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# Southern India: Parliamentary representation, resource sharing and provision of responsive public services post-2026

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# Southern India: Parliamentary representation, resource sharing and provision of responsive public services post-2026

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## Abstract[1]

There is apprehension that delimitation post-2026 might affect the southern states adversely both in representation and resource sharing. This paper argues that delimitation may not be a major problem because in-migration might compensate for the low and falling total fertility rate in the South. The experience of Maharashtra and Gujarat confirms it as their share in the Indian population has hardly changed over the last 50 years (14.320 per cent in 1971 and 14.668 per cent in 2011) despite low fertility.

The major problem is the widening income disparities between the southern states and the rest of India. In 1980-81, the per capita incomes of Karnataka and Kerala were around 65 per cent higher than that of Bihar whereas in 2019-20, they are over five times that of Bihar. The widening incomes translate into serious imbalances in the distribution of taxes because some variant of income distance has been a major indicator used in determining the horizontal shares of states by the Finance Commissions over the years. One possible way out of the lack of fiscal autonomy is to allow for some tweaking of the Goods and Services Tax (GST). Fix a low base rate of GST to be shared equally between the Centre and the states and allow states to fix an increment in State GST entirely flowing into the states. Doesn't fiscal federalism mean transferring resources from the richer states to the poorer ones for the provision of basic public services simultaneously allowing for meeting the differing needs of states at higher stages of development?



**Key Words**: ~~COVID-19 Pandemic, Inequality, Consumption, CPHS~~


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## Introduction

There is apprehension that the southern Indian states would lose out both in representation and intergovernmental tax sharing post -2026 delimitation. It is not surprising that such a view is prevalent because fertility transition began in Kerala almost sixty years ago, and as the late Mari Bhat, the renowned demographer used to say fertility transition in India follows the path of monsoon. Indeed, it has turned out to be true as most of the states had reached below replacement levels of fertility (TFR of around 2.1) by the turn of the century but for Bihar, Madhya Pradesh, Rajasthan, Uttar Pradesh (all undivided states), which continue to report Total Fertility Rates (TFR) of between 2.13 (Uttara Khand) and 2.93 (Bihar) currently. The differentials in natural growth of population are a function of differing TFRs and the thinking is that the share of the southern states in the total population will fall compared to 1971. With the fall in population share representation in parliament will be so much less and tax sharing too will turn adverse to the southern states.

This paper questions this view on two grounds. Firstly, migration the pace of which is accelerating can substantially alter the population shares of states and regions and hence southern Indian states need not worry too much on lower representation. Maharashtra and Gujarat provide best examples of this trend and recent years have seen migration into south India picking up

momentum. Secondly, tax sharing is not guided by representative strength but largely by the formulae adopted by the Finance Commissions. For the last four decades, the Commissions have given a large weight to income distance and as the per capita income differentials between the two groups of states have widened over the years, the shares of southern states have been going down. Hence, the concern with tax sharing need not be linked to the population and representation issue but has to be addressed differently. As the teething troubles of the GST system are over and the system has stabilized, its dual rate structure may be taken advantage to build some autonomy for the states so that they have "own revenue" to meet the local preferences over and above the provision of comparable public services.

The paper is organized as follows. Following this introduction, section 2 presents an analysis of the natural population growth rates, change in population share and migration. Section 3 discusses the principles followed and formulae adopted by Finance Commissions over the last few decades in horizontal sharing of tax revenues. Section 4 presents the tax shares of high-, middle- and low-income states from the seventh to the fifteenth finance commissions. Drawing on the vast literature on fiscal federalism in the context of a growing economy section 5 shows the importance of striking a "balance" in the vertical structure of resources. Intergovernmental transfers from central to local governments have an important role to play in the fiscal system, but they cannot

be excessive. The need for "own revenue" for states that are more open to the world and growing rapidly needs to be recognized. Section 6 presents some thoughts on the way forward.

## 1. Migration Redressing the Falling Population Share

On the issue of falling population shares of south Indian states we begin the analysis with the relationship between natural growth rate of population (NGR) and change in the population share of the states between 1971 and 2011. Natural growth rate of population is defined as the difference between birth rate and death rate. Already by the 1970s states have begun showing variations in the NGRs. By the early 1980s when Indian population was growing at 2.15 per cent per annum the differences in NGRs among the states had become perceptible: while populations in Goa, Tamil Nadu and Kerala were growing at per cent point 0.89, 0.53, and 0.43 lower than the national average respectively, Haryana, Rajasthan, Bihar and Madhya Pradesh were growing at rates higher than the national average by more than 0.25 percentage point. Many other states were growing at around the national average growth rate. Population growth rates have been falling in all the states since then. By early 2010s, the national growth rate had fallen to 1.45 per cent, and while Goa, Kerala, Tamil Nadu, Punjab, Tripura, Himachal Pradesh and West Bengal were growing at below 1 per cent per annum, Bihar, Madhya Pradesh, Rajasthan and Uttar Pradesh were growing at close to 2 per cent per annum.

