Working paper

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Recommendations of Thirteenth Finance Comission

Implications for Bihar

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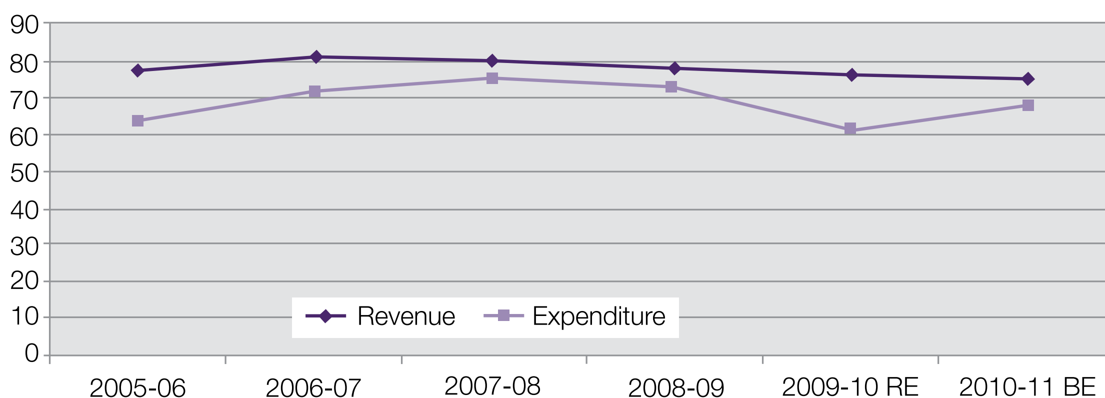
Introduction

The institution of the Finance Commission as a statutory body acting as an independent arbiter in matters relating to the transfer of resources from Centre to the States is unique in Indian federalism. Although there are multiple channels of transfers operating simultaneously in India, the largest shares of resources are being devolved through the Finance Commission[1]. The relative importance of Finance Commission transfers is greater for low-income States compared to the economically better-off States due to greater dependence of the former on central transfers to carry out their expenditure responsibilities. In this context, the implications of Finance Commission transfers on State finances, particularly on low-income States, assumes critical importance.

The role of transfers on State finances of Bihar can be understood from Figure 1. If we look at the structure of revenue of the Government of Bihar, in the year 2008-09, the share of central transfers accounted for 78 per cent of total revenue and financed more than 72 per cent of total expenditure. In the same year, tax devolution accounted for 54 per cent of the total revenues and financed 50 per cent of the total expenditure. Given huge transfer dependence of Bihar on Central government, recommendations of the Finance Commission need to be examined and reviewed to understand its fiscal implications for Bihar. It is also evident from Figure 1 that Bihar's transfer dependence has not declined in recent years.

Finance Commission transfers have two components: tax devolution and grants. Apart from the tax devolution, the Thirteenth Finance Commission (hereafter TFC) has given a large number of conditional grants linking fiscal performance with fiscal consolidation, to incentivise States to carry out certain types of expenditures. This paper will examine what some of these conditionalities mean for Bihar and how effectively Bihar can utilize these grants in the context of overall operating fiscal constraints. Apart from tax devolution and sector-specific grants, other major recommendations of the Commission are a revised roadmap for fiscal consolidation for the States and a design of goods and service tax (hereafter GST) and compensation linking adherence to the suggested GST design. The paper also examines whether the Government of Bihar would be able to adhere to the proposed fiscal restructuring path of the TFC and the fiscal implications of doing so.

Figure 1: Share of central transfers in total revenues and expenditures: 2005-06 to 2010-11



The paper is organised as follows: Section I examines the quantum and conditionalities relating to various transfers given to the State of Bihar. Section II discusses the vertical and horizontal distribution[2] of resources to Bihar. Section III evaluates the revised road map for fiscal consolidation for Bihar and

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1 The other channels of transfers are Planning Commission and various central government ministries. Planning Commission transfers are in the form of plan grants and ministry specific transfers are in the form of various centrally sponsored schemes.

2 Vertical devolution is given to correct for asymmetric assignment of functional responsibility and financial power across levels of governments. Horizontal distribution is required to correct for the differences in fiscal capacity across the same level of governments.

examines if Bihar would be able to comply with the proposed road map. Section IV critically reviews the proposed GST design of the TFC and the GST taskforce report on revenue implications and provides alternative estimates of revenue implications of GST for Bihar. Section V examines the various sector-specific grants for Bihar with special emphasis on the grants for elementary education and grants to the local bodies. Section VI concludes.

1. The total quantum of transfers

Apart from tax devolution and post-devolution Non-plan Revenue Deficit (NPRD) grants, the TFC has recommended an unusually large number of conditional grants to the States[3]. These grants are State-specific performance grants, grants for universalisation of elementary education, environment-related grants including forest, renewable energy, and water sector management, incentive grants to improve quality of public expenditure, grants for maintenance of roads and bridges and grants for State-specific needs. As these grants are conditional, actual utilization depends on meeting grant-specific conditionalities. Before we analyse the recommendations of the Commission, it is important to see the total quantum of transfers recommended by the TFC for Bihar (see Table 1).

Being a low income State, with low taxable resource base, the government of Bihar is keen to avail these funds to increase its revenue resources for development. Availing these funds is also important as the State of Bihar, as per TFC's projection, does not qualify for non-plan revenue deficit grants[4] (NPRD). In the absence of NPRD grants, it is important for the government of Bihar to make every effort to avail other conditional grants to improve the fiscal position of the State. It is also important to mention that TFC has discontinued the health equalization grants recommended by the Twelfth Finance Commission, which according to the Government of Bihar, was a very important source of revenue in augmenting health expenditure. Thus, in the absence of health equalization grants, if the State has to improve its resource position to spend on critical services it must make efforts to receive all conditional grants recommended by the TFC over and above the untied funds.[5]

Table 1: Tax devolution and Grants to Bihar as per the recommendations of Thirteenth Finance Commission

(Rs. Crore)

		Bihar	Total
1.	Share in central taxes and duties	158341.2	1448096.0
2.	*Grants-in-aid (2010-15)*		
i.	Post devolution NPRD	0.0	51800.0
ii.	Performance incentive	0.0	1500.0
iii.	Local bodies	5682.1	87519.0
iv.	Disaster relief (including capacity building)	1411.2	26373.0
v.	Elementary education	4018.0	24068.0
3.	*Improving outcomes*		
i.	Improvement in justice delivery	385.0	5000.0
ii.	Incentive for issuing UIDs	369.2	2989.0
iii.	District innovation fund	38.0	616.0
iv.	Improvement of statistical systems at State and district level	38.0	616.0
v.	Employee and pension database	10.0	225.0
4.	*Environment-related grants*		
i.	Forests	38.4	5000.0
ii.	Water sector management	304.0	5000.0

3 As per the TFC estimates, the government of Bihar will not be eligible for the non-plan revenue deficit grants.
4 Non-plan revenue deficit grants is a statutory grants given by the Finance Commissions to those states whose non-plan revenue account continue to have deficit even after the tax devolution.
5 The total Grants recommend by the Twelfth Finance Commission as health sector equalization grants amounted to RS. 19.69 crore.

