

THE ASSIGNMENT OF TAXES AND EXPENDITURES IN INDIA*

M. Govinda Rao and Nirvikar Singh⁺

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Abstract

In this paper, we review the basic theories of fiscal decentralization, apply them to the problem of tax and expenditure assignments in a federal system, and consider the Indian case in the light of economic principles. We note the centripetal bias of India's federal fiscal arrangements, which give the center indirect power over states' expenditure decisions, as well as creating a vertical fiscal imbalance that requires large center-state transfers. We describe some of the distortions that arise in the federal aspects of the current Indian tax system. In particular, we highlight internal trade barriers, inter-state tax exportation, and tax sharing arrangements as areas for reform.

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⁺ Respective affiliations: Rao - Australia South Asia Research Centre, Research School of Pacific and Asian Studies, Australian National University, and (from Dec. 22) Director, Institute for Social and Economic Change, Bangalore, India; Singh - Department of Economics, University of California at Santa Cruz, and Visiting Fellow, Center for Research on Economic Development and Policy Reform, Stanford University.

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In this paper, we review the basic theories of fiscal decentralization, apply them to the problem of tax and expenditure assignments in a federal system, and consider the Indian case in the light of economic principles. We note the centripetal bias of India's federal fiscal arrangements, which give the center indirect power over states' expenditure decisions, as well as creating a vertical fiscal imbalance that requires large center-state transfers. We describe some of the distortions that arise in the federal aspects of the current Indian tax system. In particular, we highlight internal trade barriers, inter-state tax exportation, and tax sharing arrangements as areas for reform.

The paper is organized as follows. In section I, we review the broad theoretical principles of fiscal decentralization. In section II, these principles are applied specifically to the problem of expenditure and tax assignments in a federal system. Section III describes the assignments for the case of India, including some comparative analysis where appropriate. Section IV highlights some of the policy issues and areas for reform that emerge from the study of tax and expenditure assignments in India. Section V provides a concluding summary.

I Fiscal Decentralization: Theoretical Considerations:

Fiscal decentralization has two fundamental facets: (i) the assignment of functions and sources of revenue to finance them and (ii) the layers, numbers and morphology of jurisdictions that constitute the governmental system. One could take the structure of government and jurisdictions as given and determine the equilibrium assignment of powers or, alternatively, establish an efficient jurisdictional organization or structure for the given set of functions. As the objective of this study is to examine federal fiscal issues within the framework of the given governmental structure, we mainly take the governmental structure as given and analyze the division of powers, although we do summarize the literature on the structure of jurisdictions.

This paper deals with the assignment of functions and sources of finance to undertake the assigned functions. The division of powers among different governmental units, vertically between different levels of government, and horizontally among different jurisdictions within each level, is the starting point for the examination of efficiency in the delivery of public services. The mapping of benefits across jurisdictions cannot be perfect; overlapping tax powers can create problems of fiscal disharmony and create incentive for free-riding; nor can there be a symmetry between the assignment of functions and sources of finance at each governmental level. All these problems of fiscal spillovers, disharmony and imbalances have their roots in assignments and, therefore, this issue warrants a careful analysis.

Earlier “layer-cake” models of assignment of governmental functions assumed that public services could be aggregated unambiguously into Musgravian tripartite categories - allocation, distribution and stabilization. Under this scheme, primary responsibility for macroeconomic stabilization and redistribution of income and wealth should rest with the central government (Oates, 1972, 1977). It is difficult for local governments with small, open economies to pursue independent stabilization policies. They can not be given the power to vary money supply and the effectiveness of fiscal policy for stabilization at the sub-central levels is limited by the spillover of effective demand to areas outside their jurisdictions. Similarly, potential mobility of economic agents places limits on the ability of sub-central governments to pursue serious redistributive policies. Vigorous redistribution by a sub-central authority can result in driving out the rich from, and inviting the poor into, its jurisdiction, which would be self-defeating.

It is in undertaking allocative functions, however, where decentralized provision promises the greatest gains. The decentralization theorem articulated by Oates demonstrates that provision of public services by sub-central governments, in the absence of scale economies, can result in significant welfare gains as compared to the centralized solution of uniform supply.¹ The more varied is the demand for public services across different jurisdictions, the larger are the welfare gains from fiscal decentralization. Decentralized provision of local public goods can cater to the varying preferences of people better and thus enhance social welfare. It is also demonstrated that the welfare gains from decentralization are inversely related to the price elasticity of demand for public services (Oates, 1977). Welfare gains can also accrue from the wider choice implicit in the different tax-benefit packages offered by different jurisdictions. When the choice set is wider, individuals can vote with their feet for their preferred communities. Further, the wider choice reduces the welfare cost implicit in the bundling (provided on a take-it-or-leave-it basis) of public services. However, when there are significant scale economies, or when sub-central provision of public services involves transaction and organizational costs,² the assignments should be done so as to maximize the net welfare gains.

In the real world, however, assignment of the responsibility of providing *goods and services* in terms the three functional *branches* of the government would be impossible, nor are the three functions independent, contrary to what was assumed in these models. Even more important, sub-national governments are found to have legitimate redistribution and stabilization roles in all multilevel fiscal systems. Pauly (1973) and Tresch (1981) have argued that redistribution may be considered a local public good and when population is not mobile across jurisdictions, local initiative in redistribution may be desirable. Similarly, sub-central fiscal policies can and do play a role, *albeit* limited, in managing local unemployment and hence, stabilization. (Inman and Rubinfeld, 1992, Gramlich, 1987).

When the assignment question is formulated in terms of *goods and services* instead of functional *branches* of government, three broad approaches may be discerned namely: (i) the Breton-Olson-Oates models of efficient management of spillovers; (ii) the Breton-Scott model of

¹ On the attempt to measure welfare gains, see Bradford and Oates (1974). The price elasticity of demand for local public services is estimated by Bergstrom and Goodman (1973).

² Breton and Scott (1978) identify four kinds of transaction costs: mobility, signaling, administration and coordination.

minimizing costs including transaction and administrative costs and (iii) the competitive federalism model which effects assignments according to comparative advantage.

(i) Management of spillovers

The first approach views assignments as an outcome of managing benefit spillovers from various public goods. The approach was first developed by Breton (1965) and later by Olson (1969) and Oates (1972). In this approach, broadly all public services are assumed to be of the pure Samuelsonian (1954) type, but with varying regional benefit “spans”. To minimize spillovers, public goods with different benefit spans will be hierarchically ordered into local, metropolitan, regional, provincial, national and international public goods (Breton, 1965). In Olson’s (1969) scheme, the perfect matching of benefits with geographical boundaries or “fiscal equivalence” would warrant as many governmental levels as the number of public goods.

In Oates’s approach, with stabilization and redistribution functions assigned (mainly) to the central government, decentralization is relevant only in the allocation function. In undertaking the allocation function, however, a welfare-maximizing division of powers necessarily implies that sub-national governments have a predominant role. According to the “decentralization theorem” so long as there are no economies of scale, sub-national units have greater advantage in providing the Pareto-efficient levels of public services as they can cater to the diversified preferences of people in different jurisdictions. In the case of public services with scale economies, public “provision” of the good can still maintain the advantage and private “production” can help to reap scale economies. In this case, wherever feasible, the local governments can provide privately produced services by purchasing them in the market. However, in cases of services requiring public production, optimal assignment and jurisdictional size are arrived at by maximizing net welfare gains.