**Table 1. Distribution of States by NGR and Change in Population Share between 1971 and 2011**

| NGR in 2011-13 (%) | Percentage Point Change in Population Share between 1971 and 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Less than -1.00 | -1.00 to -0.50 | -0.50 to 0 | 0 to +0.50 | +0.50 to +1.00 | Greater than +1.00 |
| Less than 0.90 | Tamil Nadu Kerala | | Goa | | | |
| 0.901 to 1.10 | | Andhra Pradesh | Himachal Pradesh, Punjab, West Bengal | Tripura, Maharashtra | | |
| 1.101 to 1.30 | Odisha | | Karnataka | Sikkim Uttarakhand | | |
| Around 1.45 | | | Assam | Gujarat, Arunachal Pradesh | | |
| 1.501 to 1.70 | | | | Chhattisgarh | Haryana | |
| 1.701 to 1.90 | | | | Jharkhand | Madhya Pradesh | |
| 1.90 and above | | | | | | Bihar, Rajasthan Uttar Pradesh |

Source: Report of the XV Finance Commission Annex 6.1 for population share and Economic Survey 2022-23 for NGRs.

It is expected that those states with NGRs significantly lower than the national average would lose their share in the total population and those with higher NGRs would gain. It is seen from Table 1 that the expectation is largely realized as the states get neatly

arranged on the diagonal cells of the table. Out of the 21 states presented in the table nine states fall neatly in the second quadrant characterized by significantly lower NGRs and negative growth in population share. At the other end seven states fall in the fourth quadrant characterized by NGRs above the national average rate and positive growth in population share. Three states –Assam, Gujarat, Arunachal Pradesh – reporting NGRs around the national average cannot easily be put in any group. Uttarakhand, Sikkim, Tripura and Maharashtra obviously call for a careful look as they report low NGRs but positive growth in population share. Among the states falling in the second quadrant, Kerala and Odisha have lost larger population shares compared to similarly placed states of Goa, or Karnataka. Reasons could be the larger emigration out of the country in the case of Kerala and out migration in the case of Odisha. All the states reporting NGRs above the national average show increases in population share. There are no exceptions here. Thus, the overall movement of population shares shows the expected relationship with NGRs, the exceptions being the four states mentioned earlier.

The group of states reporting low NGRs and increase in the population shares consists of. Uttarakhand, Sikkim, Tripura, and Maharashtra. Obviously, there exists a process countering the low natural population growth taking place in these states bringing about this situation. This could only be migration of population into these states. The same migration works differently in the case

of Odisha. The low natural population growth is further depressed by migration of population out of the state. This aspect is taken up for discussion later.

Before taking up migration for discussion we may take a look at the levels of population share of states at the two time points of 1971 and 2011. The population shares of groups of states for the two time points are shown in Table 2. It may be seen that the four south Indian states have lost almost four percentage points in their share by 2011. The seven central and northern states with NGR above 1.5 per cent have gained more than four percentage points in their share. Both these trends are on the expected lines. What is more striking is the behavior of the group consisting of Maharashtra, Sikkim, Tripura, and Gujarat whose population share has more or less remained stable. This would be possible because the low natural growth of population has been compensated by the large migratory flows into the states. These migratory movements are discussed in the following paragraphs.

**Table 2. Population Share (%) of States in 1971 and 2011**

| Groups of states | Population share in 1971 | Population share in 2011 |
|---|---|---|
| Bihar, Rajasthan, Uttar Pradesh, Madhya Pradesh, Chhattisgarh, Jharkhand, Uttarakhand | 38.557 | 42.745 |
| Andhra Pradesh, Karnataka, Kerala, Tamil Nadu | 22.196 | 18.353 |
| Maharashtra, Gujarat | 14.668 | 14.320 |
| Odisha, West Bengal | 12.304 | 11.310 |
| Himachal Pradesh, Punjab | 3.160 | 2.938 |

Source: Same as Table 1.
Note: Population share in the total population of all states.

