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Obstacles in Economic Growth of Madhya Pradesh

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Introduction:

India is the world's largest democracy and has the largest written constitution in the world. India's political system is a lot more recent than that of US and Britain owing to the fact that it got independence in the year 1947. The political system of India is complex and has many levels of hierarchy. It takes place within the framework of the constitution and follows federal system of political operations which has been borrowed from Canada, Australia and United States. The Indian states depend on the central government for an overall infrastructural, industrial and social and economic development. Different committees are formed to suggest plans for development along with Central Financial Assistance to Indian States. For the purpose of releasing funds to the state level, the Commission is required to make recommendations on 'the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of recommendations made by the Finance Commission of the State.'

The Madhya Pradesh state has created the three tier system of urban local self-government, consisting of 16 municipal corporations, 85 municipal councils and 235 Nagar Panchayats, having 47.12%, 30.62% and 22.28% share in funds allocation respectively. Their share in total urban population of the state to meet the constitutional requirements, the state government has made necessary amendments in the existing legislations relating to local bodies in the state. The constitutional amendments have provided the city government with constitutional rights to exist and function but have done little to empower them financially. Democratic decentralisation cannot be an isolated exercise at the local level only but has to cover and permeate the whole gamut of administration at all levels. The past state-municipal relations are gradually undergoing changes under the pressure of reforms taking place in different directions at different levels, initiated by the process of liberalization, the local political pressures, citizens' involvement in municipal government and judicial interventions. The limitations of local bodies are coming more and more to light against the background of inadequacy of financial resources for serving the needs of growing urban population,

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though finance is not the only factor accounting for their unsatisfactory performance. With the present level of revenue and expenditure, even obligatory functions are being inadequately performed.

A brief and rapid review of federal finance, its principles and their applications in India shows that the institutional framework militates against the expansion of local finances, and a striking feature of federal finance in India is the progressive increase in the dependence of the states on the Central Government and of local bodies on the state governments. Partly the fault lies with the state and the local governments themselves since they have exploited fully their taxation powers given to them and have not made attempts to restructure their finances for augmenting their own resources to the optimum level (Planning Commission of Madhya Pradesh, 2011).

There is and can be no final solution to the allocation of financial resources in a federal system. There can only be adjustments and reallocation in light of changing conditions. — **K. C. Wheare, commentator and writer on political studies.**

So with present paper we will be going to analysis the trend and gaps in the financial allocation by the central government to the state and the state to the local bodies. To analysis we have divided the administration in three tier central, state and local bodies. The trend and gap in the financial allocation by the central government to the state and the state to the local bodies shows delay. The funds flow from higher level governments to the lower level government is very low and lack devolution design or principles. Related literature has been reviewed under the head "**Literature review**".

Literature review:

An overview of the voluminous literature available on centre-state financial relations:

The financial adjustment in India as a part of his comprehensive study on public finance including the theory of federal finance, the fiscal adjustment process through different components of the Finance Commission transfers has been discussed in the historical background (**Bhargava (1949).** The Finance Commission being an ad-hoc body and having its undefined role vis-a-vis the Planning Commission has not been able to fulfil its role. Even the Planning Commission's conditional grants have failed to achieve any significant purpose; they distort priorities of the states, undermine their resource use and create needless friction. It is then suggested that unconditional grants would be the most suitable general method for helping the development in the state spheres. "Loans ... should pass business like tests" and should better be administered through the organisation of a Development Bank **Lakdawala (1986).** Regarding transfers, it is suggested by **V.K.R.V.Rao (1991)** that the existing central dominance needs to be reduced, may be, by allowing the states to borrow liberally from the open markets or setting up a National Loan Corporation. Grants in aid may strictly be used for redressing regional imbalances. Inter-State-Union-Council is suggested to discuss all the issues relating to the centre- state fiscal relations. In relation with this **Singhvi** in his study identified the significant issues and aspects having bearings on the centre-state relations. The main issues highlighted are: the constitutional division of resources, need for resource redistribution and their impact on national unity and fiscal responsibility and issues relating to the Finance commission. The different aspects of centre-state relations were also discussed in the Indian Economic Conference held in 1972.