Thus, the crux of the Breton-Olson-Oates approach is that an efficient design of jurisdictional boundaries or assignment of functions results from the scheme which manages the spillovers efficiently. However, when the exogenously given jurisdictional boundaries do not exactly coincide with the benefit spans, the spillovers will have to be internalized through a system of Pigovian grants administered by the higher level government. The problem with this approach, as pointed out by Weldon (1966), is that it requires an omniscient central government to accurately calculate the spillovers, and if the central government has so much information to accurately estimate spillovers, there are no supply side reasons for decentralization. In this case, the division of functions is not only unnecessary, but also wasteful, and in such cases a single tier unitary structure would be ideal. Besides, it must be noted that in this spillover approach to assignment, the division of functions can be done only by an *omniscient* central government or an *omniscient* planner (Breton, 1996, p. 185).

(ii) Minimizing transaction costs

The second approach takes optimal assignments as a consequence of minimizing costs. According to the decentralization theorem, discussed above, optimal assignments result from maximizing net welfare gains. This implies that a function should be decentralized so long as welfare gains from decentralized provision exceeds the additional cost disadvantages which can arise if the good in question is subject to increasing returns to scale. A clearer theory of assignment resulting from cost minimization was proposed by Breton and Scott (1978). In this, optimal assignments are achieved when transaction or organizational costs of providing the services are internalized into the decision making framework. These include the costs of mobility, signaling, administration and coordination. While analytically attractive, this approach too, to be operational, requires an *omniscient* decision maker who can model the cost functions and minimize them to achieve equilibrium assignments.

(iii) Competitive federalism

The “competitive federalism” approach, however does not need an omniscient central government, planner or any other decision maker to arrive at efficient assignment. Optimal assignment results automatically from vertical intergovernmental competition. In this approach, hierarchically ordered governmental units compete with one another in providing public goods, and, in the equilibrium, functional assignments will be according to the comparative advantage of different jurisdictions in providing different public goods. Competition will force the governmental units to specialize in the supply of public services in which each unit is relatively more efficient. Thus, according to this approach, the division of functions is not the role of the constitution. Rather, constitutional division is the consequence of the competitive advantage of different jurisdictions. In this sense, the constitution is a living entity, adjusting to accommodate the changes required by vertical intergovernmental competition.

This, however, does not mean that constitutionally entrenched assignments are irrelevant. One way to look at this issue is to make the Brennan-Buchanan (1980) distinction between constitutional changes and in-period changes. While intergovernmental competition can influence the assignments in the medium and long term through constitutional amendments and the evolution of conventions, in-period or short run intergovernmental relationships are conducted in the framework of the existing constitutional arrangements. Another way to look at the issue is to consider the existing constitution as a constraint on competition in evolving equilibrium assignments.

An important common thread in all the three views of fiscal decentralization is that an optimal division of functions is achieved when the assignment to different levels of government accords with its comparative advantage. Comparative advantage may be in terms of (i) provision of public services according to varying preferences or considerations of local choice, (ii) cost efficiency by reaping economies of scale or transaction costs, or (iii) competitive ability of different levels of government.

Thus, all the three approaches lead to some broad generalizations on the division of functions between different levels of government. In Musgrave’s tripartite division of functions,

the approaches underline the limitations on the ability of sub-national governments to undertake rigorous redistribution and stabilization functions, although these units are by no means precluded from them. In fact, they do have an important role in supplementing and assisting higher governmental units. Sub-national governments, for example have better capacity to evolve programs and policies to deal with structural unemployment at local levels. Similarly, they have definite comparative advantage in identifying the poor and designing and implementing policies to improve their well-being, depending upon local conditions and resources. In this sense, both redistribution and stabilization, like allocation are in the common domain of central and sub-central governments, but in the case of the first two branches, the former should take the dominant role whereas in the case of the third, the responsibility of the latter is more important.

II Expenditure and Tax Assignments

The major responsibility of the central government according to the principles discussed in the previous section will be (i) to provide public and merit goods and services with benefits spanning across different States and, (ii) to monitor inter-jurisdictional competition among sub-central governmental units. In the provision of public services it would have a predominant role in macroeconomic stabilization, poverty alleviation (poverty anywhere is a concern everywhere in the country), provide public services with national spillovers like defense and those with inter-state ramifications. As regards cost consideration, transaction and coordination costs can still be important in determining the division of functions; however, the possibility of accessing private supply for public provision in many cases reduces the role of the central government from the viewpoint of economies of scale.

One of the important functions of central government is to monitor inter-jurisdictional (horizontal) competition. An efficient monitoring mechanism is an essential pre-condition for securing stability in horizontal competition. This requires the central government to formulate rules to prevent “beggar thy neighbor” policies such as predatory pricing of goods and services, erection of trade barriers, creation of negative externalities to non-residents, exportation of tax bases, and promoting excessive duplication. The central government has to secure stability in competition because voluntary cooperation among the sub-national governments cannot secure stability³. The central government can secure stability in horizontal competition by setting the rules of competition and enforcing them to achieve (i) competitive equality of jurisdictions and’ (ii) appropriability of costs of benefits of public services in each of the jurisdictions. The central government can achieve these preconditions for stable inter-governmental competition by employing three instruments individually or in conjunction with others namely, (i) the use of prohibitions and standards; (ii) the use of regional policies and intergovernmental transfer programs.

³ For details, see, Breton (1996) pp. 240-245.

(i) Regulations, prohibitions and standards

The use of regulations, prohibitions and standards is essentially to prevent sub-national governments from undertaking measures advantageous to them, but inimical to the economy as a whole. Erecting barriers to prevent free movement of resources and goods across boundaries, indulgence in unhealthy tax competition -- the "race to the bottom" -- and according liberal fiscal and financial incentives by sub-national governmental units to attract capital into their jurisdictions are examples of this. Such policies segment the factor and commodity markets, distort the pattern of resource allocation, remove the advantages of a common market, cause significant inter-state tax exportation, bring about non-correspondence between taxes and public services, and redistribute resources in favor of more "powerful" jurisdictions, which is necessarily inequitable. Thus, from the viewpoint of bringing about cost-benefit appropriability, preventing diversion of trade and capital from their natural locations and ensuring a common market for the country, regulations may be called for.

(ii) Regional policies and intergovernmental transfers

Competition among sub-national governmental units, to be stable and beneficial, calls for "competitive equality". This is analogous to the firms in a competitive industry where no single firm is in a position to dominate the scene and influence prices. A necessary condition for equalizing the competitive strength of different regions (states) within a country is to enable them to provide equivalent levels of social and economic infrastructure at a given tax-price through central transfers or through the center's direct investments. This ensures that larger/stronger units can not continually dominate, coerce or prevent smaller/weaker units from making independent decisions, nor can they inflict disproportionate damage on them (Breton, 1987). The central government can ensure equality in the competitive powers of sub-national governments either by employing its own expenditure priorities and allocations to achieve the intended pattern of regional benefit spread, or through regionally discriminating regulations or intergovernmental transfer systems.

Thus the central government does not have a comparative advantage in undertaking the expenditure function relative to state and local governments. The center's functions include provision of public services with inter-state and nation-wide spillovers and ensuring competitive equality of different states through regional policies and intergovernmental transfers. In contrast, state and local governments are a better place to incur expenditures on most quasi-public goods including many social services like education, preventive and curative health care, water supply and social security and welfare and economic services like building physical infrastructure.