We do not have good and current estimates of inter-state migrant population. Economic Survey 2016-17, Chapter 12 provides an important source. Successive Censuses suggest an annual average migration number of about 3.3 million. The cohort-based migration-metric suggests 5-6 million. And an estimate of internal work-related migration using railways data for the period 2011-2016 indicates an annual average flow of close to 9 million between the states (Economic Survey 2016-17, p.265). The rate of migration has been accelerating. In the period 2001-11, according to Census estimates, the annual rate of growth of labour migrants nearly

doubled relative to the previous decade, rising to 4.5 per cent per annum in 2001-11 from 2.4 per cent in 1991-2001. It, probably, has increased further during the recent decades.

There is a clear regional pattern to Indian internal migration (Table 3). Delhi attracts the major share of the total numbers. Other than Delhi, during 1991-2011, Maharashtra, Kerala, and Gujarat were the major recipient states and Uttar Pradesh, Bihar, Rajasthan, Assam and Karnataka were the sending states. This underwent a major change in the next decade. During 2001-11, Tamil Nadu, Kerala, Maharashtra, Karnataka and Gujarat became the major recipients and senders remained the same, except that Madhya Pradesh (undivided) got added as a major sender. Clearly, the southern states have become major recipients displacing Maharashtra and Gujarat. And notably, Karnataka which was a sender till the turn of the last century has become a recipient. And Tamil Nadu and Kerala have replaced Maharashtra and Delhi as major recipients.

The numbers shown in Table 3 are estimated based on the population by age reported in the Census. It is well-known that Census counts can be underestimates as the definitions of residences and households, and enumeration of persons could be leaving some living outside the listed houses and not falling within the definition of households. There is an indication of it from the estimates of migrant numbers arrived at from railway ticket sales between different locations as worked out in the Economic Survey

2016-17 (p.272) – annual flow of 9 million versus the Census estimates of 3.3 million.

**Table 3. Cohort-based Migration Metric (CMM) in selected states, 1991-2011**

| State | Net Migrants in 20-29 cohort, 1991-2001 (Thousands) | Net Migrants in 20-29 cohort, 2001-2011 (Thousands) |
|---|---|---|
| Delhi | 887 | 466 |
| Tamil Nadu | 26 | 1013 |
| Goa | 22 | 19 |
| Kerala | 395 | 900 |
| Gujarat | 69 | 343 |
| Karnataka | -224 | 348 |
| Maharashtra | 1064 | 507 |
| Madhya Pradesh* | -166 | -765 |
| Rajasthan | -602 | -791 |
| Himachal Pradesh | -80 | -90 |
| Bihar* | -1135 | -2695 |
| Uttar Pradesh* | -2955 | -5834 |

Source: Economic Survey 2016-17, Table 2, p.268.

Note: * Undivided states.

CMM (t) = 100 x [Population in 20-29 age cohort in Census (t) – Population in 10-19 age cohort in Census(t-10) - Cohort Mortality]/ Population in 10-19 age cohort in Census(t-10).

**Table 4. Population shares (%) of select States, 1971-2011**

| State | 1971 | 1981 | 1991 | 2001 | 2011 |
|---|---|---|---|---|---|
| Gujarat | 4.870 | 4.988 | 4.881 | 4.926 | 4.992 |
| Maharashtra | 9.197 | 9.188 | 9.326 | 9.417 | 9.281 |
| Karnataka | 5.345 | 5.435 | 5.314 | 5.137 | 5.046 |
| Kerala | 3.894 | 3.725 | 3.438 | 3.095 | 2.759 |
| Tamil Nadu | 7.516 | 7.084 | 6.599 | 6.066 | 5.958 |
| West Bengal | 8.084 | 7.988 | 8.043 | 7.794 | 7.538 |
| Bihar | 7.685 | 7.654 | 7.624 | 8.068 | 8.597 |
| Uttar Pradesh | 15.296 | 15.386 | 15.602 | 16.156 | 16.502 |

Source: Same as Table 3.