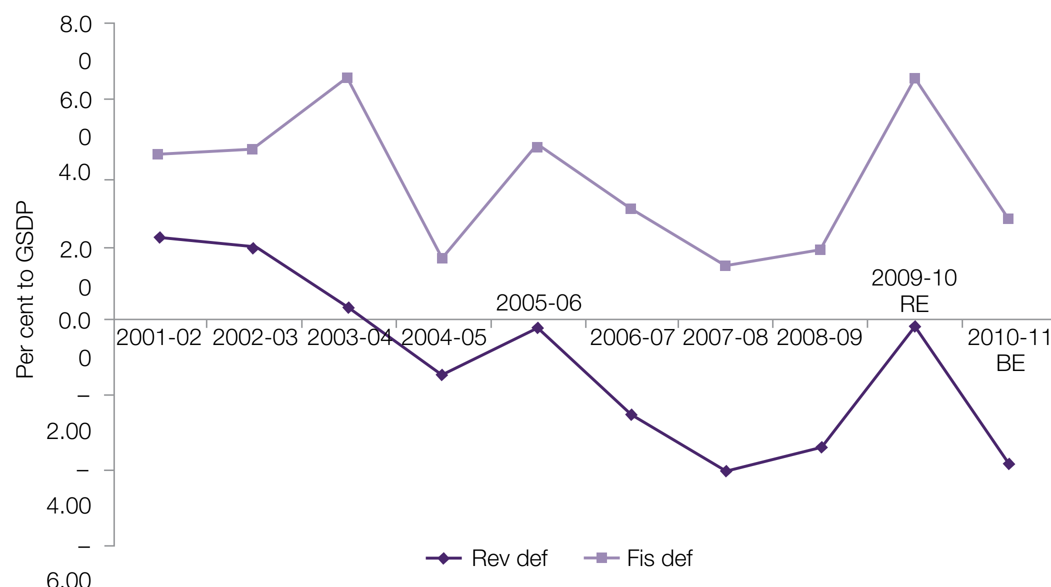
(Rs. Crore)

		Bihar	Total
5.	*Maintenance of roads and bridges*	464.0	19930.0
6.	*State-specific*	1845.0	27945.0
7.	Total grants in aid (sum of row 2 to 6)	14602.8	258581.0
8.	Total transfers (total of row 1 + row 7)	172044.1	1706676.0

Source: Report of the Thirteenth Finance Commission, table 12.7.

Among all the grants, for Bihar, the State-specific grants assume significance as regards its quantum and conditionalities. Under the State-specific grants the TFC has recommended Rs.1845 crores for Bihar during its award period. In order to avail the State-specific grant, the State should amend Fiscal Responsibility Act (FRA) by incorporating the State-specific fiscal reform path worked out by the Commission for Bihar. In response to the demands made by the State, the TFC made recommendations for grants-in-aid amounting to Rs.12757.9 crores in various sectors includes grant to local bodies, disaster relief, elementary education, improvement of justice delivery, incentives for issuing UIDs, district innovation funds, grants for improvement of statistical systems, employees and pension database and environment-related grants. The quantum of all these grants to Bihar is given in Table 1. While every grant has grant-specific conditionalities, the basic necessary condition to avail each of these grants is the amendments of FRA incorporating the fiscal adjustment path recommended by the TFC for Bihar. According to the Commission, this requires measures to bring back fiscal prudence at the earliest opportunity for all States. Bihar currently has a manageable fiscal deficit and has shown a significant increase in development spending and large revenue surplus (Figure 2). From the latest available data it appears that the fiscal situation has significantly improved in recent years. However, according to the TFC report, the fiscal restraint will have to be imposed and the State should follow the defined fiscal restructuring path proposed by the TFC.

Figure 2: Fiscal imbalance profile of Bihar



II. Tax Devolution: Vertical Quantum and Horizontal Distribution

The TFC has enhanced vertical share of tax devolution to the States to 32 per cent and the share of Bihar is estimated at 10.917 per cent (see Table 2). Bihar's share of total tax devolution has progressively declined over the award period of successive Finance Commissions and the aggregate share of low income States in total horizontal distribution remained more or less stagnant at 54 per cent. The aggregate share of middle income states declined sharply and that of high income States

increased from 9.75 to 11.19 per cent during the award period of Twelfth Finance Commission and then declined marginally to 10.94 per cent as per the award of the TFC. Aggregate share of special category States increased sharply from 7.29 per cent to 9.6 per cent during this period. In other words, despite attaching high weightage to the income distance or fiscal capacity index for fiscal equity, the horizontal distribution formula failed to increase the aggregate share of devolution to the low income States and in the specific context of Bihar, its share continued to decline over the award period of the successive Finance Commissions, putting enormous fiscal strain on State finances. One of the major reasons behind low level of per capita development expenditure in Bihar vis-à-vis other States is the failure of the transfer system to offset fiscal disabilities of low income states.

Table 2: Tax devolution

	TFC	TwFC	EFC
Bihar	10.917	11.028	14.597
Low Income States	53.618	53.788	53.762
Middle Income States	25.839	26.842	29.189
High Income States	10.943	11.199	9.75
SC States	9.6	8.171	7.299
NSC States	90.4	91.829	92.701
Total	100	100	100

Source: Report of the 11th, 12th and 13th Finance Commission's Reports

The horizontal distribution formula of the TFC comprises of four different indicators viz., area, population, fiscal capacity distance and index of fiscal discipline. The weights assigned to these are the following: fiscal capacity distance (47.5 per cent); area (10 per cent); population (25 per cent); and index of fiscal discipline (17.5 per cent).

'To arrive at a new formula on the horizontal distribution of tax revenue among States, the TFC has worked out the average tax to gross State domestic product (GSDP) ratios separately for general and special category States and applied the group-specific averages to obtain the potential tax effort to estimate the per capita fiscal capacity at comparable levels of taxation. It has then computed the fiscal distance (weight of 47.5 per cent) by benchmarking the per capita revenue of Haryana and simultaneously dropping the income distance method proposed by the Twelfth Finance Commission. This is an interesting innovation, but while the TFC claims this is a more direct way of estimating fiscal capacity than the income distance method, it is important to remember that the relationship between income and tax is non-linear because of the differences in the taxable consumption basket between high, middle and low income States. Also, as the central sales tax (CST) continues to exist, there is significant tax exportation taking place from the producing high-income States to the consuming low-income States. Thus, the new horizontal formula creates an inherent bias against the low income States.' (*Economic and Political Weekly*, March 27, 2010, page 7).

Area and population are neutral indicators of need, while fiscal capacity distance tries to equalize fiscal capacity differences across States. On the other hand, the index of fiscal discipline tries to capture the efficiency in fiscal management by comparing own revenue to total revenue expenditure ratio of the States in two different time points. The index of fiscal discipline is worked out with 2005-06 to 2007-08 as reference years and 2001-02 to 2003-04 as base year.

