ISSUES BEFORE THE ELEVENTH FINANCE COMMISSION

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Introduction

In their tasks to fulfil their constitutional obligations, the Eleventh Finance Commission have to face and solve two broad group of issues. The first relates to the basic principles that ought to govern the devolution of Central tax revenues, the inter-se distribution of the amounts devolved, and the principles of grants- in- aid, and the second relates to the rather precarious conditions of the finances of the government sector as a whole and those of the Centre and most of the States taken individually.

The basic functions of the Finance Commission as envisaged in Article 280 of the Constitution are to make recommendations to the President regarding sharing of taxes and the principles of grants-in-aid. The President at his discretion may also refer for the Commission's recommendation any other matter in the interests of sound finance. Under this clause, inter alia, the President has asked the Eleventh Finance Commission "to review the state of the finances of the Union and the States and suggest ways and means by which the governments, collectively and severally, may bring about a restructuring of the public finances so as to restore budgetary balance and maintain macro economic stability". This term of reference clearly indicates that the Commission's recommendations on the manner of sharing the revenue resources between the Centre and the States should be consistent with the measures needed to restructure the public finances so as to restore fiscal balance.

The Eleventh Finance Commission has thus been entrusted with a major responsibility: as a neutral body it has been asked to enlist the co-operation of the Centre and the States and to suggest co-ordinated action by both the levels of government to put the country's public finances in order.

However, whatever suggestions the Commission might make for co-ordinated corrective action by the governments will have no long-term beneficial effect unless the Commission's recommendations on the sharing of revenue resources are themselves based on sound principles of federal finance. One is constrained to point out that while much valuable work has been performed by the earlier Finance Commissions, the successive Commissions have not succeeded in evolving over the years consistent principles of ordering inter-governmental fiscal relations on which the Commission's recommendation could be based. It is true that each set of recommendations resulted in a formal or constrained balance of revenues and expenditure on "non-Plan" revenue account (or some surplus in some cases), but this balance was arrived at in different ways by the several Commissions and did not represent an optimum outcome of the application of certain basic principles.

Importance of the Basic Approach

It is now well-accepted in the theory of federal finance that the inter-governmental fiscal relations should be constructed on the basis of the principles of adequacy, inter-state equity, autonomy, fiscal discipline and economic efficiency. Of these, "economic efficiency" is particularly important in determining tax assignment to the two levels of government. As this is laid down in the Constitution and any change would require a Constitutional amendment, we may not consider it here. All the other principles are vitally important and a balance has to be struck among them so as to enable the two levels of government to fulfil their functions effectively, while at the same time ensuring the essential conditions of autonomy without undermining fiscal discipline.

The traditional approach of the Finance Commissions has been to make "reasonable" forecasts of the growth of non-Plan revenue expenditure and revenues over a five-year period covered by the Commission's recommendations and to tailor its recommendations on tax devolution and grants-in-aid under Article 275 to bring about a condition of balance or some surplus on non-Plan revenue account of the various State Governments. Some adjustments are made to the "moderated" forecasts of revenue and expenditure, but the basic fact to be noted is that the actuals of a "designated" base year are taken as the basis for the forecasts. Thus, effectively, the forecasts worked out by the previous Finance Commission are thrown into the dustbin of history. Only whatever the States (and the Centre) have done in terms of commitments, growth in expenditure, tax concessions and tax administration count. The fait accomplis will form the basis of the forecasts of any given Commission. Thus the forecasts count only so far as the recommendations on transfers during the next five years are concerned. Once the pattern and quantum of transfers are determined, a State can make additional commitments and let its revenue expenditure grow faster than forecast by running a (larger) revenue deficit. It can safely hope that the actuals reached at the end of the five-year period will be chosen as the base by the next Commission. This procedure obviously puts a premium on improvidence. Under this system no norm of equity can be effectively applied. To preserve fiscal discipline and to avoid being unjust to the States which tend to be more self-reliant and/or prudent, it is best to construct a system of transfers, which while satisfying other criteria, would tend to be neutral in the sense that the system should not induce a State either to spend more or less or to raise more or less resources. The freedom to spend and raise resources according to a State's own discretion is the essence of autonomy.

The Finance Commission would need a standard to judge capacity and needs. Generally speaking, the average can be taken as the standard. In specific cases, a norm arrived at on the basis of consensus could be taken as a standard. A State would be free to deviate from the norm, say spend more or less without attracting the censure of less transfers. However, it will have to bear the price of its autonomy.