A careful look at the evolution of shares of Maharashtra and Gujarat, the largest migrant recipient states, in the all-state population over 1971 to 2011 would suggest the way it is going to shape up in South India in the years to come. Both Maharashtra and Gujarat showed hardly any decline in their shares throughout the period (Table 4). In particular, Maharashtra, despite reporting a lower TFR than Karnataka, has not shown any fall in its share all these years. The large inflow of migrants has more than compensated the low natural growth rate. Gujarat has the advantage of relatively higher TFR as well as large migration. Interestingly, Tamil Nadu, while showing a fall in its share since 1971 along with falling birth rate, has reported moderation in its population share during 2001-11 buoyed by the increasing migration. Tamil Nadu has one of the lowest TFRs in the country. The Tamil Nadu experience, in a way, presages the population

trends in south India in the years to come. Thus, south India is expected to become a mirror image of what Maharashtra and Gujarat witnessed during 1981 to 2001. As these states attract migrant workers and their families, their population shares will be rising and the shares of the migrant sending states will start moderating. Relative representation in Parliament post-1926 might be lower for the south Indian states but liking it with the population shares after every Census would ensure its rise in successive Census. Thus, South has hardly any reason to worry much.

Overall, while fertility reduction resulted in lower population growth and lower share in total population, migration altered the situation substantially as the number of people migrating from states with high fertility and population growth has been increasing. Maharashtra and Gujarat are best examples of this trend of migration more than compensating low population growth. Soon the southern states will also be reflecting a similar trend as migration into south has been accelerating. Hence, there is hardly any reason to worry that southern states will have a lower share in total population and lower representation in Parliament after delimitation[2]. 'Make the migrants your own people' should be the

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[2] According to the Constitution (84th Amendment) Act, 2002, there is a freeze on readjustment of constituencies till the first Census after 2026.

*mantra*. Don't treat them as 'outsiders'. More importantly, get them counted in the Census.

## 2. Horizontal Transfer

Turning to the issue of allocation of resources among the States, the principle of Horizontal Fiscal Equalization (HFE) is designed to correct for economic disabilities experienced by sub national governments. The economic disabilities are a result of horizontal fiscal imbalances, a situation in which there exists differences between subnational jurisdictions in their ability to provide comparable levels of government services while imposing comparable tax burdens. These differences may arise from tax raising disabilities (for example, from lower per capita tax payer incomes) and/or cost disabilities in the provision of government services (for example, from different population age structures). HFE is fundamentally based on the principle of equity between sub national jurisdictions and this principle has been accepted by all the Indian Finance Commissions. HFE is the equalization of the fiscal capacity of the states. State governments should then receive funds from the Centre such that if each made the same effort to raise revenues from its own sources and operated at the same level of efficiency each would have the same capacity to provide services of the same standard. The revenue bases of states taken for comparison should, however, reflect the range of activities, transactions and assets the states actually tax, as such

bases capture the revenue raising advantages and disadvantages ("disabilities") that states face.

The test of the adherence of the Indian Finance Commissions to the principle of equalization is the formulae and indicators used for distribution of horizontal shares. Population and collection/assessment were the only two criteria used for determining the *inter se* shares of the states in the case of Income Tax up to the sixth Finance Commission. In respect of Union excise duties, the criteria, as these evolved over time, had placed greater and greater emphasis on factors relating to economic backwardness and fiscal weakness of the states. However, population continued to be the largest determining factor up to the Sixth Commission (1974-79), although its weight went down from 100 to 75 percent. This weight was further reduced to 25 percent by the Seventh Commission (1979-84). Further, from the Seventh Commission onwards 1971 population has been used.

The recent Finance Commissions have taken per capita income as a measure of fiscal capacity as is evident from the income distance appearing in the devolution formulae. In using the income distance criterion, the Fifth Finance Commission had already sought to close a part of the gap between the fiscal capacities of states whose per capita income was below the average per capita income of all states. The Sixth Finance Commission allowed a positive share to

accrue to all states, the value of which was determined by the difference between the per capita income of the respective state and that of the state with the highest per capita income, scaled to population of that state. The Eighth (1984-89) and Ninth Finance Commissions (1989-95) also used the same method. Until the Ninth Finance Commission, two indicators supposed to reflect differentials in revenue capacities of states, namely, income distance and inverse income were being used. The Tenth Finance Commission (1995-00) discarded the inverse income indicator due to some inherent procedural difficulties. In estimating the income distance, the Ninth and Tenth Finance Commissions, considered the distance of the state's per capita income from that of the state with the highest per capita income. Noting some inconsistencies, the Eleventh Finance Commission (2000-05) modified this procedure of using the highest income-state as the representative benchmark from which such distances are measured. Instead, the Commission arrived at the shares by calculating distances from the weighted average of the per capita Gross State Domestic Product (GSDP) of the three highest ranking states in terms of per capita GSDP, with the weights being the respective populations of these top three states. The income distances of these three states were arrived at as a fraction of that of Haryana, where the fraction was the ratio of the per capita GSDP of Haryana to that of the respective state.