If we look at the horizontal distribution formula, fiscal capacity distance and the index of fiscal discipline together in the same formula contradict the objective of achieving horizontal equality. The fiscal capacity distance tries to enhance the fiscal capacity of the States, the index of fiscal discipline tries to limit States expenditure in relation to States' own revenue. If the objective of fiscal equalization is to provide comparable levels of public services at comparable levels of taxation, such a principle cannot be achieved by an index of fiscal discipline defined as own revenue to revenue expenditure ratio, but through some measure of expenditure equalization given the total revenues including devolution and grants. If the objective is to equalize fiscal

capacity, both indexes of fiscal discipline and fiscal capacity may provide conflicting signals to the States. Given largescale inequality in government expenditure in per capita terms, it is critical that the principle of devolution should primarily be driven by equity considerations. We have tried to examine if the index of fiscal discipline criteria is eliminated and the assigned share of the index is attributed to the fiscal capacity distance criteria, what would be the distributional

Table 3: Horizontal distribution formula: alternatives and outcomes

	States	FC-XIII shares	No fiscal discipline criteria	13FC shares
1	Andhra Pradesh	6.937	6.627	-0.310
2	Arunachal Pradesh	0.328	0.327	-0.001
3	Assam	3.628	4.045	0.417
4	Bihar	10.917	12.659	1.742
5	Chhattisgarh	2.470	2.512	0.042
6	Goa	0.266	0.245	-0.021
7	Gujarat	3.041	2.276	-0.765
8	Haryana	1.048	0.765	-0.283
9	Himachal Pradesh	0.781	0.760	-0.021
10	Jammu and Kashmir	1.551	1.691	0.140
11	Jharkhand	2.802	3.033	0.231
12	Kamataka	4.328	3.865	-0.463
13	Kerala	2.341	1.897	-0.444
14	Madhya Pradesh	7.120	7.596	0.476
15	Maharashtra	5.199	3.637	-1.562
16	Manipur	0.451	0.472	0.021
17	Meghalaya	0.408	0.435	0.027
18	Mizoram	0.269	0.272	0.003
19	Nagaland	0.314	0.325	0.011
20	Orissa	4.779	4.876	0.097
21	Punjab	1.389	0.990	-0.399
22	Rajasthan	5.853	6.045	0.192
23	Sikkim	0.239	0.244	0.005
24	Tamil Nadu	4.969	4.130	-0.839
26	Tripura	0.511	0.553	0.042
27	Uttar Pradesh	19.677	21.229	1.552
28	Uttarakhand	1.120	1.222	0.102
29	West Bengal	7.264	7.272	0.008
	All States	**100.000**	**100.000**	**0.000**
	SC States	9.600	10.346	0.746
	GC States	90.400	89.654	-0.746

change in devolution across States. The result is reported in Table 3.

Note: Basic Data from Thirteenth Finance Commission's Report.

Under the new formula, the share of devolution to the low income States increases significantly while the corresponding shares of high and middle income States decline. The share of Bihar under the new formula would have been 12.659 per cent as against 10.197 per cent recommended by the TFC. Similarly, the share of low income States like Chhattisgarh, Jharkhand, Madhya

Pradesh, Orissa and Uttar Pradesh would have gone up significantly under the new horizontal distribution formula as reported in the table. The fiscal distance criteria is already penalizing the State for its inefficiency by taking the group specific average tax effort not the actual tax effort. In other words, the fiscal distance estimated for States with lower tax effort than the average would have been higher otherwise with correspondingly higher transfers. Thus, also having the index of fiscal discipline in the horizontal distribution formula penalizes the States twice.

III. Revised Roadmap for Fiscal Consolidation

The Commission is unduly concerned about the fiscal expansion that has taken place during the global financial crisis and has argued for a return to the pre-crisis levels of fiscal balance. The logic of macroeconomic imbalances and the need for fiscal consolidation are not settled in economic theory, but even if one assumes that consolidation is a must for higher economic growth, is it right to seek a contraction in a time-bound manner when the economy is in a recovery phase? The timeline proposed to achieve a revenue surplus and bring down the fiscal deficit to 3 per cent of GSDP varies across states, depending on what their respective revenue and fiscal deficits positions were in 2007-08. It is proposed that states which incurred a zero revenue deficit or achieved a revenue surplus in 2007-08 should eliminate the revenue gap and bring down the fiscal deficit to 3 per cent of GSDP by 2011-12. Other general category States are supposed to eliminate the revenue deficit by 2013-14 and achieve a 3 per cent fiscal deficit by 2014-15 and there is also a separate path for fiscal consolidation for Kerala, Punjab and West Bengal, the States with large fiscal imbalances. This appears completely ad hoc and arbitrary, based on an exogenous numerical capping of debt limits of States. It is wrong to impose the same binding constraints on the States as recommended by the Twelfth Finance Commission – of fixing a uniform deficit reduction target for all the States. The only contrast now is that the TFC has proposed dissimilar fiscal adjustment time paths for different States to reach the fiscal deficit target of 3 per cent of GSDP. As the States are on varying growth paths, laying down a common fiscal deficit target will have a greater adverse impact on some States. This has the potential to further compound the problem of horizontal inequality (*Economic and Political Weekly*, March 27, page 7). The dissimilar fiscal adjustment path is designed in such a manner that those States who exercised greater fiscal restraint in the past, are given stricter norms compared to States with large deficits in 2007-08. As Bihar had a revenue surplus in 2007-08, the State has to have zero revenue deficit and 3 per cent of fiscal deficit by 2011-12.

This apart, the larger question is: given the restrictions imposed by the Commission for fiscal consolidation and the State-specific path for fiscal adjustment, we need to examine if Bihar has to follow the proposed path of fiscal adjustment would it be possible for Bihar to do so without cutting the discretionary development spending of the State, especially when there has been a spurt in development expenditure in recent years despite rule-based fiscal controls? In order to understand that, we first need to examine if the present fiscal policy stance of Bihar continues what will be the likely fiscal situation in Bihar during the award period of the TFC.

As is evident from table 4, if the present fiscal policy stance of the government of Bihar continues, the state will not be near to the proposed fiscal adjustment path of the TFC. Although the revenue surplus of the state will increase from 3.9 per cent of GSDP to 4.97 per cent of GSDP during 2010-11 to 2014-15, the fiscal deficit will go up from 2.73 to 6.02 per cent and the debt to GSDP ratio will go up to 38.63 per cent by the end of 2014-15. What are the possible reasons for such huge increases in fiscal imbalance? As evident from Table 4, both the social and economic services expenditures as a percentage of GSDP show a sharp increase and the capital expenditure to GSDP ratio increases sharply from 6.63 per cent in 2010-11 to 11.58 per cent in 2014-15. In other words, this increase in deficits will primarily be due to the increase in development expenditure of the State provided the growth of expenditure remains at the observed level used for projection. Given low development spending (in per capita term) vis-à-vis other States and corresponding physical and social infrastructure deficits, such an increase in government expenditure would not be possible given the fiscal consolidation path

proposed by the TFC unless the state revenue increases accordingly, which is unlikely given the low resource base of the state.