It would be fair to say that such considerations have not been part of the deliberations of the Indian Finance Commissions[1].

[1] The Ninth Commission did make some attempt to move towards neutrality and away from "gap filling" but its exercise has proved to be a bubble.

As stated earlier, the principle of adequacy is one important criterion. The Finance Commission should of course ensure to the best of its judgement that States would have adequate resources to fulfil their responsibilities, subject to the overall constraint of resources. But the manner of transfer of resources should not be such as to undermine fiscal discipline. Also the needs of the Central Government should be kept in view as much as the needs of the States.

Trends in Inter-Governmental Transfers

It is often stated that the States are starved of resources or have too little as compared to the Centre and have narrow tax bases. Neither of the statements is strictly speaking true. Nor has transfers of more resources over the last 20 years improved the finances of the States. Central loans to the States are not to be included in transfers. They are made available from market borrowing; the Centre acts more as a conduit.

While the Centre collects 64.4 per cent of the aggregate tax revenues of the Centre and the States, it retains for its own use only 47.5 per cent of the total, while 52.5 per cent of the aggregate tax revenues accrue to the States after devolution (Tables 3 and 4). Similarly, 60.38 per cent of the total tax and non-tax revenues accrue to the States after devolution of taxes and transfers, while the Centre has for its use only 39.62 per cent of the total (Tables 3, 4 and 5). As against this, the share of the States in the aggregate revenue expenditure has been hovering around 57 per cent over the years (Table 1). Prime facie the share of revenue resources accruing to the States cannot be termed inadequate; the degree of expenditure decentralisation, also, seems substantial[2].

As of 1980 - 81, the total revenues (tax and non-tax) of the Centre and States formed 17.5 per cent of the GDP, of which 11.1 per cent of GDP accrued to the States; in 1997-98, the total revenues rose to 20 per cent of GDP, of which 12.1 per cent of GDP accrued to the States. As for tax revenues, the total tax revenues of the Centre and the

[2] The ratio of the State's aggregate expenditure to GDP is 15 per cent as against that of the Centre at 11.0 per cent (Table 2).

States rose from 14.59 per cent of GDP to 16.89 per cent during the same period, while the share of the States (on accrual) rose from 7.69 per cent of GDP to 8.84 per cent (Table 6). Thus the shares of tax and total revenues accruing the States as per cent of GDP have increased over time and GDP itself has been increasing in real terms, at about 5.5 per cent over these years. Yet the finances of most State Governments are in a very unsatisfactory condition.

Thus we can conclude that the States have at their disposal by far the major part (more than 60 per cent) of the total (combined) revenue resources of the Centre and the States and that their revenue accruals have increased in real terms steadily since at least 1980-81. As much as 12 per cent of GDP now accrues to them. Yet their finances are in a sorry state. The revenue deficit of the States has persisted since the late 1980's growing steadily as per cent of GDP since 1993 – 94; and because of this, they are using a not inconsiderable part of their borrowing to finance revenue expenditure. The Plan loans they have received from the Centre cannot be repaid out of current or revenue surplus, and so past loans are being paid out of the current borrowing from the Centre with a consequent reduction in Plan investment. It may also be noted that the States' revenues have increased in the manner indicated in spite of the fact that, during the same years, most State Governments have virtually abolished land revenue, have granted a large number of sales tax exemptions and the so-called industrial incentives in competition with one another and engaged in rate competition which has been shown to be mutually harmful and revenue-destructive. Thus it is clear that merely making available more and more resources for filling gaps will not solve the financial problems of the States (or of the Centre either).

Since the President has asked the Eleventh Commission to review the state of the finances of the Central and State Governments and to suggest ways by which the Governments, collectively and severally, can restore fiscal balance so as to ensure macro-economic stability, the Commission needs to consider, inter alia, whether the relative neglect of the principle of fiscal discipline - that is, the Government which wishes to spend more (than the average) should as a rule correspondingly raise more resources - has not contributed to the lack of fiscal restraint and if the Commission should not try to bring about the needed changes in the basic principles underlying the scheme of current transfers. The Eleventh Commission, simultaneously with their suggestions to the Centre and the State Governments on measures to restore fiscal balance, can also make a beginning with an approach that divorces the recommendations on transfers from the actual expenditures and revenues incurred and raised at the discretion of a State Government.

