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Tax devolution and discriminatory effects on southern India

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Abstract

This paper analyzes tax devolution policies and their discriminatory impact on Southern Indian states such as Andhra Pradesh, Karnataka, Kerala, Tamil Nadu, and Telangana, during the periods of the 10th to 15th Finance Commissions. The study utilizes secondary data to explore how India's fiscal federalism has evolved in terms of tax devolution versus grants. The paper is divided into four sections: an introduction, a brief review of tax devolution, an examination of trends and performance of tax devolution and discriminatory effects in Southern India, and a summary with conclusions. Key findings indicate a shift from tax devolution to increased grants over time, especially during the 15th Commission, which aimed to address regional inequalities. The study also notes a rise in non-FC grants, particularly during the COVID-19 period, highlighting a trend toward flexible, program-based funding. Despite overall growth in financial allocations and decentralization, Southern states have experienced a declining share of Union taxes. This decline is attributed to lower population growth, higher per capita income, and a redistributive focus on poorer, more populous Northern states. For example, Andhra Pradesh's share decreased significantly after bifurcation, while Kerala and Tamil Nadu also saw reductions. In conclusion, the study emphasizes that India's resource distribution has become less favorable to Southern states, reflecting broader shifts in fiscal priorities and governance strategies. It underscores the need to balance equitable tax devolution, targeted grants, and reforms to promote inclusive, high-growth development. Additionally, Southern states' concerns about tax distribution highlight the importance of fairness and sensitivity in financial transfers to maintain national cohesion while addressing diverse developmental needs.

Keywords: Discriminatory effects, Finance Commission, Financial grants, Fiscal federalism, Horizontal transfer, non-financial grants, Southern States, Tax devolution, Tax sharing, Union taxes, Vertical transfer.
JEL Classification: A14; E60; E62; E63; H30; H20; H21; H27.

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Contribution of this paper to the literature
I have compiled data on tax transfers from the 10th to the 15th Finance Commissions for Southern India. Based on this data, I have created a table that highlights an issue in the Finance Commission allocation. The Southern states are receiving a smaller share of funds compared to the Northern states.

1. Introduction

The Finance Commission has focused on fundamental development issues and the equitable distribution of public goods across states in India. The 16th Finance Commission, operating under Vision India 2047, faces more intricate challenges. It must address traditional issues like resource allocation while managing a fragile fiscal federal relationship. The dynamic between the centre and states has become more delicate, with increased scrutiny on states' fiscal health. The Prime Minister's support for the role of states in Vision India 2047 adds a new dimension to the Finance Commission's work. The Commission's recommendations will play a pivotal role in shaping the country's fiscal federalism and its ability to achieve the ambitious goals of Vision India 2047. It aims to elevate India to a higher level of development by its centenary year. The 16th Finance Commission's recommendations are more crucial than ever, as its decisions will have a significant impact on India's fiscal federalism, which is vital to achieving the goals of Vision India 2047.

1.1. Daunting Challenge of Achieving Aspirational Targets

Govinda (2024) highlights the significant challenge of achieving the aspirational target of a per capita income (PCI) of $13,200. India's current PCI is far below this goal, and reaching it within 25 years requires extraordinary growth and sustained effort. To achieve this target, India's PCI needs to increase fivefold, requiring an annual growth rate of 7.5 percent over the next 25 years. India's GDP growth rate must reach 9-10 percent per year. This is a challenging goal, especially when compared to the rapid growth experienced by countries like China (9.6 percent GDP growth for 40 years starting in 1978) and South Korea (which became an OECD member within 25 years). Achieving these growth targets requires inclusive growth, creating enough jobs to absorb the 2 million people entering the workforce annually and transitioning millions from agriculture or the unorganized sector to more productive, well-paying, formal jobs.

