC to render such grants mostly unconditional and automatic. Almost bordering on "arbitrariness or mere caprice or whims", sometimes, the 12th FC "went overboard and went into minor details regarding how the schemes financed by the grants should be utilized" (George and Krishnakumar, 2008: 5). A perplexing aspect has been the funding of a large number of state level subsectors/needs including health, education, maintenance of roads, bridges, public buildings and conservation of forests and heritage under the grants-in-aid. These, while dissipate emphasis upon horizontal equity between states, eventually, result in "duplication, overlapping and conflict of jurisdiction" with centrally sponsored schemes in the same or similar areas in the states.

7. Concluding Observations

Disparities in regional economic growth have persisted and even grown during the era of economic reforms as a phenomenon of serious concern in India. A move towards market-driven growth strategy since the early 1990s also has exerted its influence over the capacity of states to generate investible resources and finance its manifold areas of expenditure. It has come to be recognized that relatively poorer states, due to weak infrastructure and/or natural resource endowment, have been finding it increasingly difficult both to attract investment as well as to spend on various physical and social infrastructure. Under the changing environment of economic reforms and liberalization, the role of the FC has been more complex than before, partly due to less dependence on its awards by certain better-off states. It has, nevertheless, has been noted that despite expected efforts by some of the poorer states to improve their fiscal strength, the financial transfer policy of the centre has not been appropriately progressive to counter growing disparities.

So far as the FC transfers are concerned, an important malaise concerns the selection of and weightage assigned to parameters/variables, as, for instance, population size and geographical area of a state. Chances are high that higher levels of aggregation of these variables would gravely miss out on *including* the socially and economically marginalized section of a given society, exerting greater pressure on income poorer states to address the problem. Similarly, considering the per capita income (as against the more useful per capita expenditure) as a criterion could introduce biases against some states.

Another area of ambiguity has been the somewhat recently emphasized aspect of fiscal performance by states. It is known that prominent losers, in the process of contributing heavily to *national* development over the decades, have been some of the natural resource

(especially, minerals and forests) rich states which have suffered due to irrational tax/royalty structure of the centre. These are also some of the states which could not manage to build up a strong manufacturing and infrastructure base, severely hurting their fiscal performance ability. Grants-in-aid awards have also not been impartial in their effect, though may not be in the intent. The growing conditionalities in their allocation and arbitrariness in selecting areas or needs of individual states have also been construed as unhelpful in achieving the elusive goal of horizontal equity.

These issues of horizontal equity call for a deeper scrutiny of FC awards and the defining approaches or parameters, keeping in view the imperatives of the emerging macroeconomic scenario.

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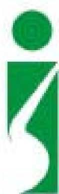

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