GULATI INSTITUTE OF
FINANCE AND TAXATION

Do electoral and partisan considerations affect central transfers?
An analysis of Kerala

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Abstract

Though states have no discretionary power on central transfers, the transfers from the centre have an effect on the budget resources available to state governments. In financial relations, the centre holds greater authority than the states. In this context, this study examines the trend of central transfers to Kerala for the time period from 1980 to 2020 and analyses whether central transfers to states are tampered with by electoral or partisan considerations. The result indicates a slight effect, and the central transfers are trending downward, demanding the need for additional revenue streams.

Introduction

Recently, there has been a surge in empirical evidence revealing that national politicians prioritise their electoral motives over normative concerns about efficiency and equality in allocating funds to regional governments. (Grossman, 1994; Worthington and Dollery, 1998, 2001; Johansson, 2003; Khemani, 2003, 2007; Rao and Sing, 2000; Rodden and Wikinson, 2004; Datta et al., 2007). Researchers agree that the Indian Federation provides a valuable laboratory for this purpose due to the existence of two agencies that decide general-purpose federal transfers to state governments. One is a quasi-judicial body endowed with constitutionally mandated legal authority and expected to be free from political influence, and the other is a political body composed of the executive heads of the central and state governments. If non-affiliated states are politically disadvantaged and likely to have fewer

national resources directed towards them, whether through intergovernmental fiscal transfers or direct spending by the central government, then the independent agency would direct more significant transfers to them not because of any political motives of their own but because they happen to be the resource-poor states. (Khemani, 2007).

The state government is impacted by the centre's transfers in two ways. On one side, it increases the budget resources available to state governments to allocate at their discretion. Another argument is that the intergovernmental transfers may create perverse incentives in collecting states own revenues. There are two systematic channels of general-purpose transfers from the centre to the states in India. Transfers determined by the Finance Commission, a constitutional body appointed every five years, are also called statutory transfers. Besides tax devolution and grants to states based on the recommendations of the Financial Commissions, the Central Government provides specific grants for various purposes through its respective ministries, which are discretionary. The purpose of specific transfers is to ensure the minimum standard of services which are considered meritorious or with significant interstate spillovers. The states' development objectives are entirely dependent on the central government's policies. Without the central government's active financial support, no state could afford to function. In the context of declining central assistance, this study analyses whether the central transfers to states are tampered by electoral or partisan considerations.

Trends in central transfers

The share of central transfers in total revenue receipts shows a declining trend in the initial stage, then a fluctuating trend (Figure.1), which was 40.28 percent in 1984-85, came down to the level of 30.92 percent in 1995-96 and further to 24.90 percent in 2016-17. Out of the total receipts, in the years 1991-92, the share of central taxes and central grants was 20.24 percent and 15.29 percent, respectively, which decreased to 13.58 percent and 12.96 percent in 2015-16. As a percent of total revenue receipts, the share of central tax and grant deteriorated sharply from 23.64 and 8.11 (1980-81) to 15.18 and 8.4 (2013-14). Besides, it reveals the fact that the total transfer from the centre as a percentage of total revenue receipt was 35.64 percent in 1980-81, which decreased to 32.37 percent in 2017-18. Moreover, the figure shows a declining trend in central transfers, including tax shares. The trend depicts that the share of central tax has remained relatively constant throughout the years, except a jerking trend after 2017, combining with GST compensation, and then a drastic decline in the last year (2020-

21), i.e., 11.84 percent of total revenue receipts. It shows that the decrease in central transfers is due to the decline of central transfers in other forms, but a change occurred after 2016 with the initial effect of the fourteenth finance commission and an increase in grants.

Figure: 1 Trends in central transfers, 1980-2020
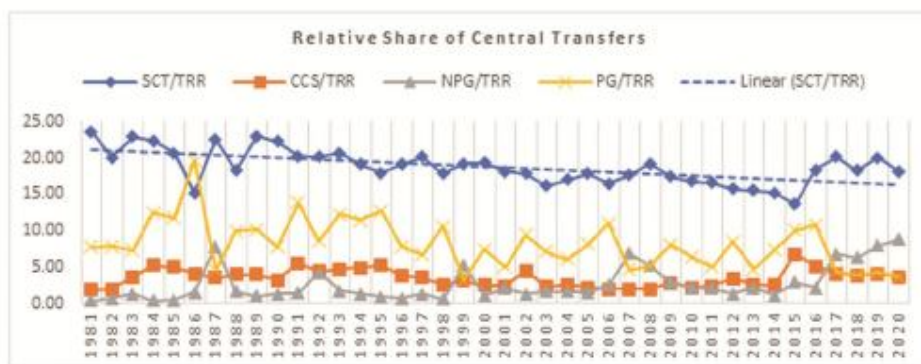
Source; RBI, A study on State Finances, various issues; GOK, budget in brief, various issues; plotted by researcher.