To facilitate this transition, substantial investments are needed in education, skills development, and the creation of high-value sectors that can employ large numbers of people. India's current investment-to-GDP ratio is around 30-31 percent, but it must increase to 40 percent to drive necessary economic growth. Improvements in productivity, especially in manufacturing and services, are crucial. A key measure is the Incremental Capital-Output Ratio (ICOR), which indicates how much investment is needed to generate a unit of output. India's current ICOR is around 5, meaning a large amount of investment is required to achieve growth. The required investment increase from 30-31 percent to 40 percent of GDP cannot be achieved solely through domestic savings. India will need significant external investments, including foreign direct investment (FDI) and foreign portfolio investment (FPI). This necessitates creating an investment-friendly environment to attract global capital, alongside domestic reforms that encourage savings and investments.

1.2. Macroeconomic and Structural Reforms

Prof. Rao emphasizes the need for extensive macroeconomic reforms to support this determined growth. These reforms should include repairing the financial sector, enhancing infrastructure, fostering innovation, and ensuring that the benefits of growth are broadly shared. Additional reforms in labor laws, taxation policies, business regulations, and education systems will be necessary to facilitate the economy's transition to a high-growth, high-productivity state. India's bright future and the economic empowerment of its younger generation remain distant goals, and the path to achieving these growth targets will be challenging, full of obstacles, uncertainties, and complexities.

1.3. Objectives of the Paper

The objective of this study is to investigate tax devolution and discriminatory effects on Southern India during the 10th to 15th Finance Commissions in India. The paper begins with an introduction, followed by a brief review of tax devolution. The third section examines the trends and performance of tax devolution and discriminatory effects in Southern India. The fourth section provides a summary and conclusions.

2. Theoretical Foundations of Tax Devolution

Fiscal federalism theory was developed by Musgrave (1959) and Oates (1972). They examine the effectiveness of tax devolution. This theory suggests that decentralizing fiscal powers allows local governments to adapt tax policies to local preferences and needs. It highlights the challenges that arise, such as inter-jurisdictional competition, inequality between regions, and the need for central oversight to ensure national cohesion.

Musgrave (1959) benefit-cost theory suggests that local governments should raise taxes. Tax devolution is an optimal solution when the costs and benefits of public goods are largely local in nature. Tiebout (1956) suggests that people "vote with their feet" and move to jurisdictions that best match their preferred tax and service levels. Tax devolution may lead to more efficient outcomes by enabling local governments to compete for residents and businesses through tax and service offerings.

Oates' Decentralization Theorem Oates (1972) argues that decentralization can improve the efficiency of public service delivery by aligning government policies. Fiscal decentralization may worsen regional disparities without proper redistributive mechanisms. Vertical Fiscal Imbalance occurs when local governments do not have the fiscal capacity to fund their responsibilities independently. It is leading to reliance on transfers from the central government. Studies on India and Argentina highlight this imbalance and suggest that tax devolution alone is insufficient without accompanying equalization measures (Oates, 1999; Srinivasan, 2000).

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2.1. Empirical Studies on Tax Devolution and Discriminatory Effects

The literature on tax devolution explores its potential to affect equity and regional disparities. It focuses on fiscal imbalances, public service provision, and the role of political elites. Several empirical studies highlight the complexities of decentralization.

Bird (1999) examined how tax devolution could lead to enhanced competition among regions for investment and citizen satisfaction. Local governments would have a greater incentive to provide better services if they could raise their own taxes and compete with other regions. Tanzi (1996) highlighted that wealthier regions with greater fiscal autonomy and higher tax revenues could provide better public services, while poorer regions often face limitations in generating sufficient tax revenue, exacerbating regional disparities. Oates (1999) discussed horizontal fiscal imbalances between regions. He pointed out that fiscal disparities could result from differences in economic development, leading to inequitable public services across regions.

Boadway (2009) expanded on vertical fiscal imbalances and horizontal fiscal imbalances. It emphasizes that local governments may not have the revenue-generating capacity to meet their expenditure responsibilities, leading to reliance on central transfers. This can result in inefficient public service delivery and unequal development. Bardhan (2002) explored how decentralization, including tax devolution, could positively impact economic growth if local governments had significant fiscal autonomy and capacity. However, the lack of administrative capability in local governments, particularly in developing countries, could limit the effectiveness of decentralized taxation.