The broad generalizations made above help us to state three principles of tax assignment:

- (i) Sub-national governments should only levy user charges and benefit taxes on immobile economic units;
- (ii) The non-benefit taxes needed to be levied, particularly for redistributive purposes, should be levied by higher level (central) governments;
- (iii) To the extent that sub-central governments have to levy non-benefit taxes, they should employ taxes on bases which are relatively immobile across jurisdictions.

These principles place a distinct advantage to the central government in levying taxes on broad-based and mobile bases, because taxes on such bases if levied by sub-national governments could result in significant evasion and avoidance, besides the mobility of the tax bases in search of tax havens leading to resource distortions (Musgrave, 1983, Breton, 1996). Similarly, they have distinct advantages in borrowing from the market or creating resources through seignorage.

The principles of assignment thus result in a “vertical fiscal imbalance”. While the central government has a distinct advantage in raising revenues, the state and local governments are better placed to provide public services. Thus, in most multilevel governmental systems, revenue raising authorities are different from those incurring expenditures. This provides another reason for the vertical transfer of resources, besides intergovernmental transfers given to ensure competitive equality of jurisdictions. It must also be noted that the divergence of revenue and expenditure decisions can have adverse efficiency consequences, and, in the ultimate analysis, the equilibrium assignment should weigh the tradeoff between welfare gains from efficient revenue and expenditure assignments with the efficiency loss due to the divergence of revenue and expenditure decisions. In other words, tax and expenditure assignments can not be entirely independent, particularly at lower levels of government which predominantly provide quasi-public services. Linking expenditures on public services with prices (user charges or tax payments) tends to preserve incentives and accountability, makes the system transparent, and enhances consumers’ choice.

How then should the assignment of taxes and expenditure functions between different levels of government be sequenced? In the literature, it is suggested that the assignment of spending responsibility should precede the division of tax powers. This is because division of tax powers, besides being based on the principles of tax assignment, should be determined by the requirements of different spending agencies. Decentralization of tax powers based on expenditure responsibilities is desired so that sub-national governments do not have to rely exclusively on intergovernmental transfers to finance their expenditures. The linking of revenue and expenditure decisions at lower levels of government is considered important to preserve the incentive to provide public services in a cost-effective manner (Shah, 1994). Excessive recourse to intergovernmental transfers to finance sub-national expenditures severs the revenue-expenditure linkage as explained above, and can have adverse effects on fiscal management at sub-national levels, besides creating disincentives for raising resources at the central level. Thus, even when the tax powers assigned to sub-national governments have distortions, it may be preferable to do so if it results in more cost effective public service provision. Thus, the choice between assigning tax powers and providing transfers to sub-national governments to finance their services depends upon the trade off between the additional efficiency loss due to sub-national taxation and efficiency gains from cost-efficient spending by them plus considerations of regional equity.

The broad principles of assignment discussed above are helpful in designing expenditure and tax assignments. However, it is necessary to recognize that actual assignments do not strictly follow the theoretical ideal. This is because, actual fiscal arrangements are determined by historical, political and other non-economic factors, besides economic considerations. For example, though customs duty theoretically should be a central levy, in Malaysia, it is

administered by local governments. Similarly, the property tax, which should theoretically be a local levy, is a central tax in Indonesia, and a provincial tax in Pakistan. Income tax, given the mobility of the tax base, should be a central levy, but in Canada and the United States of America, the state or provincial governments can levy the tax concurrently with the central government. In many countries, revenues from natural resources, particularly minerals, accrue to the center, but in Canada, oil revenues constitute a significant proportion of the revenues of the province of Alberta. Such examples of deviation of actual assignments from the theoretical principles abound. These deviations, unless measures are taken to harmonize, may create distortions and inequities and they can be taken as constraints posed by non-economic factors in determining assignments.

III Tax and Expenditure Assignments in India: Constitutional Assignments

The discussion on economic principles in the preceding section provides us the guidelines for evaluating the actual assignment of tax and expenditure powers to different levels of government in Indian federation. Briefly stated, these principles are: (i) assignment of taxes and expenditures should be according to the principle of comparative advantage. In the case of expenditures, this would imply provision of public services conforming to the diverse preferences; minimization of production, administrative and coordination costs; and avoiding the scope for free-riding. In the case of tax assignment, comparative advantage is determined by the enforceability of taxes, and neutrality with regard to location decisions. (ii) the assignment should not adversely affect incentives and accountability for both central and sub-central governments. It should preserve a strong link between revenue and expenditure decisions to avoid disincentives in fiscal management at all levels of government. (iii) the assignment should ensure not only efficient provision of public services, but also pave the way for overall allocative efficiency. Specifically, the assignment of taxes and expenditures should not promote “free-riding” among the sub-national governments and should minimize market segmentation and impediments to the free movement of the factors and commodities across the country.

In India, the first systematic attempt at defining the roles of central and state governments was done as far back as 1918, when the Montague-Chelmsford reforms were implemented. However, it was the Government of India Act, 1935, which clearly demarcated the roles of the two levels of government, and in many respects, the present constitutional assignment closely follows that demarcation. The constitution, in its seventh schedule, assigns the powers and functions of the center and the states. The schedule specifies the exclusive powers of the center in the Union list; exclusive powers of the states in the State list; and those falling under the joint jurisdiction are placed in the Concurrent list (see Appendix Table A2). All the residuary powers are assigned to the center..

The functions of the central government can be classified as those required to maintain macroeconomic stability, international trade and relations and those having implications for more than one state, for reasons of economies of scale and cost efficient provision of public services. Issuing currency and coinage, dealing in foreign exchange, foreign loans, the operation of the

central bank of the country (Reserve Bank of India or RBI), international trade, banking, insurance and operation of stock exchanges are some of the major functions assigned to the central government to maintain macroeconomic stability. Functions like the operation of railways, posts and telegraphs, national highways, shipping and navigation on inland waterways, air transport, atomic energy, space, regulation and development of oilfields and major minerals, inter-State trade and commerce and regulation and development of inter-state rivers are the major functions assigned to the center for reasons scale economies and spillovers in respect of services with benefits spanning more than one State.

The power of the center has been further augmented by placing a number of additional items in the concurrent list and vesting it with overriding powers in regard to these subjects. The important items included in the concurrent list are: economic and social planning (which embraces virtually all items under economic and social services), commercial and industrial monopolies, trade unions, social security, employment and unemployment, welfare of labor, price control and trade and commerce in and production of certain basic goods such as foodstuffs, cotton and any other goods if the Parliament decides to bring it into this category.

The major subjects assigned to the states comprise public order, police, public health, agriculture, irrigation, land rights, fisheries and industries and minor minerals. As mentioned earlier, the states do have jurisdiction over concurrent items and can take initiatives with regard to these subjects. However, in the event of conflict between the center and the states, the former has overriding powers. Subjects like public health, agriculture and irrigation involve considerable governmental intervention and expenditures. Even in regard to the subjects in the concurrent list like education and transport, social security and social insurance, in a democratic polity, being proximate to the people, the states would be compelled to assume a significant role.