Table 4: Base Scenario: 'Business as Usual 'Fiscal' Adjustment Path

(as per cent to GSDP)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Revenue receipts	25.01	25.46	28.07	29.13	30.32	31.65	33.13
Own tax revenues	4.68	5.47	6.32	6.23	6.14	6.06	5.97
Own non-tax revenues	0.87	0.65	0.72	0.79	0.88	0.97	1.08
Central transfers	19.45	19.33	21.02	22.10	23.30	24.62	26.08
Revenue expenditure	21.62	25.34	24.17	25.09	25.97	27.00	28.17
General services	7.98	9.46	9.18	9.51	9.76	10.09	10.51
Interest payment	2.85	2.80	2.68	2.71	2.64	2.64	2.72
Pension payment	2.64	3.18	3.49	3.69	3.89	4.11	4.34
Social services of which	9.29	10.68	10.59	10.74	10.89	11.05	11.21
Education	5.06	5.84	5.61	5.77	5.93	6.10	6.27
Health	0.78	0.96	0.93	0.93	0.93	0.93	0.93
Economic services	4.34	5.20	4.40	4.84	5.33	5.86	6.44
Capital expenditure	5.29	6.68	6.63	7.57	8.69	10.02	11.58
Total expenditure	26.91	32.02	30.79	32.66	34.66	37.01	39.75
Revenue deficit	-3.39	-0.12	-3.90	-4.04	-4.34	-4.65	-4.97
Fiscal deficit	1.90	6.57	2.73	3.53	4.35	5.37	6.62
Outstanding debt	35.63	38.15	36.45	35.50	35.49	36.49	38.63

We have estimated the alternative fiscal scenario to see the level of development revenue expenditure contraction required to adhere to the path of fiscal consolidation proposed by the TFC. The alternative fiscal adjustment path compliant with the TFC recommendation is given in Table 5. As is evident from the table, if the fiscal deficit will have to be at 3 per cent as specified in the fiscal adjustment path of the TFC's revised road map for fiscal consolidation, development expenditure on social and economic services are expected to fall sharply during 2010-11 to 2014-15. If the entire burden of adjustment falls on capital expenditure, it would decline as a per cent of GSDP from 6.63 to 3.93 per cent during the same period. The outstanding debt to GSDP ratio will fall from 36.45 to 31.54 per cent. In other words, if the government of Bihar has to adhere to the fiscal consolidation path proposed by the TFC, the State would possibly not be able to bring in development expenditure equalization vis-à-vis other States in the award period of the TFC.

Table 5: Reform Scenario: Fiscal Adjustment Path Compliant with TFC Recommendations

(As a per cent of GSDP)

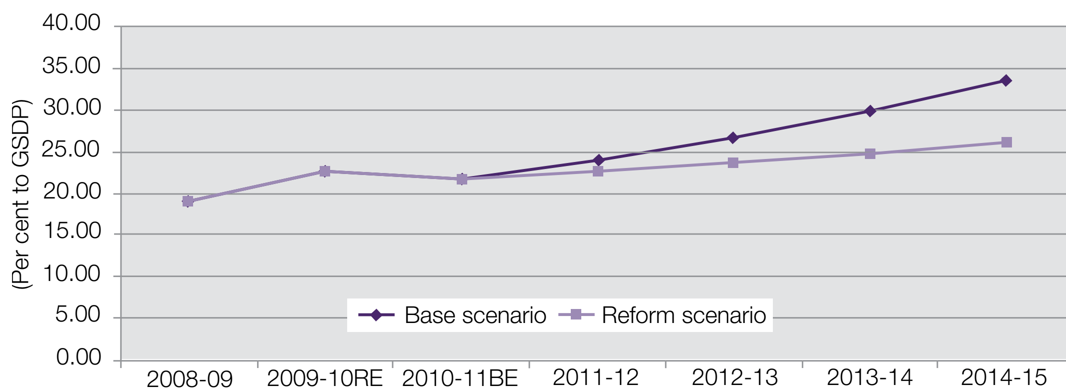
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Revenue receipts	25.01	25.46	28.07	29.13	30.32	31.65	33.13
Own tax revenues	4.68	5.47	6.32	6.23	6.14	6.06	5.97
Own non tax revenues	0.87	0.65	0.72	0.79	0.88	0.97	1.08
Central transfers	19.45	19.33	21.02	22.10	23.30	24.62	26.08
Revenue expenditure	21.62	25.34	24.17	25.90	27.71	29.80	32.20
General services	7.98	9.46	9.18	9.51	9.72	9.95	10.21
Interest payment	2.85	2.80	2.68	2.71	2.60	2.51	2.42
Pension payment	2.64	3.18	3.49	3.69	3.89	4.11	4.34
Social services of which	9.29	10.68	10.59	11.55	12.67	13.99	15.54

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Education	5.06	5.84	5.61	5.77	5.93	6.10	6.27
Health	0.78	0.96	0.93	0.93	0.93	0.93	0.93
Economic services	4.34	5.20	4.40	4.84	5.33	5.86	6.44
Capital expenditure	5.29	6.68	6.63	6.23	5.60	4.85	3.93
Total expenditure	26.91	32.02	30.79	32.13	33.32	34.65	36.13
Revenue deficit	-3.39	-0.12	-3.90	-3.23	-2.60	-1.85	-0.93
Fiscal deficit	1.90	6.57	2.73	3.00	3.00	3.00	3.00
Outstanding debt	35.63	38.15	36.45	34.97	33.68	32.54	31.54

The development spending gap that would emerge is given in Figure 2. As is evident, if the present fiscal stance continues the development expenditure to GSDP ratio will increase from 21.61 to 33.57 per cent during the award period of the TFC. In the TFC-compliant path the increase in development spending would be from 21.61 to 25.92 per cent during the same period which is much lower than the base scenario.

It is worth highlighting the estimates made by the Committee constituted by the Government of Bihar in 2006 titled 'Vision Bihar: Managing Financial Resources'. According to this Committee, of which the author was a member, in Bihar, in order to equalise per capita expenditures on developmental heads with all-State average per-capita expenditures for the year 2006-07 as the norm, additional resource requirement amounted to Rs. 14696.89 crores which worked out to be 20.07 per cent of GSDP (Table 6). Inability to cover such a large proportion of the

Figure 2: Development expenditure path: Alternative scenario



state's requirements year after year has created large social and physical infrastructure deficits hampering growth and private investment.