Khemani (2006) study on fiscal decentralization in India found that disparities in revenue generation between Indian states were a key driver of inequalities in service provision. Wealthier states could provide better services (e.g., education and healthcare), while poorer states faced resource constraints. Poterba (1997) study examined the role of local governments in setting tax rates, concluding that decentralization in ethnically or politically fragmented states could lead to targeted taxation policies that favor certain groups over others. Such policies might marginalize minorities or disadvantaged groups.

Feld and Kirchgässner (2001) studied the impact of local tax rates and found that decentralization could lead to regressive taxation if local governments set taxes too high or too low without proper oversight or equalization mechanisms. This could disproportionately harm disadvantaged groups. Zodrow (2003) discussed how global tax competition could exacerbate discriminatory effects in developing economies, as regions or countries with greater tax devolution compete by lowering tax rates, often at the expense of public services.

Smart and Bird (2009) study on equalization systems aims to reduce disparities. They fail to address structural factors contributing to inequality. These systems are frequently subject to political manipulation. They may not be adequately designed to equalize fiscal capacity across regions.

Cox and McCubbins (2000) study explored the experience of tax devolution in Latin American countries, finding that while decentralization gave local governments more fiscal autonomy. It also deepened disparities in public service quality between wealthier and poorer states. Shah and Shah (2006) focused on the former Soviet states, finding that fiscal decentralization led to increased income disparities. Wealthier areas attracted foreign investment and had higher tax revenues, while poorer regions struggled to meet basic fiscal needs.

De Mello (2001) study showed that regions with higher fiscal autonomy and tax capacity were able to provide better educational outcomes, while poorer regions continued to face challenges in providing adequate education and public services. Ribeiro (2005) study emphasizes that without proper equalization policies, fiscal decentralization can deepen regional disparities and reduce the effectiveness of decentralized governance, particularly in developing countries.

Studies on India's tax devolution show that the Finance Commission plays a key role in equalizing fiscal resources across states, but issues related to corruption, bureaucratic inefficiency, and the informal economy hinder the effectiveness of these arrangements (Srinivasan, 2000). Chelliah and Bagchi (1993) have explored the challenges of revenue-expenditure mismatches, emphasizing the need for equity and efficiency in devolution. The equity-efficiency trade-off in inter-state transfers, where resources are redistributed to less developed states, often at the expense of more developed one (Srivastava & Rao, 2020) show that northern states benefit disproportionately from central transfers, while southern states face challenges in sustaining their development trajectories under reduced allocations.

These empirical studies illustrate the complex relationship between tax devolution and its potential discriminatory effects. While decentralization can promote local autonomy, efficiency, and citizen satisfaction, it also brings challenges such as horizontal fiscal imbalances, vertical fiscal imbalances, and regressive taxation. These challenges can exacerbate regional disparities and socio-economic inequalities, especially when local governments lack sufficient fiscal capacity or administrative capabilities.

The studies suggest that while tax devolution can improve local autonomy and efficiency, it can also deepen inequalities unless carefully managed. To address these issues, many scholars advocate for equalization transfers, capacity-building, and targeted policies to ensure more balanced development across regions.

3. Research Methodology and Data Base

This study relies on secondary data collected from various published and unpublished sources, including central and state government documents. Government documents were obtained from the Reserve Bank of India, Finance Commission Reports, Ministry of Finance, and Government of India. The study covers the period from the 10th to the 15th Finance Commissions, and simple percentages and averages were used to calculate the effects of tax devolution in India.

4. Results and Discussion

The criteria for horizontal devolution have shifted over time, particularly with the Finance Commission's inclusion of the 2011 Census data. This shift has raised concerns among southern states with lower population growth rates, which feel disadvantaged despite their demographic management successes.

4.1. Horizontal Devolution Criteria

These are designed with the idea of providing basic minimum public goods equitably to all the states. This is not with Vision India 2047, and the 16th Finance Commission has to redesign it to ensure co-evolution.

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Table 1. Criteria for Horizontal Devolution Across Indian States.