The assignment of tax powers, however, is based on the principle of “separation”, and the tax handles are exclusively assigned either to the center or to the states. Most of the broad-based and productive tax handles have been assigned to the center perhaps, for reasons of stabilization and redistribution stated earlier. These include, taxes on income and wealth from non-agricultural sources, corporation tax, taxes on production (excluding those on alcoholic liquors, opium, hemp and other narcotics) and customs duty. A number of tax handles are assigned to the states as well. These include taxes on agricultural income and wealth, taxes on the transfer of property (stamp duties and registration fees), taxes on motor vehicles, taxes on the transportation of goods and passengers, sales tax on goods, excises on alcoholic beverages, entertainment tax, taxes on professions, trades, callings and employment, property tax and taxes on the entry of goods into a local area for consumption, use or sale (octroi). However, from the viewpoint of revenue productivity, only the tax on the sale and purchase of goods is important. The center has also been assigned all residual powers which implies that the taxes not mentioned in any of the lists automatically fall into its domain. The division of tax and expenditure powers as placed in central, state and Concurrent lists of the Seventh Schedule to the Constitution are given in Appendix Table A1.

The Constitution recognizes that assignment of tax powers and expenditure functions would create imbalances between expenditure needs and abilities to raise revenue. The

imbalances could be both vertical among different levels of government and horizontal among different units within a sub-central level. Therefore, the constitution provides for the assignment of revenues (as contrasted to assignment of tax powers), sharing of the proceeds of certain centrally levied taxes with the states, and making grants to the states from the Consolidated Fund of India.

Assignment of tax revenues includes those taxes levied by the center, but with the proceeds assigned to the states. Articles 268 and 269 empower the center to levy taxes such as estate duty on non-agricultural property, terminal taxes on passengers and goods carried by railway, sea or air; taxes on railway fares and freights, taxes on transactions in stock exchanges and futures markets, taxes on the sale and purchase of newspapers and on advertisements published therein and taxes on sale and purchase in the course of inter-state trade. All of them except the last one are levied and collected by the center and the proceeds assigned to the states entirely. In the case of the last one, the states have been allowed to collect the tax subject to a ceiling rate specified by the center.

The Constitution also provides for the compulsory sharing of the net revenue from non-corporate income tax (Article 270), and optional sharing of the proceeds of Union excise duty (Article 272). The shares of the center and the states and their allocation among different states of both the taxes are to be determined by the Finance Commission appointed by the President of India every five years or earlier as needed. As this arrangement is alleged to have created serious disincentives to the central government in raising revenues from the two taxes, and based on the recommendation of the Tenth Finance Commission, the central government has proposed replacing of the sharing of the two taxes with sharing of revenues from all central taxes. However, constitution is yet to be amended for the purpose.

In addition to tax devolution, the Finance Commission is also required to recommend grants to the states in need of assistance under article 275. The quantum of shared taxes, their distribution among the states and the amount of grants to be given to the states are determined by an independent quasi-judicial body, the Finance Commission, appointed by the President of India every five years (or earlier).

The actual role of the central and state governments in executing revenue raising and expenditure decisions are summarized in Tables 1 and 2. The states on an average raise about 35 per cent of total revenues, but incur about 57 per cent of total expenditures. The revenues derived from exclusive central taxes constitute about 24 per cent; those from exclusive state taxes 31 per cent, shareable sources contribute about 27 per cent and the remaining 17 per cent consists of non-tax revenues. The major taxes levied exclusively by the center consist of customs duty (15 per cent of total tax revenue) and corporation tax (8 per cent). Among the state taxes, the revenue from sales tax constitutes almost 16 per cent. Other state taxes individually contribute less than 6 per cent of total tax revenue.

It is seen that the expenditure shares of central and state governments indicate a fairly high degree of decentralization. However, states' control over expenditure policies is much less than what is indicated by these figures. On an average, in 1994-95, the states incurred 57 per cent

of total expenditures. Their share in current expenditure was 58 per cent and in capital expenditures, 54 per cent. However, about 15 per cent of states' expenditures was on central sector and centrally sponsored schemes which are specific purpose transfer schemes administered by various central ministries. States' expenditures on these schemes has actually shown an increasing trend from about 7 per cent of total expenditures in 1985-86 to 15 per cent in 1995-96.⁴

The pattern of expenditures presented in Table 2 shows that the central government plays a major role in providing defense, meeting interest payments and industrial promotion. The states on the other hand, have a predominant share of total expenditures on internal security, law and order, social services like education, health, family welfare, housing and social security and on economic services like agriculture, animal husbandry, forestry, fisheries, irrigation and power and public works. The states' share in expenditure on administrative services is about two-thirds; on social services they spend over 85 per cent and on economic services their expenditure share is almost 60 per cent.

It is also seen that over the last decade, while the share of the states in raising revenues has remained constant, their expenditure share has shown a steady increase particularly since 1991 by about five percentage points. This has occurred because fiscal reforms initiated in 1991 have led to a deceleration in the growth of central government expenditures, but not so much in central transfers to states. Consequently, state expenditures have continued to increase even as central government expenditures decelerated. Thus, the states' expenditure share has increased both in current and capital expenditures.

⁴ There are 179 Central sector and centrally sponsored schemes. Faced with severe criticism, the Planning Commission has finalized plans to transfer 115 schemes constituting 13 per cent of the expenditures on such schemes to the States. The Center will, however retain 64 schemes constituting 87 per cent of expenditures on centrally sponsored schemes. See, Business Line (Internet Edition) June 9, 1997.

Table 1

Revenue Receipts of the Central and State Governments: 1994-95*							
Items of Revenue	Revenue Share 1985-86		Revenue Share 1990-91		Revenue Share 1994-95		(Per cent)
	Center	States	Center	States	Center	States	Per cent of Total
	A. Tax Revenue (a+b)	49.0	51.0	49.1	50.9	45.5	54.5
a.Exclusive Central Taxes	100.0	-	100.0	-	100.0	-	24.0
1. Corporation Tax	100.0	-	100.0	-	100.0	-	7.6
2. Custom Duties	100.0	-	100.0	-	100.0	-	15.2
3. Other	100.0	-	100.0	-	100.0	-	1.3
b. Exclusive State Taxes	-	100.0	-	100.0	-	100.0	31.2
1. State Excise Duties	-	100.0	-	100.0	-	100.0	4.4
2. Sales Taxes	-	100.0	-	100.0	-	100.0	16.4
3. Taxes on Transport	-	100.0	-	100.0	-	100.0	2.6
4. Other	-	100.0	-	100.0	-	100.0	7.8
c. Shared Taxes	51.6	48.4	51.4	48.6	49.1	51.9	27.4
1. Personal Income Tax	26.5	73.5	23.4	76.6	22.2	77.8	6.3
2. Union Excise Duty	56.6	43.4	57.5	42.5	55.9	44.1	21.1
B. Non-tax Revenue	62.1	37.9	54.3	45.7	80.8	19.2	17.3
1. Net Contribution from Public Enterprises	-875.9	975.9	-288.1	388.1	119.2	-19.2	2.0
2. Administrative Receipts	47.1	79.2	33.8	66.2	18.8	81.2	8.9
2. Interest Receipts	66.6	33.4	59.6	40.4	161.2	-61.2	5.8
3. External Grants	100.0	-	100.0	-	100.0	-	0.7
C. Grants to States		100.0		100.0	-	100.0	-
D. Total Revenue Accrual	38.2	61.8	37.7	62.3	38.4	61.6	100.0
E. Total Revenue Collections	65.6	34.4	63.9	36.1	65.5	34.5	100.0

* Revised Estimates.

Source: Public Finance Statistics, Ministry of Finance, Government of India, 1993.