I have argued earlier that the practice of taking the actuals of a designated 'beginning' year for forecasts is wrong since it would make the Centre (i.e. the whole country) pay for unilateral commitments made by any one State. This is inequitable as well since it tends to be a disincentive for fiscal discipline and trends to penalise State Governments which follow more prudent policies. (The Centre's fiscal indiscipline has also to be curbed; the Finance Commission may make suggestions in this regard.) The flaw in the line of approach which says that the Centre shall necessarily come forward to enable the States to meet the consequences of all commitments already made can be well illustrated by taking the case of revision of emoluments of Government servants. It is argued by the unions of State Government employees that they should be paid emoluments on the same scale as the employees of the Union Government in different grades.

Let us accept this argument for a moment[3]. Even then, it would be wrong to ask the Centre to meet the additional liabilities to the State Governments arising out of the pay revision, because each State Government has made its own decision regarding the number of employees it would have in different grades including in several cases the

[3] This argument cannot in fact hold good in a federation. Uniformity of pay scales in the Federal and State/ Provincial Governments does not exist in any of the true federations like USA or Canada. The pay scales in the State of Alabama is not the same as in the US Federal Government. Similarly, Quebec has its own structure of Government and pay scales and they are dissimilar to those prevailing in the Federal Government at Ottawa. Federalism implies autonomy and differences. One cannot have someone else pick up the bill and yet have the autonomy to detriment the scales of services and the quantum of employment.

numbers of employees in its public enterprises who would be given the benefit of pay revision to the same extent. It is only fair that if the Centre (that is the whole country) should pay the bill, it should also have a voice in determining the number of employees. But giving the Centre such a voice would be destructive of the principle of federalism.

On the other hand, if the Centre is simply to pay the bills, then each State Government would be induced - and even pressurized by vested interests - to spend more than it would have done if it had to meet the whole or most of the additional cost.

This example brings out clearly the consequences of one level of government determining the level of expenditures (through the determination of the standard and extent of services as well as the scale of emoluments) and another level of government underwriting any resultant deficits. The recipient government or governments will tend to spend more than if the total cost of the expenditure has to be met through its own resources i.e., by taxing its own citizens/residents. The government sector as a whole will end up spending more than what the citizen benefiting from the various services would have wished if they had been told of the costs they would have to bear. Thus in a fiscal federal system it is extremely important that each government must be made to bear the cost of its expenditure decisions at least at the margin, given a system of transfers not related to the actual expenditures (or forecasts based on actual expenditures). All the above prepositions will hold good also in respect of a system in which the central government is partially dependent on transfers from the constituent governments in a federation.

Implications of Conditionalities

In an attempt to ensure that the Finance Commission would not have to take into account, so to speak automatically, the revenue deficit that would emerge on the basis of a simple projection of the revenues and non-Plan and Plan revenue expenditures in the initial year, i.e. 2000 - 01, the President has stipulated in Clause 5 of the terms of reference, that the commission "shall have regard" to a number of considerations mentioned in the sub-Clauses of Clause 5. Taken together, they constitute norms, restraints, incentives and certain overall objectives that must be applied by the Commission in assessing the revenue requirements of the States over the five-year period. The most important of these are:

a. potential for raising additional taxes must be taken into account apart from the target for additional resource mobilisation for the Plan;
b. the need for generating surplus for capital investment and reducing fiscal deficit must be kept in view in assessing the requirement for meeting the Plan and non-Plan revenue expenditure;
c. in regard to maintenance of capital assets, the norms will be specified on the basis of which specific amounts of transfers are to be recommended and also the manner of monitoring the expenditure will be indicated;
d. the Commission shall have regard to the need for ensuring reasonable rates of return on investments by the States in all their public enterprises including irrigation and power projects and State road transport undertakings;
e. the Commission shall have regard to the provision for emoluments and terminal benefits as on a specified date, to be determined by the Commission, for Government servants and employees of aided Institutions, with reference to objective criteria and not on the basis of actual increases granted by the States;
f. in considering all these, the scope for better fiscal management, "consistent with" efficiency and economy in expenditure, and incentives to be provided for better realisation of tax and non-tax revenues should be taken into account.

In a true federation, the grant giving Government and the transfer recommending authority will not include conditions that will interfere with the autonomy of the States to determine their own levels of expenditures and revenues subject perhaps to a limit on the fiscal deficits (less important conditional grants will be an exception because they will induce spending in particular directions). But then in such a federation the Federal Government would not underwrite revenue deficits. In the Indian case, since the States in general expect the Centre to provide them the resources to cover the revenue deficits, the Centre is imposing conditions which might ensure that the deficits would be kept moderate and that each State would try to raise the maximum possible resources, ensure economy of expenditure and would sanction only emoluments that could be considered appropriate on the basis of “objective criteria”[4].

