CHAPTER II

OUR APPROACH

2.1 Article 280(3) of the Constitution charges the Finance Commission with the duty of recommending the division of shareable taxes between the Centre and the States, and the making of grants-in-aid to the States in need of assistance. This involves two steps: first, the revenues must be divided between the Union and the States; and, second, the share of the States has to be allocated among them. Each of these steps requires the Commission to take into account numerous considerations and imponderables. In the discharge of its functions, the Finance Commission has to perform a balancing exercise almost at every turn.

2.2 The crux of the problem is that the resources are limited, and the needs of the States are enormous. It is to their credit that they are impatient to achieve further development as fast as possible. The degrees of development vary. Some States are relatively more advanced while others are lagging behind. Naturally, this leads to many competing claims, and the Finance Commission is compelled to adopt some approach in fixing priorities. At the same time, it has to have regard to the needs of the Centre which has many responsibilities. The overriding consideration which has guided this Commission, is the national interest taken as a whole. Ultimately, the solutions we have chosen have been judged on this touchstone.

2.3 We have carefully considered the memoranda sent to us by the States, and the points made by the Chief Ministers and their colleagues during our discussions with them. They are unanimous in their demand for a larger share in the total Central revenues. There are divergent views as to how this should be done. The common thread, in all that they urged, was the desire for accelerated economic development, and the need for proper maintenance of assets already created. The extent of the share demanded by the States from the Centre's revenues, varies from 40 per cent to 75 per cent.

2.4 In this connection, the demands on the Centre's resources, also, need to be remembered. The expenditure on defence, subsidies on food and fertilizers, and interest payments is, in the present circumstances, inescapable. These items alone absorb nearly half the Centre's revenues. Out of what remains with the Centre, about 37 per cent is at present being transferred to the States, largely on the recommendations of the Finance Commission and the Planning Commission.

2.5 While we have the greatest sympathy for the needs of the States, the parameters within which we have to function are, thus, obvious. Within the scope which was available to us, we have tried to do our best.

2.6 In making the allocation between the States we had, again, to balance divergent considerations. How to reconcile the need to accelerate the development of the backward States, without hindering the further development of the more advanced ones? It is true that we have leaned in favour of the former, and tried to make our scheme of devolution more progressive; but, we think, that this is what the national interest, at present, requires.

2.7 All the States seem to prefer a share in the devolution of taxes rather than grants-in-aid under Article 275 of the Constitution. The reason, plainly, is that whereas taxes are buoyant, grants-in-aid are fixed sums whose value is eroded, in real terms, over the years. We are impressed by what the States have said. We have tried to accommodate their view in two ways. Firstly, we have set apart 5 per cent of the net proceeds of the shareable excise duties exclusively for deficit States. Secondly, we have tried to give grants a measure of buoyancy by providing a 5 per cent rate of growth during the forecast period.

2.8 One of the points constantly brought up by the States, was regarding administered prices. According to them, while a rise in administered prices made available to the Centre sizeable extra-budgetary resources, it casts additional burdens on the States in the form of additional costs of inputs required by them for their undertakings. The States think that, instead of raising resources by increasing administered prices, the Centre should raise resources by revision of excise duties, which are shareable with the States.

2.9 We have given this matter our careful consideration. We think, that an increase in administered prices is justified if there is an increase in the cost of production, provided that the public sector undertakings concerned are functioning with reasonable efficiency. Also, in fixing the administered prices, provision can be made for reasonable profits. But, if obtaining revenue is the sole consideration, then, it seems to us, that the appropriate course is to increase excise duty.

2.10 Most States, also, urged that the surcharge on income tax and the corporation tax should be made shareable. Some of them also wanted that the levy of a tax on Railway passenger fares ought to be revived as, they thought, they would be better off if that was done. On the other hand, the Centre has complained about the overdrafts on the Reserve Bank resorted to by some States. We have dealt with these topics in their appropriate places in this Report, and need not say anything further here.

2.11 The State Governments have also drawn our attention to the fact that they are being given a smaller share in the total market borrowings. We have examined the position, and find that there has been a decline in the share of the States in recent years. During the Fourth Plan period, the share of the Centre was 55 per cent, and that of the States 45 per cent. But, during the Sixth Plan period, the estimated share of the Centre has increased to nearly 77 per cent, whereas that of the States has fallen to 23 per cent. We think, that this pattern of distribution of total market borrowings requires correction, and the share of the States ought to be raised.

2.12 We would like to end this Chapter by dealing with a criticism to which, we know, we are bound to be subjected. Most of the earlier Finance Commissions have been castigated for adopting what has been called a 'gap filling' approach. And, it will be said that we have done the same. The two main objections raised against this approach are: firstly, that it encourages the less well-managed States to squander resources, knowing that their deficits will be made up by the Finance Commission; and, secondly, that a revenue deficit is not a complete indication of the needs of a State.

2.13 As regards the first objection, we need only say that it is not as if the Finance Commissions accept the forecasts sent by the States at their face value. We, like all previous Finance Commissions, have realistically re-assessed the forecasts and applied certain norms. Our approach has been objective both on the revenue and the expenditure sides.

2.14 As regards the second point, we think, that the requirements of the States on account of developmental needs should, according to the exising practice, be estimated and generally met by the Planning Commission. Consequently, even if fiscal needs are to be taken into account, they would have to be limited to the needs on non-Plan account for which we have made appropriate provisions.

2.15 We would like to add that we have, in fact, taken steps to reduce the regional imbalances between the States, in addition to covering the revenue gaps. We have tried to achieve this objective to some extent by our recommendations relating to grants for upgradation of the standards of administration. Moreover, our scheme of devolution has also a redistributive role, in that, it provides additional resources to the less developed States.