Figure: 2 Share of plan grants and non-plan grants- year-wise comparison
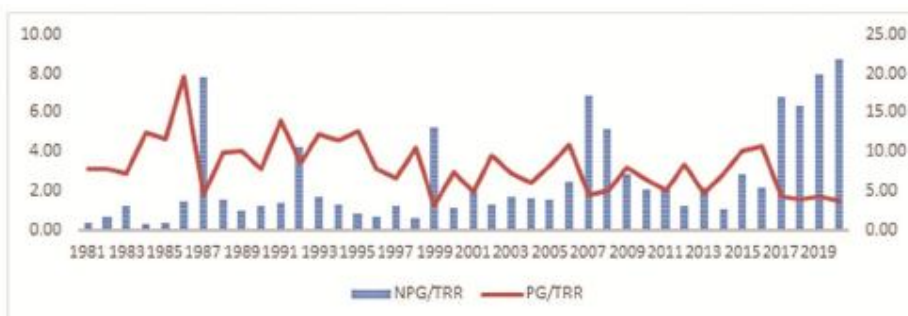
Source; RBI, A study on State Finances, various issues; GOK, budget in brief, various issues; plotted by researcher.

Partisan and electoral incentives on central transfers

Empirical evidence has been documented that, in addition to normative considerations of equity and efficiency in federal setup, the central government's decisions on regional resource allocation are also affected by partisan and electoral objectives (Khemani, 2003, 2007; Rao and Sing, 2000; Rodden and Wikinson, 2004; Datta et al., 2007). It argues that the variations in intergovernmental transfers (central transfers) to sub-national jurisdictions in a federal setup are also affected by political variables representing the electoral incentives of public

agents. That is, states governed by the same political party governing at the centre are likely to receive substantially greater fiscal transfers from the political agency determining transfers. In this regard, this analysis tests whether there is any such variation in inter-governmental transfers due to electoral or political considerations. This part analyses central transfers to Kerala for 36 years, from 1980-81 onwards, using precise econometric models.

Generally, the specified model is:

$$Y_t = \alpha + \gamma\, P_t + \beta\, Z_t + \varepsilon_t$$

Here, vector 'Y' is the dependent variable, which corresponds to each dependent item in its different forms taken for the purpose of the analysis. Subscript 't' indexes the years. Z_t stands for a set of control variables, P_t for political variables, and ? and ? are estimated regression coefficients.

The testing models are[1];

$$G_t = \alpha_1 + \gamma_1\, affli + \gamma_2\, bece + \phi_3 y_t + \phi_4\, tr_t + u_t \quad \text{......(1)}$$

$$G_t/tr_t = \alpha_1 + \gamma_1\, affli + \gamma_2\, bece + \phi_3 y_t + \phi_4 pop + u_t \quad \text{......(2)}$$

Findings and conclusion

The findings from this model show a slight influence of the political affiliation dummy. That is, an increase in grants during years when the incumbent state is affiliated with the center's ruling party. But the coefficient on political affiliation (affli) is found to be significant only at 10 percent. As per trend, a dummy (bece) introduced for the time before the central election is affected by the timing of the Lok Sabha election (table 1). Also introduced another electoral variable to capture whether there is an increase in transfers related to legislative assembly elections (bele), when the incumbent of the state is affiliated with the ruling party of the centre, and the other (atce), for the time when the Lok Sabha election is held at that time when the incumbent of the state is affiliated. Both variables are found to be significant at the 10 percent level. Also, the result elucidates a positive relationship between population and grant and a negative relationship between income and grant from the centre.

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[1] Appropriate variables are introduced according to model fitness.