Population and area have been adopted by the different Commissions with varying weights as measures of fiscal need. Some Commissions have added poverty ratio, index of backwardness and index of infrastructure as well to better reflect the fiscal need. As is evident, the pendulum has shifted from the end of fiscal need- almost the entire weight placed on population by the Commissions in the early years- to the fiscal capacity – the bulk of the weight placed on income distance by the Seventh Commission onwards. In recent years some weight has been placed on tax effort and fiscal discipline as well. The devolution formulae used by the Eleventh to the Fifteenth Finance Commissions combined the fiscal capacity and expenditure side variables with different weights but the bulk resting on income distance.

The constitution makers of India thought it necessary to have a constitutional body to make periodical awards on vertical devolution as well as horizontal sharing given the imbalance in expenditure responsibilities and powers of taxation between the Centre and the states. The vertical devolution has evolved from sharing individual taxes – income tax, excise duty – to the sharing of a divisible pool, and horizontal sharing that largely adhered to the criterion of population shares in the initial decades switched to the measure of income distance from the Seventh Commission onwards. Recent years have seen some balancing of the weights

but the single largest weight has continued to fall on income distance criterion.

## 3. Changing Tax Shares of States

The criteria and weights adopted in arriving at a formula for sharing tax revenue among the states have all sought to enhance horizontal equity. An assessment of whether the goal of equity has been achieved is not our concern here. Our focus is the question, 'how have they changed the shares of different states'. An early attempt to analyse the changing shares was made by Guhan (1995). Part of Table 14 of Guhan (1995) is reproduced here as Table 5. The reference population data used by all the Commissions were of 1971. It may be seen that the award of the Sixth Finance Commission to groups of states with population having a large weight was no different from their share in population as of 1971. But the shift from population to income distance as the indicator carrying large weight from the Sixth to the Seventh Commission brought about a significant change in the shares of states. The high-income states lost around 3 percentage points share in income tax and basic excise and the share of low-income states increased by almost equal percentage points. As the per capita incomes of the high-income states was growing at a rate higher than the rest of the states, their share kept falling and that of low-income states kept rising. Between the sixth commission and the tenth the reduction in tax share was around 6 percentage points for the high-

income states. There was an almost equal gain by the low-income states. The middle-income states (largely south Indian states) hardly lost their share.

**Table 5. Horizontal Sharing from Sixth to Tenth Commissions**

| Groups of States by Income | 1971 Population Share% | Weighted Shares of Income Tax and Basic excise, excluding earmarked shares for deficit States by Finance Commission | | | | |
|---|---|---|---|---|---|---|
| | | Sixth 1974-79 | Seventh 1979-84 | Eighth 1984-89 | Ninth 1989-95 | Tenth 1995-2000 |
| High Income | 18.542 | 18.52 | 15.600 | 13.109 | 13.816 | 12.871 |
| Middle Income | 33.082 | 33.19 | 32.623 | 32.248 | 32.751 | 31.787 |
| Low Income | 43.098 | 43.40 | 46.824 | 49.455 | 48.335 | 49.008 |

Source: Guhan (1995).

Note: Income classification is as of the First Report, Ninth Finance Commission.

High income – Gujarat, Haryana, Maharashtra and Punjab; Middle Income – Andhra Pradesh, Karnataka, Kerala, Tamil Nadu, and West Bengal; Low Income – Bihar, Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh.

A comparable exercise was carried out by Mohan and Shyjan (2009) where a detailed analysis of the movement of incomes of different groups of states till 2006 could be found. We propose to continue that discussion to the present before turning to the

discussion of tax shares of states as income distance is the main criterion in the distribution of tax shares. It is seen that the grouping of states by per capita income does not show any change during their period of analysis from 1980 to 2006. But within groups the positions of states had undergone changes. By 1995, Punjab had lost its top position in the high-income group states and moved to the second position. In the middle-income category, West Bengal was holding the top position initially but had moved to the bottom of the group by 1995. What was more striking, however, was the movement of income differentials. The ratio of average income of high-income group to that of low-income group has risen from 1.86 during 1980-85 to 2.40 in 2000-06. The ratio of per capita income of middle-income group to that of low-income group too had moved from 1.25 to 1.87 during the period. Simultaneously, the distance between the middle income and high-income groups of states has been narrowing.