Over's a wide range of issues relating to the central transfers through Finance and Planning Commissions, budgetary procedures, federalism and planning, the dual allocation results in wastes and specific law are necessary to take care of the conflicting interests in a federation. The organisational and functional aspects of development planning to highlight the different points of dispute in the context of centre-state relations, Central domination over allocating the plan assistance and plan priorities and the failure of the states to develop effective different and proper plan machinery are the issues focussed on. It is concluded that the reorganised Planning Commission has gone a long way since 1967 to put centre-state relations in planning on a more systematic and rational basis. But still much more needs to be done to depoliticise the planning and development process, strengthen the state planning machinery, adopt a long term planning strategy and create development banks for financing major investments etc **Chatterji (1993).** The system of grants lacks coherence and conformity except in the case of statutory grants; states are heavily dependent on the central grants while centre normally had the money it does not always have the same power as the states have to execute the projects. The focus on the financial position of Panchayats in India reveals that the Panchayats have very little fiscal autonomy. The locally raised revenues are very negligible. The funds flow from higher level governments is very low and lack any devolution design or principles. The transfers are mediating the convenience and mercy of such governments, **Aggarwal (2002)** and **M Devendra Babu (2009).**

All these reviews highlight that the transfers and funds flow path is not as direct and simple as is explained in government accounts. The time leg aggravates the problem of the respective three tier system. It is because of this reason, it is important to find following research objective through this paper.

Objectives and design of the study:

The specific objectives of the study are:

1. To analyse the trend in transfers from Central to State i.e. Madhya Pradesh.
2. To study the Gap in amount sanctioned and actual amount received.
3. To study the Gap in potential (anticipated) growth and actual growth received from various sector.
4. To suggest policy measures to overcome these obstacles in Madhya Pradesh state.

The study has focused on the trend and gaps in the financial allocation to the state by the centre. The analysis made in this paper is based on secondary data sources. The data is available from 2000-2001 to 2014-2015, the analysis is restricted to that time period. The main data sources for the study are: Central Finance Commission Reports,

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State Finance Commission Reports, Reserve Bank of India publications and Central Government Finance Department Reports.

Analysis:

1. To analyse the trend and Gap in amount sanctioned and actual amount received:

With the inception of economic reforms in 1991, the responsibility of the State has gone up substantially in meeting the increasing needs of the basic services of the people. Over the years, the centre has become stronger in terms of higher revenue potential through collecting taxes from states. While states (especially BIMARU) got burdened with greater functional responsibilities in the areas of education, health, economic and social infrastructure, social Security and welfare due to more dependency on central funds* (MP Development Report 2010, Planning Commission Government of India, New Delhi). The division of expenditure obligations and revenue powers between the two levels of the federal government gives rise to two types of fiscal inequalities — vertical and horizontal. Vertical fiscal imbalance refers to disproportionate allocation of expenditure and revenue between the Central and State governments. Horizontal fiscal imbalance refers to the varying fiscal capacities and needs of the State governments. As a result inequality across the states and within the states has increased with respect to providing public services (MP Development Report 2011, Planning Commission Government of India)*. Further, the enactment of Fiscal Responsibility and Budget Management Act (FRBMA) by the Centre which directs States to bring in discipline in the management of public finances has added pressure, particularly in improving productive assets of the poorer States. The fiscal discipline, though necessary, has resulted in decline in the share of capital expenditures in most of the states, particularly backward states (**Draft Discussion Paper** Dr. Sindhushree Khullar Former Secretary, Planning Commission, June, 2014 Government of India)*. As States are depending more and more on market borrowing on the face of declining central loans to states that has led to reductions of the tenure but increased the cost of borrowing and worsening state debt burdens. Here with the help of the below table and graph we can easily make out the situation, Gap and analysed the trend in Madhya Pradesh state which is shedding the BIMARU tag (backward state).

Table 1

Trend in Central Transfer to Madhya Pradesh State (Rs. in Cr.)