It is clear that if these conditions are made really effective, the States would be managing their finances according to criteria laid down by the Centre to the extent that they are applied by the Finance Commission. The States should fix salaries of their servants at levels deemed proper with reference to appropriate objective criteria; the States which achieve "better realisation of tax and non-tax revenues would be rewarded; similarly in determining the levels of assistance the scope for better management “consistent with efficiency and economy in expenditure" would be taken into account, and what are economy and efficiency in expenditure will be determined not by the States, but by some one else; and so on. All these would surely limit the autonomy of the States. This kind of objection does not apply to conditions b, c and d as they relate to the determination of relative fiscal capacity (condition d) or general fiscal norms (condition b and c). The States have themselves invited such thorough - going intervention by not imposing fiscal discipline on themselves and expecting, and even demanding that the Centre should increase transfers quinquennially to enable them to cover their revenue deficits.

As a nation, we shall move away from true fiscal federalism, with loss in state fiscal autonomy. That happens if these conditions could be effectively imposed. The States are aware that at the end of five years only the results of their own decisions on tax effort or lack of it, economy or extravagance in expenditure, efficiency or

[4] In my view, it is virtually impossible to evolve such objective criteria since all human attributes and actions are measured in relative terms. This sort of difficulty applies to most of the conditions laid down in the terms of reference. Of course, the Commission can evolve relative standards, for example, in particular services and in staff ratios; but these will not ultimately be effective unless actual figures, as different from standards derived from averages of actuals, are given up.

inefficiency of expenditure will be taken into account since the actuals of a designated year will be taken as the base for the exercise by the next Finance Commission. So to the extent they can, they will follow their own preferences and run revenue deficits in the intervening years utilising part of the permitted fiscal deficit for covering such deficits. Thus applying these conditionalities merely to the determination of the quantum of transfers for a five-year period, without adopting normative figures for the base year does not make much difference in the long run.

In the end, we get neither true federalism nor fiscal discipline. As shown earlier, the revenue resources at the disposal of the States have grown over the years absolutely and at least at the same real rate as GDP. Yet revenue deficits continue and there are not enough resources for expenditure on the social sectors or for capital formation in infrastructure sectors.

A New Approach

The Eleventh Finance Commission should consider suggesting to the President a new approach to determining transfers to the States.

Three basic rules should underlie the new approach. First, the relative proportion of devolution of taxes to total transfers from the Finance Commission should not be increased. Grants-in-aid could be more finely tuned to fulfil equity goals and to equalise fiscal capacity. While devolution can be used to deal with mainly vertical fiscal imbalance, grants can be more effectively used to deal with horizontal imbalances.

Second, whether or not the Constitutional amendment is passed to enable the sharing of all Central tax revenues, the relative level of devolution should be stabilised around the level recommended by the Tenth Finance Commission minus the share of additional excise duties which should be kept separate in the proposed amendment. As the non-tax revenues of the Centre grow through better recovery charges and higher dividends from better run public enterprises, grants-in-aid could be relatively increased, if need be.

Third, the grants-in-aid should not be related to or tailored to cover the deficits forecast on the basis of projections of the actuals of a base year. Strictly speaking, grants, apart from being given for upgradation of specific services on a strictly conditional basis, should be aimed at only equalising relative fiscal capacity and/or to offset cost disadvantages (e.g. Canada, Australia).

The new system should consist of the following elements:

a. Since the distinction between Plan and non-Plan expenditure is to be done away with, all revenue expenditure should come under the purview of the Finance Commission and consequently all Central transfers on revenue account (except for a limited number of Centrally sponsored schemes) should be through the Finance Commission. (Grants in respect of natural calamities would be governed by some rules, but will be separate.)
b. In order to impart the necessary degree of certainty to Central and State finances, and to induce an attitude of self-reliance as well as to enhance autonomy, the proportion of devolution to Central gross tax revenues should remain constant. Either this proportion can be fixed constitutionally or the Finance Commissions can make their recommendations on devolution to achieve this result. This proportion can be changed only with the consent of the Centre and of the majority of the States.
c. The proportion of Central grants (other than grants in respect of natural calamities) to gross Central tax revenues minus devolution plus Central non-tax revenues should also remain constant. The bulk of the grants should be distributed for making up deficiency in relative fiscal capacity of the States. A small part of the grants may be in the nature of conditional grants for upgradation of specified services.