Beyond 2006, the grouping of states by per capita income underwent a major change. In 2011-12, while Haryana and Maharashtra retained their positions in the top group, Gujarat and Punjab had moved to the sixth and seventh positions with Kerala, Tamil Nadu and Karnataka occupying the positions in between. By 2019-20[3] , Gujarat regained its position behind Haryana but

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[3] Although data for 2020-21 are available we have taken 2019-20 for comparisons because it is an abnormal year owing to COVID 19.

Maharashtra and Punjab fell below the three south Indian states mentioned above. More importantly, the income ratios widened further. Giving up the group averages (groups lose meaning when the ranks change) and focusing on individual states it may be seen that already by 2011-12, the ratio of per capita income of Haryana to that of Bihar and Uttar Pradesh respectively were 4.88 and 3.31. It went up to 5.96 and 4.12 by 2019-20. With these preliminary discussions on income movements, we turn to the discussion of trends in tax shares of states.

**Table 6. Horizontal Sharing from Eleventh to Fifteenth Commissions**

| Groups of States by Income | Population Share% | | Shares of States in the All-state share of the Divisible Pool (%) | | | | |
|---|---|---|---|---|---|---|---|
| | 1971 | 2011 | Eleventh 2000-05 | Twelfth 2005-2010 | Thirteenth 2010-15 | Fourteenth 2015-20 | Fifteenth 2020-26 |
| High Income | 18.701 | 19.175 | 9.544 | 10.940 | 10.677 | 11.266 | 12.695 |
| Middle Income | 33.366 | 29.071 | 29.189 | 26.842 | 25.839 | 25.302 | 23.323 |
| Low Income | 43.468 | 47.164 | 53.762 | 54.727 | 54.738 | 52.580 | 54.233 |
| | | | | | | | |
| Gujarat and Maharashtra | 14.320 | 14.668 | 7.453 | 8.566 | 8.240 | 8.605 | 9.795 |
| South India | 25.136 | 21.324 | 21.073 | 19.785 | 18.575 | 17.978 | 15.800 |
| Low Income * | 39.393 | 43.601 | 48.706 | 49.566 | 49.959 | 47.938 | 49.705 |

Source: Finance Commission Reports; For population, Fifteenth Finance Commission Report.

Note: Population shares are of all states excluding Jammu and Kashmir; Groups of states in the upper panel as in Table 4; South India – Andhra Pradesh, Telangana, Tamil Nadu, Kerala and Karnataka; Low Income* – Bihar, Jharkhand, Madhya Pradesh, Chhattisgarh, Rajasthan, Uttar Pradesh, Uttarakhand.

In Table 6, the upper panel presents the trends for the groups of states as defined in Table 4. The trend in the share of low-income states is a continuation of what was seen for the period till the Tenth Finance Commission, namely a steady gain in share of taxes. But high income and middle-income groups of states show trends different from that seen till the Tenth Commission. The high-income states have started gaining tax share and the middle-income states are losing in a big way. The reasons are fairly evident as the incomes of some of the states in the middle-income group are rising rapidly and some in the high-income group are not rising as fast as those in the middle-income group. To bring these trends clearly a different classification of states is called for and that is what is shown in the lower panel of Table 6.

Drawing on the classification of states as shown in Table 2 the lower panel of Table 6 shows tax shares of different groups of states. The fall of Maharashtra from the top of the income group has reduced the income distance and in turn contributed to the gain in tax shares from the eleventh to the thirteenth finance commissions as the population was fixed at 1971 for these commissions. Use of 2011 population numbers by the Fourteenth and Fifteenth Commissions resulted in further gains to Maharashtra and Gujarat as their population share in 2011 was higher than that in 1971. In the case of the south Indian states, it was just the opposite. As income distances widened, their tax

shares fell from the Eleventh to the Thirteenth Commissions. The Fourteenth and Fifteenth Commissions worsened it as the 2011 population shares of south Indian states fell sharply (by about four percentage points) in addition to the widening of income distances. Thus, over five finance commissions south India lost over five percentage points in tax share. The low-income states continued to gain in tax shares during the whole period.

It is evident from the analysis that migration gets converted into census population counts with a time lag. The low fertility and resultant low natural population growth has a counter in migration contributing to rise in population shares and in turn contributing to gains in tax shares. These factors helped Maharashtra and Gujarat show a turnaround in tax shares after a prolonged drop. Currently, South India is in the situation in which Gujarat and Maharashtra were during the period from 1980 to 2000. As seen in Table 4, this situation would change as population growth takes place with larger migration to the south in recent years. But the income distance is unlikely to change as the south Indian states are rapidly urbanizing and moving into manufacturing and service industry in a big way.