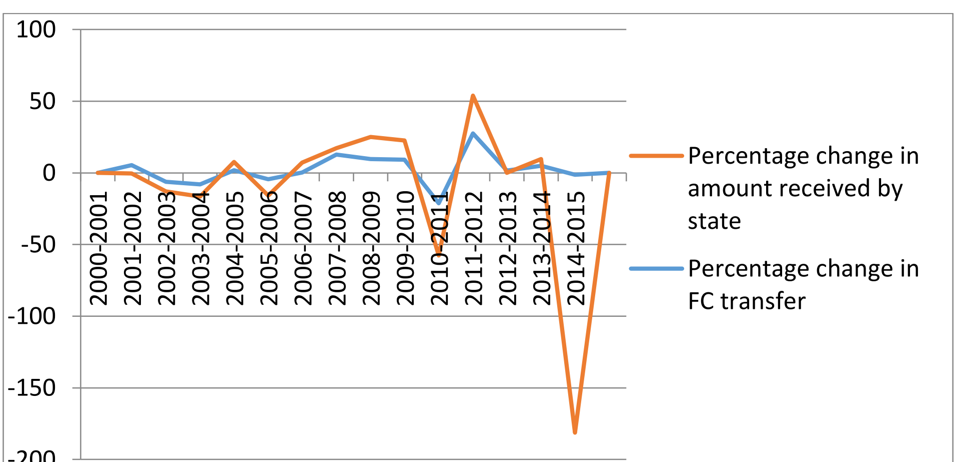
Period	FC (Finance Commission) transfer (Rs. Cr.)	Percentage change in FC transfer	Amount received by state (Rs.Cr.)	Percentage change in amount received by state	(Gap)In %
2000-2001	1,613,594	-	1,417,599	-	13.82%

2001-2002	1,705,782	5.4	1,340,851	-5.72	27.21%
2002-2003	1,599,724	-6.21	1,257,114	-6.66	27.25%
2003-2004	1,470,520	-8.07	1,158,486	-8.51	26.93%
2004-2005	1,498,641	1.91	1,230,364	5.84	21.80%
2005-2006	1,432,626	-4.4	1,103,661	-11.48	29.80%
2006-2007	1,436,878	0.29	1,185,272	6.88	21.22%
2007-2008	1,647,906	12.8	1,240,040	4.41	32.89%
2008-2009	1,826,116	9.75	1,466,855	15.46	24.49%
2009-2010	1,996,235	9.31	1,691,135	13.26	18.04%
2010-2011	1,647,906	-21.13	1,240,038	-36.37	32.89%
2011-2012	2,103,495	27.64	1,680,556	26.21	25.11%
2012-2013	2,136,990	1.56	1,656,372	-1.46	29.0%
2013-2014	2,250,997	5.06	1,734,708	4.51	29.76%
2014-2015	990,138.1	-1.27	619,659.0	-179.94	59.78%

Source: Table created for the paper with the help of data available on State Finance Commission Madhya Pradesh for different years.

Fig. 1

Percentage change in FCT and AR



Source: Based on above table

Table 1 reveals Gap in state transfers by the FC over the study period. The fluctuation in state receipts from both finance commission and central government mounted uncertainty in front of the state as far as growth is concerned as the Coefficient of variation ratio (0.91) is very high which indicate that state transfers are highly uncertain that was one of the major reason of slow economic growth of Madhya Pradesh. The finance commission transfer showed very low consistency throughout the period of study.

With the objective of maintaining long term stability in the relative share of centre and states in the total revenues, the **Union Finance Commission** (UFC) have set the target for transfers from all sources of revenue to states by different percentages. The centre is receiving huge revenues from sources such as telecom auctions, agriculture, infrastructural development projects, and FDIs etc. of which the states get no share. There is also increase in the number of centrally sponsored schemes involving huge expenditure which exceeds the set limit (Rao's 2010). Yet the UFC does not make enough efforts to fulfil these criteria and in fact continues with the gap **(See Table & fig. 1).** This always affected the equity and incentives of the states adversely. While looking at the trend we can easily make out the situation that there is also deficit financing in the state. This shows the vastly dependence of the state on the central transfers. One of the reasons of gap in transfers by Eswaran Sridharan (2011)* shows government's discretionary powers over resource-allocation in numerous domains. For example; the political party-funding, election-expenditure, misuse of government's discretionary powers over resource allocation to raise funds for fighting elections and sustaining political parties, so called defined as corruption.

J. R. Hicks observes, "Many forms of social expenditures are well adopted for administration by local or regional authorities; if they are also financed by local or regional taxes, the wealthier areas will have higher standards, purely as a result of their greater taxable capacity."* Thus, the inter-State disparity in socio-economic development is reflected in the inequality in fiscal means and needs.

In continuation, with the adverse effect to the state, the state would delay in releasing funds to the local bodies. Further we will assess the gap in anticipated growth received from various sector and actual growth received from various sector.

Assessment of the Gap in anticipated and actual growth received from various sector:

Another focus of the paper is to assess the gap in anticipated growth received from various sector and actual growth. **Table 2** below explains the growth rate achieved by all three sub sectors indicate uneven growth attained by them in the state. The fund released by the central government to the MP government shows delays (as explained above). This changes the growth rate at different sectors in state.