Table 6: Equalization of Per-capita Development Spending of Bihar with All State Average

Per capita Development Spending: All States (in Rs.)			
	2004-05	**2005-06 RE**	**2006-07 BE**
Development Expenditure	2514.03	3277.78	3357.34
Social Services	1315.43	1623.58	1772.53
Economic Services	1198.60	1654.20	1584.81
Per capita Development Spending: Bihar (in Rs.)			
Development Expenditure	903.78	1448.31	1763.45
Social Services	552.55	851.82	953.06
Economic Services	351.23	596.49	810.39
The Gap in Per Capita Spending (in Rs.)			
Development Expenditure	1610.25	1829.47	1593.88

Social Services	762.88	771.77	819.47
Economic Services	847.37	1057.71	774.41
Total Spending with equalization (In Rs Lakhs)			
Development Expenditure	2244122	2974654	3095734
Social Services	1174202	1473436	1634416
Economic Services	1069919	1501218	1461318
The Aggregate Gap (In Rs. Lakhs)			
Development Expenditure	1437371	1660283	1469689
Social Services	680975	700394	755618
Economic Services	756395	959889	714071
Gap as a per cent of GSDP			
Development Expenditure	22.89	23.38	20.07

IV. Design of Goods and Service Tax

The Empowered Committee of State Finance Ministers in early January could not reach a consensus on what the revenue neutral rate (RNR) of a GST should be (the rate which would leave the States with at least the same level of tax revenue as at present). Besides, more clarity is required on the proposed design of the GST with a number of issues yet to be settled. Which taxes will be subsumed under the new tax? What will be the compensation mechanism if there is a revenue loss to the States? What will be the nature of the constitutional amendments required to introduce the tax and will they also protect the fiscal autonomy of the States? What could be the acceptable rate of GST for both the Centre and the States? Should the States have two rates as in the case of the value added tax (VAT) or only a single GST rate?[6] With all these issues being discussed, the TFC proposed a GST design with its five specific components. These are (Rao: 2010):

1. A consumption-based tax subsuming the bulk of all indirect taxes including stamp duty and State excises, single rate regime with few exemptions[7], uniform threshold for Centre and all States, uniform rates of tax across all states, and a proposed design of treatment of inter-State transactions.

2. Emphasis on harmonised tax laws and procedures for administration, and common dispute resolution and advance ruling mechanisms, as well as simultaneous implementation by all States

3. A binding agreement between the Centre and the States on the design and rates of tax to be adopted as well as the conditions under which the rates could be altered. A proposed scheme of the commission argues that to reduce the rates all States would have to agree, and to increase the rates only two thirds need agree, with a veto power accorded to the Centre.

4. Precise disincentives for non-compliance in the form of withholding of State specific grants and GST compensation grants in the event of violation of the agreement.

5. Phased implementation allowing for delayed incorporation of real estate transactions into the base and allowing for a two rate tax in place of one rate in the initial years of implementation with an agreement to move forward before 31 December 2014.

Although, it is ideal to have a GST with a broad base subsuming the bulk of the indirect taxes, in reality the GST design proposed by the Finance Commission is far from what is being discussed in the Empowered Committee of State Finance Ministers. Also, as per the TFC's Terms of Reference, it was required to assess the implications of a GST on the finances of Centre and States in making its recommendations. Instead it has suggested an alternative model of GST which is in no way near to what the states are discussing in the empowered committee. The other major problem of the Finance

6 Chakraborty, Pinaki, 2010

7 Prescribed list of exemptions are unprocessed food, public services provided by all governments excluding railways, communications and public sector enterprises, service transactions between an employer and an employee and health and education services.

Commission's deliberations is its taskforce report on GST, which proposed a revenue neutral rate of GST at 7 per cent for the States and 5 per cent for the Centre, putting the combined GST rate at 12 per cent, which is even lower than the existing general VAT rate at the State. The taskforce report has serious methodological problems and States like Bihar needs to argue for an appropriate revenue neutral rate so that the State at least continues to have the fiscal autonomy in terms of taxation of consumption. The major limitations of the task force report are summarized below.

The study used profit and loss account of producers available with the Income Tax Department to estimate the GST base. For the purpose of estimating the GST base, the study used the following methods: (a) subtractive-indirect method, (b) consumption method, (c) revenue method, and (d) Shome Index method. Using these methods, the study uses a range of variations in the GST base and resultant RNRs. To begin with, if four different methods provide four different estimates, it is not appropriate to take an average of these estimates and present the same as the estimate. Further, what is estimated as Shome Index method, is more wishful thinking than estimate. By assuming that the design and administration of the tax should aim for the ½ mark and inferring a base from the same is inappropriate. Shome Index works with a base and the rates suggest what the likely revenue collection can be. Therefore, our comments do not cover this estimate. For the rest of the exercise, our comments are listed below:

The gross value of output of the sample entities as reported in the report is Rs 91, 12, 385 crores in 2007-08. The report compares this figure to a figure for value of output from the National Accounts Statistics. In this context, it needs to be mentioned that National Accounts Statistics does not provide any figure for the total value of output in the country. Value of output is provided for the few sectors listed below. As evident from the Table the factor of adjustment varies widely across sectors. Further, the values of output associated with any level of GDP would vary significantly depending on the structure of industry- a vertically integrated industry would have lower levels of output given the levels of GDP and vice-versa. Thus, the discussion on the appropriateness of the CSO number does not appear valid. Also, arriving at the gross GST base based on gross value of output may give over/ under estimation of base due to the reasons discussed above.

Table 7: Sectoral Value of Output and Sectoral GDP

(Rs. Crore)

	Value of Output (1)	GDP (2)	Factor of Adjustment (1)/(2)
Agriculture and Allied	894420	718278	1.25
Mining and Quarrying	155075	118276	1.31
Manufacturing Registered	2459813	520689	4.72
Manufacturing Unregistered	944794	221169	4.27
Construction	1070400	365735	2.93
Communication	40610	27808	1.46
Total	5565112	1971955	2.82
Nonagricultural Sector	4670692	1253677	3.73

Source: National Accounts Statistics (2009), CSO

In our view, instead of arriving at the GST base from the data on profit and loss from producers, available with the Income Tax Department, the direct way would be to estimate the incremental base available for the taxation of services. With that one should be able to add the realistic base of goods as goods that are already being taxed. This gross base needs to be further adjusted for the input tax credit, cascading and final sales of output still available for input tax credit, to arrive at the net base available for taxation.

The report talks about the input tax credit for capital goods. The estimate of the value of capital goods purchase appears to be a gross underestimation. The value of capital goods purchase is estimated at Rs. 457505 crore and that works out to be only 25 per cent of the gross capital formation in a year.

Lower capital good purchase would mean higher net base for taxation and correspondingly lower revenue neutral rate. For a realistic estimate of net base one needs to have a second look at the quantum of capital goods purchase and corresponding input tax credit. The study also reports Rs. 1713887 crore worth of intermediate input purchases from the unregistered dealers. Since both income tax authorities as well as indirect tax authorities would be uncomfortable with documentation for expenses from the informal sector – a sector which cannot provide appropriate bills – it is not clear how the study can assume such large proportions for purchases from the informal sector. While there are no substantive studies to document the extent of transactions between the formal and the informal sector, however they may be defined, there is recognition of the possibility of very limited interactions between these sectors, especially in the context of the operation of VAT regimes. Conservative assumptions on this account would therefore be more appropriate. Further, it should be recognized that a GST regime, if it leads to formalization of the economy, would actually result in a reduction in any such potential tax revenues.