From the analysis, a strong partisan effect on central transfers cannot be identified. Perhaps it may be because the same government in the state and the centre did not crop up with much at the same time. Besides, the study was analysed in proportion to total revenue receipts and total central transfers to Kerala. Further scope of research is envisaged to compare with other states and total central transfers to analyse the magnitude and real effect. The result indicates that central transfers are in decline and demand alternative sources of revenue by utilising fiscal space for productive channels. The rationale of intergovernmental transfers is, of course, to balance the fiscal disabilities of subnational jurisdiction. Therefore, specific purpose grants should be given to supplement services with a high degree of inter-state externalities or those that are considered highly meritorious.

Table 1: Electoral and partisan effects on inter-governmental transfers

dependent/ independent	TG/ RR	SPG/RR	CSS/ RR	NPG/RR	TTC/TR
affi	3.31 (1.96)*	1.35 (1.97)*	1.01 (2.01)*	15.36 (1.93)*	3.64 (1.99) *
bele	8.78 (1.77) *				2.61 (1.79)*
atce		-0.135 (0.15)			
bece		-1.67 (-2.03)*	-1.12 (-1.4)		-4.30 (-2.03)*
atcs	-9.08 (0.079)*				
pop	0.001 (1.97)*	(0.003) (2.26) **	0.0001 (0.72)	0.0006 (2.72) **	0.004 (4.87) ***
Yt	-6.181 (-1.35)	-1.20 (-.59)	-4.601 (-2.68)**	-0.008 (-4.31)***	-0.0041 -(3.63)**
Constant	8.99 (4.70)***	3.01 (5.01) ***	2.93 (0.004)	16.21 (0.4)	28.27 (15.00)***
R2	0.69	0.41	0.53	0.78	0.65
DW	1.86	1.83	1.5	1.52	1.48
F-P value	2.75 (0.05) ***	2.91 (0.02) ***	3.94 (0.005) ***		7.79 (0.000)***

*Note: The numbers in parenthesis are the t-statistics. *, **, and * ** denotes significant at 10%, 5% and 1% level respectively.*

Appendix

Table -1 Relative share of central transfers

YEAR	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
SCT	23.64	20.08	22.95	22.42	20.74	15.21	22.58	18.24	23.03	22.26
CCS	1.86	1.95	3.66	5.18	4.98	4.04	3.54	3.96	3.97	3.19
NPG	0.38	0.72	1.28	0.34	0.44	1.51	7.81	1.59	1.04	1.27
PG	7.80	7.88	7.29	12.47	11.71	19.67	4.54	9.95	10.21	7.75
TG	8.18	8.60	8.58	12.82	12.15	21.18	12.35	11.54	11.25	9.03
Year	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
SCT	20.24	20.21	20.70	19.15	17.97	19.12	20.22	17.87	19.20	19.33
CCS	5.50	4.37	4.66	4.88	5.22	3.84	3.59	2.61	3.10	2.51
NPG	1.39	4.31	1.71	1.34	0.89	0.74	1.28	0.60	5.25	1.14
PG	13.90	8.56	12.32	11.48	12.67	7.89	6.69	10.55	3.21	7.45
TG	15.29	12.87	14.02	12.82	13.56	8.64	7.98	11.14	8.45	8.59
Year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
SCT	18.16	17.82	16.13	17.03	17.81	16.46	17.66	19.20	17.44	16.85
CCS	2.40	4.52	2.29	2.62	2.12	1.94	1.94	1.96	2.75	2.16
NPG	2.08	1.30	1.68	1.65	1.56	2.48	6.93	5.18	2.91	2.12
PG	4.98	9.46	7.14	6.03	8.16	10.99	4.59	5.14	8.06	6.43
TG	7.05	10.77	8.82	7.68	9.72	13.47	11.52	10.31	10.96	8.55
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
SCT	16.59	15.76	15.50	15.19	13.68	18.38	20.14	18.23	20.10	18.18
CCS	2.35	3.41	2.58	2.48	6.76	5.15	4.04	3.87	4.06	3.62
NPG	2.08	1.29	2.17	1.12	2.90	2.16	6.85	6.32	8.01	8.78
PG	5.01	8.47	4.68	7.29	10.06	10.77	4.41	3.95	4.26	3.68
TG	7.09	9.76	6.85	8.41	12.96	12.92	11.26	10.27	12.27	12.45

SCT=Share of central tax, CCS=Centrally sponsored scheme, NPG=Non plan grants= plan grants. All the data given here is computed by the author as a share of total revenue receipt. Source; RBI, A study on State Finances, various issues; GOK, budget in brief, various issues.

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