Table 2

Growth in different Sector Compared to Preceding Year

Source: Economic Survey, Gov. Of MP, different years

Period	Primary sector (%growth)	Secondary sector (%growth)	Tertiary sector (%growth)
2000-2001	-	-	-
2001-2002	-28.29	-16.16	4.34
2002-2003	27.31	12.07	5.23
2003-2004	-19.64	20.96	5.51
2004-2005	40.14	-34.12	7.22
2005-2006	-4.71	25.78	8.06
2006-2007	4.17	17.08	9.10
2007-2008	2.80	-12.31	12.45
2008-2009	6.09	7.94	20.76
2009-2010	-17.92	5.31	27.00
2010-2011	30.01	3.54	31.89
2011-2012	22.50	-18.71	36.02
2012-2013	37.63	11.01	40.13
2013-2014	-18.01	2.12	40.67

The primary sector growth which employs about 70 per cent of state's population has had very wide fluctuations during last 10 years (**Table 2**). The principal reason for such wide variation is over dependence of agriculture on the monsoons, lack of policy implications and no proper use of the funding or resources. Growth in the secondary sector is also marked with varying fluctuations year after year. Madhya Pradesh industrial performance measured by any parameter has been on the low side. A major part of the state is still backward both in terms of magnitude and quality of industrial units, employment and investment. One reason is the decrease in the share of fixed capital, the other point to be noted here is that the share of value added from the state has remained stagnant (5 %) over two decades (Diwedi,2010,Shodhganga). While, the tertiary sector growth in Madhya Pradesh has been more even and positive and is in line of national trend where services sector have shown remarkable growth post economic reform period, particularly in the decades of 2000. Tertiary sector tends to move above as compared to the growth rate of the primary and secondary sector. Sudden drops in sect oral performance tend to hit the poor the worst. Stagnation in agriculture, slow rate of investment in industry (secondary sector) are the major challenges for the state at present. The remaining service sector seem to be pulling up the state's Economy.

The data regarding finances of local bodies in the state are not available at the macro level. The Directorate of Economics and Statistics of the state government

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collects data in respect of all municipalities of the state. The total achievement by the state achieved through the finances is fluctuating. The consolidated fund of the states needs to be augmented for supplementing the resources of local bodies. The performance of the state plan (2000-2015) and share of revenue can be shown at the below table.

Performance of the State Plan:

Achievement in approved plan outlays of M.P from 2000-2001 to 2014-2015 is given below in the table.

Table 3 Achievement of Plan Outlay

Years	Approved Plan Size by State Finance Commission (Rs cr.)	Actual Expenditure (Rs cr.)	% of GSDP
2000-2001	9025.00	9500.14	7.10
2001-2002	9803.03	10001.00	7.43
2002-2003	10012.00	10112.00	6.50
2003-2004	10367.00	10533.00	7.13
2004-2005	10026.00	10226.00	7.36
2005-2006	10475.12	10572.82	6.12
2006-2007	11890.00	11900.00	7.32
2007-2008	12011.00	12047.44	7.46
2008-2009	14182.61	12787.08	6.48
2009-2010	16174.17	16450.77	7.22
2010-2011	19000.00	20156.84	7.75
2011-2012	23000.00	22663.81	7.32
2012-2013	28000.00	28349.41	7.83
2013-2014	32064.17	33023.01	7.93
2014-2015	36032.13	37103.11	-

Source: FC GSDP growth rate

The performance of the state during 2000 to 2015 **(Table 3)** indicates that the State Finance Commissions has made an attempt at achieving a greater degree of equalization but failed to do so. When we compare the two **Tables 1 and 3,** we can see that **(Table 1)** the amount received by the state by central government and the approved plan size of Madhya Pradesh State **(Table 2)** differs. Further **(Table 3)** the actual expenditure is more than the approved plan size. This creates deficit financing, increases burden and uneven growth within the economy. It may also imply a response to increasing inequalities in per capita incomes within state. The fiscal policy of the state aimed at increasing capital expenditure to ensure investment in certain sectors. It did so but on one hand it increases the debt of the state and on the other hand states GDP is quite good. The reason for good GDP is the increase in the tertiary sector. The state still maintained its growth through local revenue generation and global investment this year (2014-15).