The size of the unregistered manufacturing sector in terms of value of output as per the CSO data for the year 2007-08 is only Rs. 944794 crore and the GDP of the sector is Rs. 221169 crore. The major limitation of the study is that the value of purchases from the unregistered dealer is taken at Rs. 16, 82145 crore. This means not only that the entire unorganized manufacturing sector sells to the formal sector but also unorganized services will have sales worth around Rs. 700000 crore to the formal sector. This appears to be a completely unrealistic assumption and before arriving at such a number one needs to quantify the linkage between the formal and informal sector with regard to the purchase of goods and services.

One is also not certain whether the profit and loss account data available with the Income Tax Department also has the sectors which are exempt or will be exempted from indirect taxation. There may be business accounts paying income tax but falling in the exempted category when it comes to indirect taxation and vice-versa. Unless this is adjusted, the estimation of base will not be correct.

Further the data needing to be adjusted are those for the construction sector, financial services and real estate and dwellings. In the case of construction it should only be the value added in the construction. In the case of financial services it should be adjusted for the interest on advances which would not be part of the GST and in the case of ownership and dwellings a large part is notional income and would not be available for taxation. The discussion paper does not present any views on whether these sectors would be brought under the tax net. The Real Estate sector has always been dogged by issues of valuation. Clearly, all real estate sales cannot be subject to GST, since there would be stamp duty paid on these transactions already. If sales in old property are to be brought under GST, valuation issues will remain. Without addressing these concerns, it not clear whether a slippery base such as real estate should be brought into the tax net for estimating the base and the resultant rates.

Finally, the estimated RNR will also have to be adjusted for the various design issues discussed in the discussion paper, particularly taxes that remain outside the GST. It appears that Goods and Passenger Tax and Electricity Duty will not form part of the GST. The estimate is required to be adjusted for such changes in the design of taxes.

In this context, an alternative estimate of the GST base and revenue neutral rate is required for the State of Bihar. We have taken data for the fiscal year 2007-08 for the purpose of RNR calculations, since that is the latest year for which comprehensive data is available. For the purposes of this exercise, we have defined the revenue target as equivalent to that raised through VAT, CST and Electricity Duty at present. While there are some other taxes proposed to be subsumed into GST, since information on the bases associated with these taxes is not accessible, they are eliminated from the exercise. Since these taxes come with some associated bases, the overall rates would not be altered substantially by this exclusion. The approach adopted in this exercise is as follows: for the goods part of the tax base, the base presently under tax by the State government is taken as estimate and for the services component, the sales turnover for various activities for companies covered by the PROWESS database is taken. Since information on the turnover associated with State VATS is not readily available, the information on revenues was used to derive an estimate for the taxable base, based on the following assumptions: 30 per cent of the trade tax revenue has been deducted on account of revenue from

petrol, diesel and alcohol. For the rest of the revenue, 2 per cent of total taxable turnover is assumed to be taxes at 1 per cent, 33 per cent of the taxable turnover at 4 per cent tax rate and the rest at the standard rate of 12.5 per cent.

To arrive at the base for services, we have started with the National Industries Classification code of 2004 to identify what constitutes service sector industry at the national level (See Table 8). Having obtained the NIC classification, we used the Prowess data base (CMIE) to find out what could be the available base for services for the purpose of taxation at the national level.

Table 8: What is Service Sector as per NIC Classification?

NIC-2004	Activity
55	Hotels and Restaurants
602	Other Land Transport
61	Water Transport
63	Supporting and Auxiliary Transport Activities: Activities of Travel Agencies
64	Post and Telecommunications
659	Other Financial Intermediation. [this group includes financial intermediation other than that conducted by monetary institutions.]
66	Insurance and Pension Funding, except Compulsory Social Security
67	Activities Auxiliary to Financial Intermediation
70	Real Estate Activities
71	Renting of Machinery and Equipment Without Operator and of Personal and Household Goods
72	Computer and Related Activities
73	Research and Development
74	Other Business Activities
80	Education
85	Health and Social Work
90	Sewage and Refuse Disposal, Sanitation and Similar Activities
9191	Activities of Religious Organisations
9199	Activities of Other Membership Organisations NEC
92	Recreational, Cultural and Sporting Activities
93	Other Service Activities

It is important to understand what is available from the Prowess data base. Prowess is a database of large and medium sized Indian firms. It contains detailed information on over 20,000 firms. These comprise:

- All companies traded on India's major stock exchanges.
- Several others including the central public sector enterprises.
- The database covers most of the organised industrial activities.
- Banking.
- Organised financial and other services sectors in India.

The companies covered in Prowess account for 75 per cent of all corporate taxes and over 95 per cent of excise duty collected by the Government of India. Prowess provides detailed information on each company. This includes a database of the financials covering 1,500 data items and ratios per company. It provides quantitative information on production, sales, consumption of raw material and energy use. The data extracted on the service sector sale at all-India level is reported in Table

9. This for the year 2007-08 works out to be Rs. 3,35,189 crores. The all India services sector sales as reported in Prowess data set as a percentage of service sector's GDP works out to be around 7 per cent of GDP and 14 per cent of service sector GDP and around 1/3 of the service sector GDP excluding the exempted sector.

Table 9: Service sector sales as per NIC classification

Sales Data: As per NIC Code	2007-08
Service Sector Sales (all India)	335189
Revised Sales Figure	844986
GDP at Factor Cost	4320892
Service Sector GDP	2339468
Service Sector Sale as % of GDP	19.6
Service Sector Sale as % of Service Sector GDP	36.1
Service Sector Excluding Exempt Sectors	1227470
SS Sales as % of Services Excl. Exempt. Services.	68.8

Sales data obtained from the Prowess data set are a very conservative estimate of service sector activity. We have tried to have a more realistic estimate of service sector base by mapping service-wise tax collection data against the data on sales obtained as per the NIC code and adjusting the turnover/ sales based on the tax collected from each category of services. Having done this adjustment, we have obtained a revised sales of service sector at Rs. 754883 crore. This is further adjusted for some of the important currently exempt services which would be part of GST base, viz., railway passenger fare and railway freight on exempt commodities, electricity revenues from supplies to domestic consumers and exempt sectors and air fares. For all the services, two kinds of adjustments have been made, viz., deduction for taxable inputs used for service provision and deduction of services provided when used as inputs into taxable activities. For these corrections, the input-output table for 2006-07 has been used to derive service-specific input-output ratios (See Table 10). As evident from Table 9, service sector sales as a percentage of service sector GDP excluding the exempt sector works out to be 68.8 per cent. However, this is a gross base which has been corrected for inputs for which tax credit will be claimed and using services as an intermediate input, to arrive at the net taxable base. When talking about the sale within a State one has to exclude the exports and include imports. Given the nature of the service sector, a major part of the service export would be IT exports. In order to derive a conservative estimate of base we have excluded the entire computer and related activities from the base (See Table 10). We have also excluded real estate activities and limited the tax base for the following services according to the service tax collection, viz., research and development, education and health services. After these corrections, the net tax base as reported in Table 10, is Rs. 259119 crore.