d. Given these transfers on well defined lines and independent of the actions of the States, each state will have full autonomy to run its finances according to its best judgement. Then States can raise more revenues without losing out on transfers and they will not be rewarded if they run larger revenue deficits.
e. For purpose of recommending transfers, it will be assumed by each Finance Commission coming after the Eleventh Commission that the Central Government will not allow its revenues to fall as a ratio to GDP. Thus if the States raise the ratio of their revenues to GDP, the revenues at their disposal including Central transfers will rise as a proportion of GDP.
f. The Finance Commission should impress upon the Central Government the need not only to respect the agreements entered into with the Reserve Bank of India regarding Ways and Means advances and overdraft, but also to control its overall fiscal deficit.

Re-structuring Central and State Finances:

Having suggested the new approach to ordering the system of Central transfers, and to Centre – State financial relations, the Eleventh Finance Commission should turn to the important task of suggesting ways and means by which the Governments, collectively and severally, can restructure the public finances so as to restore budgetary balance (as required by the Fourth Term of Reference). The results of this exercise will provide a picture of Central and State Finances, against the background of which, the Commission's own recommendations on Central transfers could be formulated.

The restructuring would be spread over a medium term of 5 years, beginning with the fiscal year 2000 – 01. The programme would consist of the following components:

a. The fiscal deficit of the Central Government should be reduced gradually from about 6.0 per cent of GDP in 1999 – 2000 to 4.0 per cent in the terminal year.

b. The fiscal deficit of the States (excluding net borrowing from the Centre) should be reduced from about 1.5 per cent of GDP to 1.0 per cent by the terminal year.
c. Thus the combined fiscal deficit of the Centre and the States would be reduced from 7.5 per cent of GDP in 1999 – 2000 to 5.0 per cent by the terminal year.
d. However, the ratio of the combined expenditure of the Centre and the States to GDP would be kept constant at about 27.0 per cent of GDP (Table 2). While the level of total expenditure as per cent of GDP will be kept constant, its composition will be changed and the growth of revenue expenditure should be restricted so that the revenue deficit would be eliminated or made marginal by the terminal year.
e. Since the ratio of public expenditure to GDP will remain constant, the reduction in fiscal deficit will be brought about through an increase in the ratio of Central and State Government revenues to GDP. For this purpose, the Commission may suggest that the Central Government should raise its gross tax ratio by 1.5 percentage points of GDP from the level prevailing in 1999 – 2000 and the ratio of Central non-tax revenues by 0.5 percentage point of GDP. Similarly, the Commission may suggest that the State Governments should raise the ratio of their own revenues to GDP by 0.5 percentage point. Then the combined revenue ratio will rise by 2.5 percentage points by 2000 – 2005. Consequently, the combined fiscal deficit will be brought down to 5.0 per cent of GDP, of which the revenue deficit will form only a negligible part.

These suggestions should be placed before a Conference of the Chief Ministers of the States and a consensus should be arrived at on the respective responsibilities of the Centre and the various States.

It would be desirable to change the composition of public expenditure in favour of such sectors as education, health, roads, agriculture and poverty alleviation by reducing the proportions of public expenditure on general administration, unwarranted subsidies and interest payments. These are suggestions, which may be left to be carried out with modifications, as they wish, by the Central and State Governments. However, in making the projections of tax and non-tax revenues, the Commission would have to keep the objectives of raising the ratios of tax and non-tax revenues to GDP, not raising the total expenditure ratio and phasing out the revenue deficit spelt out above. Of course, for making these projections, the Commission will have to choose a base year. But having chosen the base year, the projection of revenues and expenditures, will be strictly in accordance with the criteria of restructuring. While revenue projections will be geared to the objective of raising the revenue ratio as stipulated, expenditure projections will assume a constant total expenditure ratio and a falling revenue expenditure ratio.

Projections will be made according to the above mentioned criteria of revenues and expenditures of both the Centre and the States. In order to arrive at absolute numbers, in base year prices, the Commission would have to assume a real rate of growth of GDP, say, of 5.5 – 6.0 per cent as it thinks best.

If it so wishes, the Commission may indicate in broad terms, the manner of raising the revenue ratio, indicating which taxes could be raised to what extent and the scope for raising specified items of non-tax revenue. Similarly, the Commission may recommend desirable changes in the composition of expenditure. These would only be suggestions and the Governments may be left free to adopt whatever ways they think best for achieving the objectives of raising revenue and re-structuring expenditure.

