



Book Review

Fiscal Federalism in India: Impact of Union Transfers on State Finances

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A federal set up creates a multiple polity based on divided functions and powers among central, state and local governments. Federalism is a dynamic and not a static concept. Although a federal system provides for divided governmental functions and powers, imbalances often (rather invariably) arise between functional responsibilities and financial resources at different layers of the government. This is so because revenue-raising capacities and revenue needs of various federating units are different. This is a characteristic feature of all federations, particularly of those whose economies are more dynamic. Even in older federations (like the United States, and Canada) financial conflicts persist between the national and sub-national governments and their once-for-all solution is unachievable.

The mismatch between functions and financial powers occurs partly because of changing responsibilities of different tiers of government and partly due to the dominant position of the national government in regard to taxation powers, which is often by design. Therefore, vertical imbalances of resources and expenditure responsibilities emerge between different levels of the government, calling for transfer of resources from the centre to the states. This is the familiar problem of federal finance. Financial imbalances at the vertical level (centre versus states), and at the horizontal level (among the states) are sought to be removed/reduced through constitutional arrangements, and in some countries through political bargaining as well.

The most important development in the field of fiscal federalism in India during the post-Independence period pertains to the new system of sharing Central taxes with the State Governments.

Prior to Constitution (Eightieth Amendment) Act, 2000, income tax and

Union excise duties were the only taxes shared with the States, apart from the grants given in lieu of passenger tax, and the collections from additional excise duty in lieu of sales tax sugar, tobacco and textiles. Taxes on income and Union excise duties were shared with States under Articles 270 and 272 respectively. The aforesaid amendment altered the pattern of sharing of Central taxes between the Centre and the States significantly. It substituted a new Article for Article 270 and omitted the old Article 272. The new Article 270 provides for the sharing of the net proceeds of all Union taxes and duties with the States. However, the surcharge levied for purposes of the Union under Article 271 is excluded from the divisible pool. Eleventh Finance Commission was the first to make recommendations in accordance with the new provisions of the Constitution.

Still further, the Constitution (Eighty-eighth Amendment) Act, 2003 has included 'taxes on services' under entry 92C in the Union List (List I) in the Seventh Schedule of the Constitution.

The book under review surveys the theoretical hypotheses that have been propounded and empirically tested by renowned economists with respect to incentive-theoretic argument. An attempt has been made to study the impact of inter-governmental grants in decentralized system, especially in the context of second-generation theories.

The basic objective of this volume is to empirically gauge the effect of federal transfers on tax efforts of 14 major Indian States, viz. Andhra Pradesh, Bihar, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. The analysis has been done particularly in the context of the use of tax efforts as a criterion for inter-se distribution by various Finance Commissions. Besides, the book also covers:

1. Understanding of the two vital concepts of tax effort and tax capacity and the alternative quantitative techniques that can be employed to capture them.
2. Conceptual aspects of fiscal federalism, which *inter alia* include fiscal federalism as a rational choice, its norms, its relevance in the era of globalization, and other related dimensions.
3. Operational aspects of fiscal federalism in India.
4. Efficacy of various channels of Union transfers and analysis of operations of Planning Commission and various Finance Commissions.

Spread over 9 chapters and 2 appendices, the work is an important contribution to the existing literature on Indian fiscal policy. Chapter 1 is introductory in nature. Chapter 2 explains the Parameters of Fiscal Federalism. Chapter 3 provides a critical appraisal of Central-State Fiscal Transfers in India. Chapter 4 discusses the Impact of Federal Fiscal Transfers. Chapter 5 deals with Fiscal Potential and Tax Effort. Chapter 6 gives an Alternative Specification of Tax Capacity and Tax Effort in the context of Tax Performance Function. Chapter 7 examines Estimation and Application of Taxable Capacity Function. Chapter 8 evaluates Allocative Effects of Indian Federal Fiscal Transfers. Chapter 9 covers Findings and Suggestions.

In short, the book explains and examines the current dynamics of fiscal federalism in India, particularly in the context of recent economic reforms and the aspirations of the State Governments.

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