Table 10 : Input Coefficients and the adjusted base

	Taxable inputs/ output ratio	**Share of sales used as inputs**	Net Additional Base (Rs. Crore)
Hotel and Restaurant services	0.310535	0.137036	5906
Transport services	0.407863	0.43389334	41279
Post and Telecommunication services	0.124205	0.70641745	33211
Financial services	0.07555	0.72606917	39070
Real Estate activities	0.046972	0.06472144	23187
Renting of Machinery and Equipment without Operator and of Personal and Household Goods	0.015183	0.64301983	4679
Computer and related activities	0.103611	0.07353309	86181

	Taxable inputs/ output ratio	Share of sales used as inputs	Net Additional Base (Rs. Crore)
Research and Development	0.045501	0.00088177	54
Other Business Activities	0.127913	0.84847271	21475
Education	0.127913	0.00088177	15712
Health and Social Work	0.299092	0.00893679	474
Sewage and Refuse Disposal, Sanitation and similar activities	-	-	-
Activities of Religious Organizations and other Membership Organizations	0.13176031	0.41057617	868
Recreational, Cultural and Sporting Activities	0.13176031	0.41057617	6282
Total			**278384**
Additional Services coming under tax net			
Railways: Passenger Earnings			11750
Railways: Freight on Exempt Commodities			2471
Air Fare			20606
Electricity Value Added-Domestic Consumption			23540
Electricity Value Added-Agriculture Consumption			31735
Services Excluded in the Estimation of Base			
Real Estate Activities			23187
Computer and related activities			86181
Net Additional Base for GST			**259119**

Source: Derived by authors using Input Output Tables, PROWESS database and service tax collections

The real challenge is to arrive at the sale of services in individual States. We have estimated the share of states in the total base by applying individual States' share in total value added in the service sector in the country. The estimated base for individual States for services is given in Table 11 and the corresponding revenue neutral rates in Table 12. We have estimated two rates: (i) RNR at a single rate (ii) if there are two rates, where the present category of 4 per cent goods continue to be taxed at 4 per cent. In the case of two rates, we assumed the same share of the turnover as taxed in the case of goods tax will also be taxed at the 4 per cent rates.

Table 11: Additional Increase in Base due to GST: Major States

	Rs Crore
Andhra Pradesh	19729
Bihar	8824
Chhatishgarh	3206
Goa	917
Gujarat	14877
Haryana	7414
Kerala	13849
Karnataka	15667

	Rs Crore
Madhya Pradesh	9570
Maharashtra	43923
Orissa	5397
Punjab	8110
Rajasthan	9308
Tamil Nadu	21790
Uttar Pradesh	21685
West Bengal	21934
Total	226200

Source: Computed

It should be highlighted that the closer we are to a single rate regime, the lower will be the corresponding RNR. In other words, if fewer commodities are in 4 per cent category, the RNR as shown in Table 10 can be considerably lower. If, for instance, the tax base subject to 4 per cent rate is limited to 20 per cent of the taxable turnover of goods instead of 33 per cent, the revenue neutral rate can be brought down by over a percentage point for each of the States considered.

Table 12: The Revenue Neutral Rates

	Single Rate	Two Rates
Andhra Pradesh	9.30	11.69
Bihar	6.80	7.72
Chhatishgarh	12.00	15.47
Goa	9.07	11.36
Gujarat	11.82	15.26
Haryana	10.72	13.71
Kerala	8.78	10.22
Karnataka	9.67	12.18
Madhya Pradesh	9.65	11.95
Maharashtra	9.84	12.19
Orissa	10.49	13.22
Punjab	9.62	11.95
Rajasthan	9.63	12.09
Tamil Nadu	9.25	11.53
Uttar Pradesh	9.05	11.11
West Bengal	8.35	9.85
All States	9.69	12.05

As mentioned earlier, having GST without some of the important services being subsumed may result in cascading and the real benefit of GST as a non-distortionary tax without cascading would be substantially compromised. Thus, it is important to find out if inclusion of both goods and passenger tax and the electricity duty would alter the revenue neutral rates to a significant extent. We have reworked the revenue neutral rates when both these taxes are subsumed in the State GST and the lower rate of tax is 5 per cent. The numbers are reported in Table 13. It shows that even with these two additional taxes the revenue neutral rates increases marginally.

Table 13: RNR with a comprehensive Base

	Single Rate	Two Rates
Andhra Pradesh	9.96	12.40
Bihar	8.46	9.35
Chhattisgarh	9.39	10.51
Goa	3.90	3.80
Gujarat	12.22	15.51
Haryana	10.21	12.21
Kerela	8.82	9.96
Karnataka	11.05	13.84
Madhya Pradesh	10.53	12.54
Maharashtra	12.12	15.74
Orissa	9.68	11.12
Punjab	8.46	9.69
Rajasthan	9.05	10.69
Tamil Nadu	10.85	13.68
Uttar Pradesh	9.99	12.30
West Bengal	9.46	11.27
Average Rate	10.30	12.52

V. State-Specific Grants

The TFC, given its vast ToR, tried addressing them through various sector and State-specific grants. As shown in Table 1, for Bihar these sector-specific grants worked out to be Rs. 14602.8 crore. Out of these total grants, local bodies grants and grants for disaster relief are Rs. 5682.1 crores and Rs. 1411.2 crore respectively so the remaining grants amounting Rs. 7509.5 crore are specific purpose transfers given to the State of Bihar. All these grants are conditional and availability of these grants could depend on meeting those conditions during the award period of the Commission. The other major grant is on elementary education to the tune of Rs. 4018 crore. The availability of this fund would depend on the conditions attached to it. The conditionality attached to the release of the elementary education grant is that Bihar has to maintain its own expenditure on elementary education at 8 per cent per annum during the award period of the Commission to be eligible for this grant. Bihar's trend growth rate of expenditure on elementary education has been 16.48 per cent during 2001-02 to 2007-08. If we take recent years, the expenditure on elementary education in Bihar has grown at the rate of 24.14 per cent during 2005-06 to 2008-09. As evident, it is much higher than the 8 per cent prescribed by the Finance Commission. However, the bigger question is whether the State of Bihar will be able to maintain this high growth in education expenditure given the fiscal constraints imposed by the revised road map for fiscal consolidations. It may so happen that due to the imposed fiscal constraint of the TFC, the State may actually have a lower expenditure despite having the grants for elementary education.

In nominal terms, the grant for elementary education proposed by TFC is much higher than what was proposed by the Twelfth Finance Commission.[8] The Twelfth Finance Commission grant for education for Bihar was 2728.76 crore. The complete equalization requirement as per the Twelfth Finance Commission norm worked out to be 18191.73 crore for Bihar for its award period. Thus the grant that has been provided by the TFC is inadequate to bring in education expenditure equalization as per the Twelfth Finance Commission norms and it is only 22 per cent of the complete equalization requirement as per the Twelfth Finance Commission norm that too in nominal terms.

8 For the purpose of partial equalization of per capita education expenditure of Bihar, Twelfth Finance Commission also given grants to selected States including Bihar.