Table 2

Share of State Governments in Total Expenditures *										
(Per cent)										
Expenditure Item	1985-86			1990-91			1994-95			Percentage of the Item to Total Exp.
	Current	Capital	Total	Current	Capital	Total	Current	Capital	Total	
A. Interest Payment	34.6	0.0	34.6	35.5	0.0	35.5	37.2	-	37.2	20.1
B. Defence	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	9.1
C. Administrative Service	85.2	0.8	78.0	76.4	1.8	73.4	66.2	14.7	65.8	13.7
D. Social and Community services of which:	94.8	67.0	92.7	78.9	74.1	78.7	86.4	71.2	85.4	21.5
i. Education	84.8	79.5	84.7	84.5	61.7	83.9	86.1	43.4	84.9	11.8
ii. Medical and Health	92.5	94.8	92.8	90.3	95.3	90.7	91.4	96.1	92.0	4.3
iii. Family Welfare	93.4	90.4	93.1	92.2	100.0	92.7	93.5	100.0	93.8	0.6
iv. Others	98.1	40.7	88.2	61.1	64.0	61.4	81.6	65.2	79.9	4.8
E. Economic Services, of which:	78.1	46.3	62.9	50.2	53.1	51.1	56.8	66.0	59.5	27.4
i. Agriculture and Allied Services	99.9	82.1	96.7	77.8	94.8	78.6	45.8	72.4	46.7	12.3
ii. Industry and Minerals	36.7	9.8	18.1	40.7	44.1	41.9	50.7	47.4	49.7	1.9
iii. Power, Irrigation and Flood Control.	94.7	65.4	73.9	86.2	62.9	69.1	91.2	77.9	83.7	7.2
iv. Transport and Communication	68.3	68.3	68.3	70.4	32.1	47.3	67.6	52.7	60.1	3.8
v Others	24.9	18.0	23.9	16.6	51.3	19.7	66.1	49.2	58.9	2.2
F. Others	80.0	14.7	33.2	57.2	0.0	57.2	85.9	-	85.8	5.1
F. Loans and Advances	0.0	51.7	51.7	0.0	51.1	51.1	-	62.9	62.9	3.1
G. Total@	55.2	43.0	52.1	55.0	44.5	52.9	58.1	53.7	57.4	100.0

* Revised Estimates.

** Includes food and fertilizer subsidies.

@ Excludes appropriation for reduction and avoidance of debt.

Source: Public Finance Statistics, Ministry of Finance, Government of India.

IV Tax and Expenditure Assignments in India : Policy Issues

The analysis of constitutional assignment in India brings out the following features:

(i) Centripetal bias

The delegation of responsibilities between the center and the states shows an inherent “centripetal” bias. The Constitutional assignment closely follows the division of powers made in the Government of India Act, 1935, which was designed to keep a firm administrative control of the country from the center. Thus, like in administrative and political spheres,⁵ the constitutional assignment of economic functions vests the center with powers to impose its will on the States if such an action, in its view, is warranted in the “national interest”. Therefore, commentators have characterized the Indian Constitution as “quasi-federal”.

Centralization in economic power can be clearly seen when we analyze the constitutional assignments. In the Constitution, as already pointed out, the central government enjoys both overwhelming and overriding powers. Assignment of major broad-based taxes to the center (except the sales tax), vesting it with residuary and overriding powers, and the restrictions on the states’ power to borrow are some of the examples of this.

Article 293 of the Constitution does allow the states to borrow from the market. However, it is stipulated that when a state is indebted to the center, it has to seek and obtain center's permission for exercising its borrowing powers. As all the state governments are indebted to the center, states have little leeway in determining their market borrowing. Actually, the Planning Commission in consultation with the Union Finance Ministry and the Reserve Bank of India (RBI), simply determines the total quantum of states' borrowing and allocates the shares of each of the states.

In effect, unless additional central transfers are given, the states’ ability to increase their expenditures depends merely on their capacity and willingness to enhance revenues from the tax and non-tax sources assigned to them. Although in each of the states the overall transactions in a year should match revenues and expenditures, there would be variations in daily and monthly positions. The cash balance position or the “ways and means” position of the States is maintained by the Central Accounts Section of the Reserve Bank of India. The cash balances of the states are invested by the RBI as per states’ instructions and the states can also take overdrafts up to the

⁵The concentration of power in political and administrative spheres has been a subject matter of a number of scholarly works on Indian federation. Article 2 of the constitution, which assigns the center with powers to redefine state boundaries, negates the very concept of federalism. More importantly, there has been considerable discussion on the legitimacy of the use of Article 256 by the center. Large number of instances can be cited where the center has used the powers to dismiss the elected state governments to meet the partisan ends of the political party in power at the center (Guhan, 1993). In fact, the entire constitutional machinery in the country was trampled with and the federal principle in the policy was brought to nought when the then Prime Minister Mrs. Indira Gandhi acquired emergency powers for the central government, merely to keep herself in power in the wake of the Allahabad High Court judgment setting aside her election. Also, the role of all India services and the absence of federal features in the national political parties seem to have contributed to the unitary bias in the Indian political federalism (Chelliah, 1991).

limits stipulated by the RBI, by agreement with the state government. Any borrowing beyond this limit is called an “unauthorized overdraft”. Until 1985, the states could resort to this means rather liberally. To that extent, central control over macroeconomic policy was less effective. Further, when the overdraft position reached very high levels, from time to time, the center simply cleared the overdrafts by converting them into medium term loans. In January, 1985, however, a overdraft regulation scheme was introduced, which stipulated that if the states continue to have the overdrafts with the RBI for more than seven continuous working days, the RBI is not obliged to honor the checks of such states.⁶ This measure has vested the center with more effective control of money supply and borrowing powers (and therefore, macroeconomic management of the economy), and at the same time has introduced harder budget constraints on the states.

The centralization of economic power in India is not merely an outcome of constitutional assignments. The public sector was expected to reach the “commanding heights” of the economy in the planned developmental strategy adopted after independence. The heavy-industry-based, import-substituting industrialization strategy with a dominant public sector necessarily augmented the economic power of the center. Entry 20 in the concurrent list (“Economic and Social Planning”) enabled the center to direct resource allocation, and by virtue of the powers conferred by Entry 52 in the Union list, the Industrial Development and Regulation Act was passed to give control over almost all important industries to the center. The Planning Commission became a pivotal agency in determining resource allocation. While the investment pattern and its regional distribution in the private sector was sought to be influenced through industrial licensing and other policy measures, the public sector allocation was determined by the Planning Commission. Of course, the states were allowed to prepare their plans but this was judged and appraised in terms of the national objectives and norms. In addition, the states’ priorities were also influenced through a multitude of centrally sponsored schemes - shared cost programs which presently number as many as 179.