## 4. Growing Fiscal Needs of States with Income Growth

Indian states have a predominant responsibility (as per the seventh schedule of the constitution) of providing social and physical infrastructures and public services besides ensuring safety, security and property rights of the people. Equitable provision of public services requires a satisfactory mechanism to resolve the vertical and horizontal imbalances. The Finance Commissions tasked with this onerous responsibility of resolving imbalances have largely stuck to the principle of horizontal fiscal equalization as regards the second imbalance so that all the states may be in a position to provide public services to their citizens at a reasonable level. This compulsion of "equal treatment" of states is best explained through Alexis de Tocqueville's observation on the U S federal system "In great centralized nations the legislator is obliged to give a character of uniformity to the laws, which does not always suit the diversity of customs and of districts, as he takes no cognizance of special cases, he can only proceed upon general principles" (Vol I, p.163 quoted in Oates 2008). The case with the principle of horizontal fiscal equalization is no different. In the Indian context, exigencies have been sought to be addressed to a limited extent by making sector specific and state specific grants under Article 275 of the Constitution by the commissions with varying outcomes. These are small compared to the tax shares and often come with conditionalities.

Recent literature on fiscal decentralization suggests that there could be problems with this approach of "equal treatment". As put by Vito Tanzi (2001), "… when income levels of regions within a country are relatively equal, and when important natural resources are not concentrated in one region, it is easier to have a well-functioning decentralized system". But pressures for more fiscal decentralization become intense with four different developments. As deepening of democratization takes place, it gives more voice and weight to the preferences of specific groups or regions. Free public transport to women or an assured monetary support to women headed households would fall in this category. Fiscal decisions made at the local level better reflect these citizen's preferences. Secondly, globalization is creating market areas that are no longer identified with national territories. With globalization, certain geographical areas within a country have become more closely linked economically to the markets of other countries than to the national market. This would be true of Bengaluru or Hyderabad. Thirdly, decentralization may be similar to a "superior good", which becomes more desirable as incomes increase. With the rising incomes of the south Indian states, it may not be surprising to see them demanding more of it. Fourth, as incomes increase and the flow of information increases the richer regions become more aware that through the tax system and spending programs, some income re-distribution is taking place

from the richer to the poorer regions. This realization leads to demands on the part of the richer regions to reduce the role of the national government and to increase that of the regional governments (Tanzi, 2001). In the Indian context where ethnic, linguistic, religious, and cultural differences characterize the populations of different regions, and especially of south India, it is possible they think themselves as different.

One of the fundamental arguments advanced for fiscal decentralization almost 100 years ago in the US context was, Justice Louis Brandeis writing in 1932,

> "There must be power in the States and the Nation to remould, through experimentation our economic practices and institutions to meet changing social and economic needs … It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory, and try novel social and economic experiments without risk to the rest of the country" (Osborne 1988 quoted in Oates 2008).

This was a repetition of what James Bryce (1888) said 50 years earlier regarding the United States, "Federalism enables a people to try experiments which could not be safely tried in a large centralized country" (Vol. I, p.353, quoted in Oates 2008). There are numerous instances in the U S in which major policy innovations were first introduced by a state or local government

and then later spread into wider use in other states or at the national level – unemployment insurance, taxation of gasoline introduced in Oregon in 1919 before federal gasoline tax in 1932, environmental regulation in California in 1959 introduced nationally a decade later. There is nothing preventing the federal government from carrying out limited experimentation. In fact, in some cases the central government may provide a framework for the states to experiment, such as emissions trading within which states innovate.

Indian experience is no different from that of the US. The forerunner of the national school midday meals program may be seen in the Tamil Nadu and Kerala experiments of the 1960s. The national employment guarantee scheme too had its origins in the Employment Guarantee Scheme of Maharashtra. The Rashtriya Swasthya Bima Yojana (current Ayushman Bharat scheme) had its roots in the Yeshasvini Health Insurance Scheme of Karnataka, and the Rajiv Aarogyasri scheme in the erstwhile Andhra Pradesh. But to carry out such experiments the states need to have the necessary fiscal space. The state governments need their own independent sources of revenue for both efficient provision of local outputs differentiated according to the local tastes and circumstances and experimentation by states, There is an important issue of "balance" in the vertical structure of resources. Intergovernmental transfers from central to local governments

have an important role to play in the fiscal system, but they cannot be excessive. This can undermine the autonomy and vitality of decentralized decision-making. If local governments are to have real and effective fiscal discretion, they must raise a significant portion of their funds from own revenue sources. This is important for two reasons: central funds come with strings attached; second, heavy dependence on grants destroys the incentives for responsible decisions (Oates 1993).