It would be quite pertinent to begin the analysis and review by highlighting the place which local bodies in the state occupy in the federal structure, in terms of what they are able to generate with fiscal powers assigned to them. The following table presents such data:

Table 4

Own revenue of local bodies in the state as percent of Central and state government revenues

Unit	Revenue (Rs. crores)		Revenue of local bodies as % of central revenues		Revenue of local bodies as % of state govt. revenues	
	2007-2012	2012-2017	2007-2012	2012-2017	2007-2012	2012-2017
Central Government (collected from MP State)	104559	232068	0.09	0.14	0.18	0.28
State Govt.	6022	13690	0.12	0.16	0.21	2.54
Own revenue of local Bodies	153	180	0.14	0.22	2.25	1.31
Local bodies total revenue	501	2263	0.47	0.97	8.31	16.53
Total	111235	248201	0.82	1.49	10.95	20.66

Source: Calculated from the data furnished by the Finance Commission and State Domestic Product of Madhya Pradesh (Directorate of Economics and Statistics - M.P. Government) (Two financial year period 2007-12 and 2012-17)

Local bodies in the state could raise very meagre revenue on their own despite giving full autonomy under 73rd amendment act, passes by Madhya Pradesh government in 1992. The state could generate approximately Rs.153 crores in 2007-2012 and Rs.180 Crores in 2012-2017, through their own tax and non-tax sources taken together, accounting for 0.09% of total central revenue in 2007-12 and a higher figure of 0.14% in 2012-17. As percent of state revenues, 'own revenue' of local bodies constituted

2.25% in 2007-12 but declined to 1.31% in 2012-17, indicating the fact that increase in own resources of local bodies could not keep pace with central and state revenues. Taking the total resources of local bodies (own and other resources), we find that such resources amounted to 0.47% of central revenue in 2007-12, increasing to 0.97% in 2012-2017, and in relation to state government revenue, the percentages for the two years were 8.31% and 16.53% respectively. The increase in these percentages may be attributed to larger flow of funds from the grants of the state government and the state/centrally sponsored programmes. The percentages in respect of own revenue of local bodies are insignificant, indicative of increasing dependence of local bodies on both central and state governments and outside sources (market sources) for financing their functions and activities. By the criteria of revenue raised, it appears that local bodies could not establish effective linkages with activities carried out within their respective jurisdictions and thus have remained peripheral to the national economy. Another criterion usually adopted to evaluate the place of local finances in the state/national economy is in terms of their financial operations as percent of GSDP of the state **(Finance Commission MP)**.

The overall analysis shows the trend and gap in the financial allocation by the central government to the state and the state to the local bodies shows delay in disbursement. The funds flow from higher level governments to the lower level government is very week and lack devolution design or principle. This creates hindrance in the economic growth of the state. The results reveal higher actual expenditure than the approved plan due to gap between central and state financing. This indicates the deficit financing, increased burden and uneven growth in the economy. It may also imply a response to increasing inequalities in per capita incomes within state.

Conclusion:

On the basis of above discussion, we can say that the vertical imbalances created by central and the state governments in financial flows up to grass root level bodies are the main hindrance for the smooth economic growth of the state. Looking at the picture of transfers recommended by the state Finance Commissions, the trend seems to be; that state Finance Commission actual plan size expenditure is higher than the approved plan. This indicates the deficit financing, increases burden and uneven growth in the state economy. It may also imply a response to increasing inequalities in per capita incomes within state (R.K Puri, "Fiscal Empowerment of Madhya Pradesh" 2010). On the overall strategy in determining fiscal transfers to the states by the successive Finance Commissions the following observation can be made:

a. The central taxes empirically proved to be more buoyant over time as a result the share of central taxes in the combined tax revenue was progressively increasing. The Finance Commissions recognized that the states had relatively larger expenditure responsibilities, and by increasing the share in the sharable pool of central taxes, the Finance Commissions were able to stabilise the respective relative shares in expenditures.

b. There was a conscious effort on the part of some of the Commissions to increase the share of tax devolution in total transfers because they considered that this was a more non-discretionary route to transfers which also automatically adjust to changes in economic conditions effecting growth and tax performance.

Hansen and Perloff (2012) describe this principle as, "Grants should be distributed to the State on the basis of relative need and relative financial resources, that is, those with the greatest need and the least resources should receive the largest per capita grants and those with the least need and greatest financial capacity should receive the smallest per capita grants, so that each government unit may provide the minimum programmes without an undue strain on its resources".

In our view, the central FC should considered the case of each state on merit basis (i.e. low developed state should be given top priority) for meeting their requirements. They should have recommended devolution of funds from the centre to the states to assist local bodies for meeting their expenditure needs over and above their own resources and the devolution of funds made on the recommendation of the SFC.

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