The Commission's own recommendations on transfers should be formulated on the premise that the finances of the Centre and the States would be restructured along the broad lines indicated by the Commission.

It might be objected by some that the Finance Commission cannot pre-empt the constitutional authority of the governments to determine the levels of their revenues and expenditures. Laying down prescriptions in terms of raising revenue ratios, keeping constant the total expenditure ratio and phasing out the revenue deficit implies as much imposition as the conditions laid down in Clause 5. It may be pointed out in justification of my suggestions in restructuring public finances that in Clause 4 of the terms of reference the President has specifically requested the Commission to make such suggestions for restoring fiscal balance. Furthermore, the suggestions would be operative, to begin with, only as assumptions on the basis of which the Commission will make its own recommendations on transfers. The States and the Centre would be free not to raise the revenue ratio according to the suggestions of the Commission, but a Government which does not do so would have to reduce its expenditure ratio, because the transfers suggested by the commission would be based on the assumption of increase in the tax ratio.

Conclusion:

The Commission may suggest to the President that once the public finances are restructured along the lines suggested, the future Finance Commissions may be requested to adopt the new approach suggested by this Commission. Once such an approach is adopted, each State Government would have the autonomy to manage its finances as it considers best and would not lose if it raises more resources or is more prudent in its expenditure policies. At the same time, it must be emphasised that the fiscal deficit of the Centre will have to be kept under control as will be suggested by the Finance Commissions in the future, if the new approach is to succeed.

The entire exercise of ensuring fiscal discipline and maintaining fiscal balance will fail, if fiscal discipline is sought to be imposed on the States alone. The States have been constantly complaining that while they are expected to observe fiscal discipline, the Centre is under no such obligation. Of course, from the point of the welfare of the people, one government will not be justified in indulging in fiscal imprudence just because another government in a federation is doing so. But the States do have a strong point in objecting to the lack of fiscal restraint on the part of the Centre: Through a large and increasing fiscal deficit, the Centre pre-empts real resources and increases the rate of inflation or raises the rates of interest. The States are then left with less scope for taxation, the purchasing power of their receipts is reduced and they may have to pay higher interest rates on their borrowings. The Commission should therefore recommend to the President that the Central Government should take the lead to bring about co-ordinated control and management of the fiscal deficit of the Centre and the States.

In this paper, I have suggested a new approach which will preserve full autonomy for the States in their fiscal policies subject to Constitutional limitations and to the scope for some conditional grants. At the same time, the share of the revenue resources going to the States will not in any case be reduced. A modified approach is to allow the Centre to impose some conditions or provide incentives "in the national interest" such as incentives for tax effort or laying down standards of economy in expenditure. If there is a consensus on such beneficent intervention, the related incentives can certainly be incorporated in the new approach.

It would be desirable if the Eleventh Commission could convene a meeting of the Union Finance Minister and the Chief Ministers and Finance Ministers of the State Governments to discuss the ways in which the Government could together bring about restructuring of the public finances. If this does not prove practicable, the Commission should suggest the convening of such a meeting by the Centre to discuss co-operative and collective action in this regard in the light of the Commission's recommendations.

TABLE 6

SHARE OF TAX AND TOTAL REVENUE OF THE CENTRE AND STATES AS PER CENT OF GDP

Total Revenue	1980-81 % of GDP	1997-98 (B.E.) % of GDP
Receipts of the Centre and the States	17.5	20
States' share of total revenues (accrual)	11.1	12.1
Centre's share of total revenues (accrual)	6.4	7.9
Total tax revenues of the Centre and the States	14.59	16.89
States' share of total tax revenues (accrual)	7.69	8.84
Centre's Share of total tax revenues (accrual)	6.90	8.05

The ratio of the State's aggregate expenditure to GDP is 15 per cent as against that of the Centre at 11.0 per cent (Table 2).

This argument cannot in fact hold good in a federation. Uniformity of pay scales in the Federal and State/ Provincial Governments does not exist in any of the true federations like USA or Canada. The pay scales in the State of Alabama is not the same as in the US Federal Government. Similarly, Quebec has it own structure of Government and pay scales and they are dissimilar to those prevailing in the Federal Government at Ottawa. Federalism implies autonomy and differences. One cannot have someone else pick up the bill and yet have the autonomy to detriment the scales of services and the quantum of employment.

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