In the Indian context, the implementation of GST raises an important issue of "balance". Earlier during the sales tax regime, the states had full autonomy to decide the goods to be taxed and the rates to be levied. Introduction of value added tax in the mid-2000s curtailed this autonomy to some extent. But Goods and Services Tax implemented since 2017 raises a big question regarding "own revenue" of the states. Decisions regarding what goods and services to be taxed and at what rates is not "owned" by the states. These are decided at the GST Council where the central government plays a dominant role. As petroleum products and electricity come under the purview of GST in the near future the fiscal space will come down further leaving only stamp duty, road tax and liquor at the hands of the states. Liquor is not a source of revenue in many Indian states. Thus, what a whole galaxy of economists and policy makers have emphasized over the last two centuries – "own revenue"- has been lost to the states. On top of

it, when the tax shares come down systematically on the ground of so-called "fiscal equity" the south Indian states have reason to be aggrieved as the principle of fiscal decentralization so central to federal polity gets hit hard.

## 5. The Way Forward

Low fertility, falling population shares and in turn reduced parliamentary representation need not be a problem for the southern Indian states. The experience of Maharashtra and Gujarat tells us that economic growth and associated inflow of migrant workers can reverse the process of falling population shares. What is needed is that migrants have to be counted in the relevant population census. In Maharashtra, over the last many decades this counting has been achieved by the migrants settling down with families in slums. To a limited extent this has taken place in Tamil Nadu and Karnataka as well. But as long as single male migrant workers get only a bunker bed at exorbitant rents and construction workers get huddled in buildings under construction (as in Kerala and Tamil Nadu) many of them will be left out in the population census. The southern states have to devise methods for getting the migrants counted in the Census.

A strategy worth considering is one of gram panchayats and municipalities leasing in vacant houses at fair rents in their jurisdictions and accommodating migrants at relatively low rentals.

This would entice single males to get their families and it will be a win-win for both, the state and the migrant workers. Lot many problems associated with crowded tenements (poor public health, lack of family support, exorbitant rent) can be done away with as far as migrant workers are concerned. For the receiving states, population shares will rise. With the coming of families spending on goods and services will extend beyond basic food items generating more GST revenue and with children's arrival eventually schools will get filled. All these could be achieved at relatively marginal cost to the state. This will be a model different from that of Maharashtra, more dignified and humane.

On the "own revenue" front, the GST structure has to be reworked. GST is seven years old and has gotten over its teething troubles and has got stabilized. The GSTN has evolved to address numerous problems of matching inputs, tracing IGST to the states to which it is due, fraudulent accounts and so on. A simple reform on the sound foundation of GST already built on the following lines could make the states "own" it up. Lower base rates of GST may be levied uniformly all over India that may be shared equally between the Centre and states (as at present). On this base rate allow the states to levy an additional rate to be decided by the states as per their requirements. This then becomes the "own revenue" flowing entirely to the state exchequer. Operationally, it need not make the system very complicated. It can be simplified further by

reducing the number of base rates from the four or five as at present to two or three. All that is needed is a general agreement in the GST Council and the resultant change in rates. This will truly herald co-operative federalism in India and strengthen the states to become 'federal laboratories' as incomes grow and export orientation gains strength.

There is an altogether different reason for tweaking the GST rates. GST with few exemptions and few uniform rates may be 'simple' and hence may be easy to administer but highly regressive. The incidence of GST is on all goods and services and same across all income groups and the burden is relatively high on the low income groups and hence highly regressive. Tax rates as a fiscal instrument for income redistribution is gone with GST. The burden of income redistribution then falls on the government expenditure. It is through expenditure, by supplying basic necessities of life at considerably lower prices than market rates for the poor that the burden of GST on them can be addressed. The burden, then falls on the state governments and they fulfill this responsibility by providing free or highly subsidized food, light, water and transport. These may not be uniform across the states; they will vary to meet the tastes and preferences of states. Some "own revenue" is absolutely essential for meeting these. The incremental SGST makes it fall only on the tax payers of the respective states.

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