It is also important to note that the TFC has pegged the grant for elementary education based on Sarva Sikhsha Abhiyan (SSA) norms and recommended a grant of 15 per cent of the estimated expenditure of each State provided by Ministry of Human Resource Development on SSA. The rationale given by the Commission is that this grant will augment State resources and provided adequate fiscal space to implement the Right to Education Act and also would help the States to provide for the anticipated increase in the share of States contribution for SSA by the terminal year of 11th Plan to 50 per cent. This is ad hoc and arbitrary. Instead of depending on the SSA norms and justifying it for the purpose of enhancement of States' contribution for SSA, the Commission should have revised its own norms for complete equalization and given grants required for States. This kind of partial approach towards equalization may not achieve the desired outcome. At best it can tinker at the margin. As there are strict norms set for fiscal consolidation and adherence to those norms is mandatory for the States for the purpose of State-specific grants, the scope for the low income States like Bihar to increase expenditure on elementary education to meet the deficient gap in providing elementary education appears impossible in the short run and the grants as transfers would serve only a very limited role. This also poses the danger of States bringing down expenditure to 8 per cent per annum to avail this grant to adhere to the fiscal constraint imposed by the Commission.

Transfer to Local Bodies

Following the 73rd and 74th Constitutional Amendments, starting from 10th Finance Commission, every Finance Commission has recommended grants in aid to local bodies. Except TFC all other FC's have recommended grants to the LBs fixed in absolute volume. It is the TFC which thought that it is important to provide a predictable resource flow to the local bodies. Although after the 73rd and 74th Constitutional Amendments States have devolved functional responsibilities to the local bodies, they still continue to be dependent on transfers and their roles remain that of largely performing agency responsibilities dictated by the higher levels of the government. In this context, the TFC approach, which states that the local government needs to be given a predictable flow of resources and correspondingly substantial increases in devolution compared to the past, is a welcome step. The Commission has also recognized "that larger fiscal transfers to the local bodies to encourage speedier implementation of the 73rd and 74th Constitutional Amendments regarding the transfer of functions and functionaries in consonance with the subsidiarity principle" is a meaningful approach towards enhancing the cause of decentralization. The most important recommendation of the TFC is its decision to link grants to local governments to a share of the divisible pool of the union tax revenue. This accounted for 87,519 crore which is more than three times higher than Rs. 25,000 crore recommended by the 12th FC.

The grant recommended by the TFC has two components, the basic component and the performance-based component. The basic grant is equivalent to 1.5 per cent of the previous year's divisible tax revenue. All the States will have access to this grant for all the five years. A part of this grant is also earmarked for Schedule V and Schedule VI areas. The performance grant effective from fiscal year 2011-12 will be 0.5 per cent for 2011-12 and 1 per cent thereafter, upto 2014-15. The availability of the performance grant is subject to 9 points of conditionalities. These conditionalities are the following:

(I) The State Government must put in place a supplement to the budget documents for local bodies (separately for PRIs and ULBs) furnishing the details (other than those relating to Finance Accounts). They should require the PRIs and ULBs to maintain accounts. To demonstrate compliance with this condition, a State Government should: (a) submit the relevant supplement to the budget documents and (b) certify that the accounting systems as recommended have been introduced in all rural and urban local bodies.

(ii) The State Government must put in place an audit system for all local bodies (all categories of ULBs and all tiers of PRIs).

(iii) The State Government must put in place a system of independent local body ombudsmen who will look into complaints of corruption and maladministration against the functionaries of local bodies, both elected members and officials, and recommend suitable action.

(iv) The State Governments must put in place a system to electronically transfer local body grants provided by this Commission to the respective local bodies within five days of their receipt from the Central Government.

(v) The State Governments must prescribe through an Act the qualifications of persons eligible for appointment as members of the SFC consistent with Article 243I (2) of the Constitution.

(vi) All local bodies should be fully enabled to levy property tax (including tax for all types of residential and commercial properties) and any hindrances in this regard must be removed.

(vii) State Governments must put in place a State-level Property Tax Board, which will assist all municipalities and municipal corporations in the State to put in place an independent and transparent procedure for assessing property tax.

(viii) Lack of resources often results in local bodies diluting the quality of services provided by them. State Governments must gradually put in place standards for delivery of all essential services provided by local bodies.

(ix) All municipal corporations with a population of more than 1 million (2001 census) must put in place a fire hazard response and mitigation plan for their respective jurisdictions.

The horizontal distribution of this grant is based on six indicators: population (50 per cent); area (10 per cent); distance from highest per capita sectoral income (20 per cent); index of devolution (15 per cent); SC/ST proportion in population (10 per cent); and FC LG grants utilization index (5 per cent). It is evident that the population is assigned the highest weightage and if we include SC/ST population, the total weightage for population works out to be 60 per cent. Population is a neutral indicator of need but is not in a position to address the issue of fiscal inequality across jurisdiction. In this context, it needs to be emphasised that Bihar being a populous State would benefit due to the higher weightage assigned to the population. Also given the weak data at the local level it is very difficult for the Finance Commission to give a meaningful indicator of fiscal inequality at the local level. Thus, the neutral indicator of need, like population, is the second best choice. Bihar is expected to get Rs. 5682 crores as grants to the local bodies as per the TFC award. Out of that the performance grants would be available based on 9-points of conditionality mentioned earlier. In this context it needs to be highlighted that these conditionalities are critically important to improve the fiscal position as well as the basic structure of decentralization at the local levels. These 9-points of conditionality are intended to improve the system of decentralized governance in the country. The government of Bihar must try to fulfill these conditionalities to improve the decentralization system of governance with appropriate devolution of functions and corresponding finances.

VI. Conclusions

On the basis of the above analysis, it can be concluded that although the Finance Commission transfers have increased the share of tax devolution to the States from 30.5 to 32 per cent, the share of Bihar in total horizontal distribution at 10.917 per cent is lower than what was recommended by the Twelfth Finance Commission. The study observed that Bihar's share of devolution has been declining consistently over the award period of recent Finance Commissions, creating serious fiscal strain on State finances. The revised road map for fiscal consolidation proposed by the Finance Commission, though attainable for the State of Bihar, will have to be with a fiscal contraction especially through reduction in discretionary development spending which can further accentuate the already existing social and physical infrastructure bottlenecks. The Commission's approach towards GST implementation is a model far away from that being discussed in the empowered committee of State Finance Ministers, and there is less likelihood that the proposed model will be accepted by the States. The revenue neutral rate estimated in this paper shows that if Bihar has to protect its current level of revenue, the rate of GST will have to be higher than what is proposed by the GST taskforce of the TFC. With regard to the specific purpose grants, especially for education, the analysis reveals that it is way below the complete equalization requirement even with respect to the norms prescribed by the Twelfth Finance Commission. However, substantial increase in the devolution to the local bodies by the TFC and the suggested reforms for decentralization if carried forward by the State, can strengthen the local-self governments in Bihar.

Reference: *Economic and Political Weekly* (2010): Whither the States in the Fiscal Arrangements, editorial, March 27, page 7-8

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