(ii) Separation of tax powers

The constitutional assignment of tax powers follows the principle of “separation” in contrast to that of “concurrence” followed in federations like the U.S.A. and Canada. The clear demarcation of the tax handles of the central and state governments has been prescribed to avoid tax overlapping and concurrency. However, tax separation in a system where the tax bases overlap can only be done in a *de jure* sense, and *de facto*, as the tax bases of the center and states are interdependent, overlapping could not be avoided. First, the splitting of the power to levy taxes on incomes and capital between the center and the states on the basis of whether they are derived from agricultural or non- agricultural sources has led to distortions, tax evasion and avoidance, besides violating the principle of horizontal equity or equal treatment of equals (Chelliah, 1991). This has not only created some problems of tax enforcement, but also led to adverse economic consequences. Similarly, the constitution assigns the states the power to levy

⁶The States have reacted to this measure by taking resort to short term borrowing from the private sector or from their own enterprises. Thus, there has been an attempt by the states to soften the budget constraint. The West Bengal government, for example, took short term loans from Peerless Insurance Company, a private sector financial firm.

sales taxes but, only on goods and not on services. There is no separate mention of taxation of services in any of the Lists in the constitution and, the center, by virtue of its power over residual items has legislated to levy taxes on selected services even though, for evolving a coordinated tax structure in the country the taxes on goods and services should go together and in terms of comparative advantage, the states are better placed to levy them. Besides, the states can not levy a broad-based and less distortionary value added tax because, they do not have the power to extend the tax on services.

Second, although in a legal sense the central and state levies are separate, they levy taxes on virtually the same base. Consequently, the problem of vertical tax overlapping has continued to plague the Indian tax system. The central government is empowered to levy manufacturing excises. The states levy sales taxes on the excise duty paid value of commodities⁷. In addition, the tax on the entry of goods into a local area for consumption, use or sale or “octroi” (contained in the state list and delegated to the local bodies) also falls on the same tax base. This is a clear example of vertical tax overlapping. Such a levy of tax on tax and margins on taxes in a mark-up pricing situation creates a divergence between the producer and consumer prices much more than the tax element. The extent of distortions caused and the welfare cost of this overlapping tax system remains unknown.

Although in principle, some progress has been made in extending input tax credit in the case of excise duties and concessional tax treatment of inputs in the case of states’ sales taxes, in practice, the scope of these concessions is limited and procedures involved in availing them cumbersome. Thus, input taxation has continued to persist. In the event, tax burden on different commodities and the extent of cascading remains unknown. Thus, existence of parallel and overlapping domestic indirect tax systems and the center-state and inter-state commodity tax competition has resulted in a complicated, distorting and inequitable commodity tax system. As the report of the NIPFP study team stated, “...the system that is operating at present is antiquated, complex - according to the knowledgeable experts, the most complex in the world - and injurious to the economy in many ways. It follows no rational pattern ... and violates all time-honored canons of taxation - certainty, neutrality and equity.” (NIPFP, 1994, p.1).

The Indian experience with separation of tax powers clearly contrasts with the assignments prevailing in a number of federations, where the Constitution itself assigns concurrent powers of taxation of some broad-based taxes. In Australia, the problem arising from such concurrency has been minimized as all major taxes are assigned to the Commonwealth government. This has helped to ensure that the tax system is relatively more harmonious, but at the same time, leads to undue dependence of the states on intergovernmental transfers. In the U.S.A. and Canada, the federal and state (provincial) governments have concurrent powers to levy income taxes, but as many of the states levy the taxes on the base determined by the federal government, the disharmony has been minimized to a great extent. In Canada, the arrangement essentially is one of piggybacking. In the U.S.A., in a majority of the states the tax bases are not

⁷In an economy where the producers are protected from both domestic and foreign competition, mark-up pricing may be an appropriate characterization. Of course, this general characterization may not be applicable to particular industries.

identical to that of the federal government in respect of both individual and corporate income taxes, but the differences are not significant enough to cause major distortions.

As regards domestic consumption taxes, a considerable degree of vertical coordination between the federal and state (provincial) levels has been achieved to make the tax system relatively simpler and more transparent. In the United States, the federal government does not levy any broad-based internal indirect tax and the states have the exclusive right to levy the sales tax. In Canada, both federal and provincial governments can levy consumption taxes.⁸ Thus, while the federal government levies a value added tax (goods and services tax or GST), the provinces levy a retail sales tax (RST). The nature of RST, however, varies among the provinces. The eastern provinces levy RST on the GST- inclusive value of goods sold to consumers. Ontario levies the tax on the value excluding the GST. Alberta does not levy RST at all. Quebec, however, has harmonized its tax fully with the GST and it collects the tax for the Federal government as well. Of course, the GST in Quebec has significant differences with the GST levied by the Federal government in other parts of the country. There is, thus, some degree of vertical overlapping of indirect taxes. In Switzerland, the Constitution allows for a significant degree of tax overlapping between the federal and the cantonal governments, but, historical developments have ensured that the federal government collects most of the indirect taxes and direct taxes are collected mostly at the cantonal level (ACIR, 1981). In Germany too, income taxes, customs and excises and important business taxes including the value added tax are leviable by the federal government, but the elaborate system of legislated sharing of taxes has ensured adequate resource flow to the states while achieving a high degree of vertical harmonization (ACIR, 1981).

Thus, many of the developed federations have, to a large extent, resolved vertical tax overlapping either through tax assignment or tax coordination. Of course, this is not to say that there is a perfect tax harmony between different levels of government in these federations. But surely, the degree of disharmony is nowhere as much as it is seen in India. In India, tax assignments have a large area of concurrency in indirect taxes, mutual understanding and trust between the center and states is inadequate and therefore, attempts at coordination have not been serious enough to minimize distortions in the tax system.⁹

The Indian experience brings out three important lessons. First, tax assignment should not be done merely on legal considerations; economic consequences of such assignments must be taken into account. Second, avoidance of concurrency in a *de jure* sense does not prevent *de*

⁸The Constitution allows the levy of all direct taxes by both Federal and Provincial governments, and the Courts have interpreted retail sales tax to be a direct tax.

⁹Some degree of coordination was achieved in 1956 when the States surrendered the right to levy sales tax on sugar, textiles and tobacco in lieu of which, the Central government agreed to levy additional excise duties on the three groups of commodities, the proceeds of which were to be assigned to the States. However, over the years, the States have been dissatisfied with this arrangement and the recommendations of the Committee extending the arrangement to five more groups of commodities were unanimously rejected by the States (India, 1983). Again, the decision taken in at the National Development Council to levy the sales tax at uniform rates on 29 groups of commodities as a measure to contain tax competition has not been acted upon.

facto overlapping. Finally, while overlapping exists in all federations, often in the assignment of the tax itself, like in the U.S.A. and Canada, the success of the federation lies in how effectively the adverse effects of tax overlapping are resolved through tax coordination and harmonization. Unfortunately, the attempts at tax coordination in India have not been successful enough to minimize distortions in the tax system.

(iii) Internal trade barriers

A major advantage of a federation over a balkanized system is the existence of a unified market not encumbered by any form of impediments to the free movement of and trading in factors of production as well as products. The Constitution recognizes this in Article 301, which reads, "Subject to other provisions of this part, trade, commerce and intercourse throughout the territory of India shall be free". However, article 302 states, "Parliament may by law impose such restrictions on the freedom of trade, commerce or intercourse between one state and another or within any part of the territory of India as may be required in the public interest". What is more, Entry 92A (inserted by Constitutional amendment in 1956) in the Union list allows the center to levy "taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-state trade or commerce". Under this provision, the center has allowed the states to levy taxes on inter-state sale subject to the specified ceiling rate. This has resulted in each state creating a tariff zone by levying a tax on its exports to other states and although there is a ceiling on the inter-state sales tax, the cascading nature of the sales tax system renders the effective tax rates on inter-state sales much higher, varying with the stage of processing of the goods sold in the course of inter-state trade (raw material, intermediate good or finished good).

An equally serious impediment to the free movement of goods is caused by the levy of "octroi", a tax on the entry of goods into a local area for consumption, use or sale, which is permitted under Entry 52 in the State list. Presently, among the major states Gujarat, Haryana, Maharashtra, Orissa and Rajasthan levy octroi. Karnataka and Madhya Pradesh have abolished this levy, but in lieu of it, a similar, but account based, state Entry Tax is levied. Octroi has been variously described as 'obnoxious' 'vexatious' 'wasteful' and 'distorting'(Rao, Pradhan and Bohra, 1985). Some of the important disadvantages of the levy are the production loss arising from hindrance to smooth traffic flow, rampant corruption and harassment to taxpayers, perfunctory assessment of the tax based on trust rather than on actual books of accounts, efficiency loss resulting from the collection of revenue predominantly on inputs and capital goods, multiple taxation of same goods in different urban local bodies and exportation of the cost of urban development to rural areas.

In spite of its known disadvantages, collections from octroi form a predominant proportion of the urban local body revenues in many states. In fact, the standards of urban local services in the states where octroi is not levied have been found to be significantly lower.¹⁰ What is more, the day-to-day collections from the tax help in the liquidity of the local bodies.

¹⁰ The Rural Urban Relationship Committee (1963) estimated the expenditure needs of the urban local bodies. Employing these norms the gaps between desired expenditures and existing revenues of the municipal bodies was estimated. For details, see Rao, Pradhan and Bohra (1985).

Due to the difficulty in finding a suitable alternative, the tax has continued to be levied in spite of its shortcomings.

Both inter-state sales tax and octroi (and other similar forms of taxes) violate the principle of free internal trade and a unified common market. In fact, these taxes have tended to create several tariff zones within the country, causing distortions in resource allocation, and perverse transfer of resources from poorer to richer regions, which cannot be easily quantified (Rao, 1993).

(iv) Free-riding and inter-state tax exportation

As already mentioned, a desirable principle of tax assignment is to entrust relatively less mobile tax bases to States and local governments so that they do not indulge in 'free-riding' by exporting the tax burden to non-residents and thereby distort the tax system. The motivation behind the constitutional amendment to allow taxation of inter-state trade was to provide a safeguard against the evasion of sales tax by camouflaging local sales as inter-state sales. The Taxation Enquiry Committee (India, 1953), therefore, recommended an inter-state sales tax at a low rate of one per cent. However, this was used as a revenue raising measure to finance developmental plans and over the years the rate was increased to four per cent.¹¹ The tax is collected by the exporting state and although the rate cannot exceed four per cent, the actual rate of tax exportation can be much higher, for, the cascading taxes on inputs and capital goods also too may be shifted forward to the consumers. This has distorted relative prices, created impediments to the free movement of goods across the nation and caused inequitable resource transfers from poorer consuming States to the richer producing States (Rao and Vaillancourt, 1994).

(v) Incentives and tax sharing

It is important that the assignment of tax powers should not adversely affect the incentives of both the center and the states. However, the prevailing system of assignments and tax sharing arrangements is alleged to have serious disincentives for the central government in raising revenues and this has led to distorted development of the tax structure in the country. In particular, it has been suggested that devolving significant shares of non corporate income tax and union excise duty to the states has led to lack of incentive for the center to raise revenue from these sources and to concentrate on import duty to raise revenues resulting in the distorted tax structure (Burgess, Howes and Stern, 1993, Joshi and Little, 1996). The tenth Finance Commission, therefore has suggested an alternative scheme of tax devolution - of pooling revenue from all central taxes and distributing a fixed percentage of these tax to the states. The states' shares will remain constant for 15 years. The proposal has been accepted by the center as well as by the inter-state council. The Finance Minister in his budget speech (1998-99) stated that the center would refer the issue of the quantum of sharing as well as its inter-state distribution every five years to the Finance Commissions and the bill to initiate a constitutional amendment is likely to be placed before the Parliament shortly.

¹¹ The CST is levied at 4 per cent or at the tax rate prevailing in the exporting State whichever is lower, when the inter-State sale is made to a registered dealer. If the goods are sold to an unregistered dealer, the lower of 10 per cent or the local sales tax rate in the importing State will apply.

V Conclusion: Summarizing Major Issues in Fiscal Assignment in India

The analysis of the constitutional assignment of expenditures and revenues across different levels of government in India brings out the following conclusions:

(i) The Constitution exhibits a clear centripetal bias in the distribution of fiscal powers. In addition to the expenditure functions assigned, the center can also influence the expenditure decisions of the states. The assignment of most of the broad-based taxes and residuary tax powers to the center, its overriding powers in regard to the functions in the concurrent list and domination through economic planning and control over virtually the entire financial sector are only some instances of the center's dominance in the economic sphere.

(ii) The assignment of tax powers follows the principle of 'separation' in contrast to that of 'concurrence' followed in federations like the U.S.A. and Canada. This however, could not avoid *de facto* overlapping. The clear demarcation of tax powers in the legal sense has not prevented concurrency in economic sense. This has prevented the center from levying income tax on a comprehensive base, hindered the development of neutral and broad-based sales taxation and has given rise to overlapping consumption tax systems at central, state and local levels which is distorting and iniquitous.

(iii) The Constitution allows levy of some taxes which can create severe impediments to inter-state trade. The levy of tax on inter-state sale of goods by the exporting state (subject to a ceiling rate of 4 per cent) besides creating resource distortions, has caused perverse transfer of resources from the poorer consuming states to the more affluent producing states. Similarly, the states can levy a tax on the entry of goods into a local area for consumption, use or sale (octroi). This has created impediments to the free movement of goods and also erected a number of tariff zones coinciding with the localities in the country (Rao, 1993). The tax on inter-state sale of goods has not only posed impediments to the movement of goods across the country, but also has been a serious source of inefficiency and inequity. Enabling the states to export the tax burden has led to widespread "free-riding, and as the ability to free-ride depends on the level of development of the state, this has caused inequitable resource transfers.

(iv) The assignment of tax powers has also been a source of disincentives to the central government. It is suggested that devolution of a very high proportion of income tax and excise duty is alleged to have robbed the central government of the incentive to collect revenues from these sources and concentrate on non sharable taxes like the customs duty, causing distortions in the tax structure. However, the recent initiative of giving the states a fixed share (29 per cent) of the total tax revenue would remedy the situation to a large extent.

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Appendix Table A1

TAXATION HEADS ASSIGNED TO THE UNION AND THE STATES IN THE CONSTITUTION (AS LISTED IN THE SEVENTH SCHEDULE OF THE CONSTITUTION)			
Union		States	
Entry in List I of the Seventh Schedule	Head	Entry in List II of the Seventh Schedule	Head
82	Taxes on income other than agricultural income	45	Land revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes.
83	Duties of customs including export duties	46	Taxes on agricultural income
84	Duties of excise on tobacco and other goods manufactured or produced in India except- a. alcoholic liquors for human consumption; b. opium, Indian hemp and other narcotic drugs and narcotics; but including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.	47	Duties in respect of succession of agricultural land
85	Corporation tax	48	Estate duty in respect of agricultural land
86	Taxes on the capital value of the assets, exclusive of agricultural land of individuals and companies; taxes on the capital of companies	49	Taxes on lands and buildings
87	Estate duty in respect of property other than agricultural land.	50	Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development
88	Duties in respect of succession to property other than agricultural land	51	Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India: a. alcohol liquors for human consumption; b. opium, Indian hemp and other narcotic drugs and narcotics; but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.
89	Terminal taxes on goods or passengers carried by railway, sea or air: taxes on railway fares and freights.	52	Taxes on the entry of goods into a local area for consumption, use or sale therein.

Appendix Table A1 (Contd)

90	Taxes other than stamp duties on transactions in stock exchanges and future markets	53	Taxes on the consumption or sale of electricity
91	Rates of stamp duty in respect of bills of exchange cheques promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.	@54	Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I.
92	Taxes on the sale or purchase of newspapers and on advertisements published therein.	55	Taxes on advertisements other than advertisements published in the newspaper @@ and advertisements broadcast by radio or television.
*92A	Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce.	56	Taxes on goods and passengers carried by road or on inland waterways.
**92B	Taxes on the consignment of goods (whether the consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-State trade or commerce.	57	Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads including tramcars, subject to the provision of entry 35 of List III.
97	Any other matter not enumerated in List II or List III including any tax not mentioned in either or both the Lists.	58	Taxes on animals and boats
		59	Tolls
		60	Taxes on professions, trades, callings and employments
		61	Capitation taxes
		62	Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.
		63	Rates of stamp duty in respect of documents other than those specified in the provision of List I with regard to rates of stamp duty.

* Ins. by the Constitution (Sixth Amendment) Act, 1956 s.2

** Ins. by the Constitution (Forty-sixth Amendment) Act, 1982, s.5

@ Sub. by the Constitution (sixth Amendment) Act 1956, s.2 for entry 54

@@ Ins. by the Constitution (Forth-second Amendment) Act, 1975, s.57 (w.e.f. 31.1.1977)

-----Extracts from the *Report of the Commission on Center-State Relations* (Justice R.S. Sarkaria), 1987.

Appendix Table A2

ILLUSTRATIVE LIST OF DEVELOPMENTAL SUBJECTS (OTHER THAN FINANCIAL SUBJECTS) INCLUDED IN UNION, STATE, AND CONCURRENT LISTS IN THE SEVENTH SCHEDULE OF THE CONSTITUTION		
(A) Union List		
S. No.	Entry No.	Subject
1	6	Atomic energy and mineral resources necessary for its production
2	22	Railways
3.	23	Highways declared by or under law made by Parliament to be national highways
4.	24	Shipping and navigation on inland waterways, declared by Parliament by law to be national waterways, as regards mechanically propelled vessels the rule of the road on such waterways.
5.	25	Maritime shipping and navigation including shipping and navigation on tidal waters provision of education and training for the mercantile marine and regulation of such education and training provided by States and other agencies.
6.	26	Lighthouses, lightships, beacons and other provision for the safety of shipping and aircraft.
7.	27	Ports declared by or under law made by Parliament or existing law to be major ports, including their delimitation and the constitution and powers of port authorities therein.
8.	28	Port quarantine, including hospitals connected therewith seamen's and marine hospitals.
9.	29	Airways aircraft and air-navigation provision of aerodromes; regulation and organisation of air traffic and of aerodromes; provision for aeronautical education and training and regulation of such education and training provided by States and other agencies.
10.	30	Carriage of passengers and goods by railways, sea or air, or by national waterways in mechanically propelled vessels.
11.	31	Posts and telegraph: telephones, wireless, broadcasting and other form of communications.
12.	41	Trade and commerce with foreign countries; import and export across customs frontiers; definition of customs frontiers.
13.	42	Inter-State trade and commerce.
14.	52	Industries, the control of which by the Union is declared by parliament by law to be expedient in the public interest.
15.	53	Regulation and development of oilfields and mineral oil resources; petroleum and petroleum products; other liquids and substances declared by Parliament by law to be dangerously inflammable.
16.	54	Regulation of mines and mineral development to the extent which such regulation and development under the control of the Union is declared by Parliament by law to be expedient in the public interest.
17.	56	Regulation and development of inter-State rivers and river valleys to the extent to which such regulation and development under the control of the Union is declared by Parliament by law to be expedient in the public interest.
18.	57	Fishing and fisheries beyond territorial waters.
19.	65	Union agenda and institutions for - a. professional, vocational or technical training including the training of police officers; or b. the promotion of special studies or research; or c. scientific or technical assistance in the investigation or detection of crime.
20.	66	Coordination and determination of standards in institutions for higher education or research and scientific and technical institutions.
21.	68	Survey of India, the geological, botanical, zoological and anthropological surveys of India, meteorological organizations.

B. State List		
1	5	Local government, that is to say, the constitution and powers of municipal corporations, improvements trusts, district boards, mining settlement authorities and other local authorities for the purpose of local self-government or village administration.
2	6	Public health and sanitation; hospitals and dispensaries
3.	9	Relief of the disabled and unemployable.
4.	13	Communications, that is to say, roads, bridges, ferries, and other means of communication not specified in List I: municipal tramways; ropeways; inland waterways and traffic thereon subject to the provisions of List I and List II with regard to such waterways; vehicles other than mechanically propelled vehicles.
5.	14	Agriculture, including agricultural education and research, protection against pests and prevention of plant diseases.
6.	15	Preservation, protection and improvement of stock and prevention of animal diseases; veterinary training and practice.
7.	17	Water, that is to say, water supplies, irrigation and canals, drainage, embankments, water storage and water power subject to the provisions of entry 56 of List I.
8.	18	Land, that is to say, rights in or over land, land tenures including the relations of landlord and tenant, and the collection of rents; transfer and alienation of agricultural land; land improvement and agricultural loans; colonization.
9.	21	Fisheries
10.	23	Regulation of mines and mineral development subject to the provisions of List I with respect to regulation and development under the control of the Union.
11.	24	Industries subject to the provisions of entries 7 and 52 of List I.
12.	25	Gas and gas-works
13.	26	Trade and commerce within the State subjects to the provisions of entry 33 of List III.
14.	27	Production, supply and distribution of goods subject to the provisions of entry 33 of List III.
15.	32	Cooperative societies
16.	35	Works, lands and buildings vested in or in the possession of the State.

(C) Concurrent List		
1	17A	Forests
2.	20	Economic and social planning
3.	20A	Population control and family planning
4.	23	Social security and social insurance; employment and unemployment
5.	25	Education, including technical education, medical education and universities, subject to the provisions of entries 63, 64, 65 and 66 of List I; vocational and technical training of labor.
6.	27	Relief and rehabilitation of persons displaced from their original place of residence by reasons of the setting up of the Dominions of India and Pakistan.
7.	31	Ports other than those declared by or under law made by Parliament or existing law to be major ports.
8.	32	Shipping and navigation and inland waterways as regards mechanically propelled vessels, and the rule of the road on such waterways, and the carriage of passengers and goods on inland waterways subject to the provisions of List I with regard to national waterways.
9.	33	Trade and commerce in, and the production supply and distribution of - a. the products of any industry where the control of such industry by the Union is declared by Parliament by law to be expedient in the public interest and imported goods on inland waterways subject to the provisions of List I with regard to national waterways. b. foodstuffs, including edible oilseeds and oils; c. cattle fodder, including oilseeds and other concentrates; d. raw cotton, where ginned or unginned and cotton seed; and e. raw jute.
10.	36	Factories
11.	37	Boilers
12.	38	Electricity

Extracts from the Report of the Commission on Center-State Relations (Ch. Justice R.S. Sarkaria), 1987.