Distribution basis	10th FC	11th FC	12th FC	13th FC	14th FC	15th FC
Income distance	60	62.5	50	47.5	50	45
Population (1971)	20	10	25	25	17.5	-
Area	5	7.5	10	10	15	15
Forest cover	-	-	-	-	7.5	-
Forest ecology	-	-	-	-	-	10
Infrastructure basis	-	7.5	7.5	-	10	-
Fiscal discipline	-	7.5	7.5	17.5	-	-
Demographic performance	-	-	-	-	-	12.5
Tax effort	10	5	7.5	-	-	2.5
Total	100	100	100	100	100	100

Source: Calculated from union finance commission reports (10 to 15).

The criterion for horizontal devolution across Indian states, as determined by different Finance Commissions, is presented in Table 1. During the 10th and 11th Commissions, emphasis was placed on income disparity, with 60 percent and 62.5 percent of the weight assigned to income distance. This focus gradually decreased in the 15th Commission, reducing to 45 percent. It reflects a broader shift towards other factors such as fiscal discipline, infrastructure, and demographic performance.

The population criterion (based on 1971 data) had significant weight in earlier FCs, but by the 15th Commission, it was excluded, signaling a move away from demographic size alone. This change highlights a preference for performance-based criteria, such as fiscal management and demographic management, rather than population size as the primary factor.

The area criterion initially had a small weight (5 percent in the 10th FC), grew over time. It reached 15 percent in the 14th and 15th Commissions. This shift recognizes that larger states require more resources for infrastructure and governance.

The 13th Finance Commission emphasized fiscal discipline, assigning 17.5 percent of the total weight. However, this criterion was eventually removed in the 14th and 15th Commissions. This change is due to improved fiscal management or a shift in focus towards other performance indicators. These changes reflect a transition from prioritizing demographic size and income disparities to incorporating a more diverse set of factors, including fiscal health, infrastructure needs, and performance-based criteria, to ensure fair and sustainable resource allocation.

Table 2. Share of Finance Commission grants in total transfers in India.

Finance commission	Tax share	FC grants	Total FC transfers to states
10th FC (1995-2000)	206343 (91.0 percent)	20300.3 (9.0 percent)	226643.3
11th FC (2000-2005)	376318 (86.5 percent)	58587 (13.5 percent)	434905
12th FC (2005-2010)	613112 (81.1 percent)	142639 (18.9 percent)	755751
13th FC (2010-2015)	1448096 (84.8 percent)	258581 (15.2 percent)	1706677
14th FC (2015-2020)	3948187 (88.0 percent)	537354 (12.0 percent)	4485541
15th FC (2021-2026)	4224760 (80.6 percent)	1016662 (19.4 percent)	5241422

Source: Calculated from union finance commission reports (10 to 15).

The share of Finance Commission grants in total transfers in India is presented in Table 2. During the 10th Finance Commission, the focus was predominantly on tax devolution, with tax shares accounting for 91 percent of total transfers (₹206,343 crore), while FC grants represented only 9 percent (₹20,300.3 crore). This low share of grants indicates that the primary objective of the 10th Finance Commission was to create a robust system of fiscal decentralization by allocating resources based on the tax revenues generated by the Union government. Thus, the approach was predominantly broad-based, with limited focus on addressing regional developmental disparities. The grants were primarily intended to tackle state-specific issues that required additional financial support beyond the general tax transfers.

The 14th Finance Commission saw a slight reduction in the share of FC grants, dropping to 12 percent of total transfers. However, the absolute value of FC grants surged to ₹537,354 crores, highlighting a shift towards more targeted financial support. The 14th FC introduced a significant increase in tax devolution, empowering states with greater autonomy over their finances. Despite the reduction in the percentage share, the increase in the total value of grants indicates that the 14th Commission still recognized the importance of providing supplementary support to states. This period marked a move towards decentralization, with the central government giving more financial control to the states, but the need for specific grants to address developmental inequalities or crises.

The 15th Finance Commission accounts for a significant 19.4 percent of total transfers, the highest proportion during the entire review period. This increase indicates a stronger commitment to providing specialized support to states facing chronic developmental challenges, including income inequality, underdevelopment, and disaster recovery. The substantial rise in the share of grants demonstrates that the 15th Commission aimed to address more targeted issues, ensuring equitable growth across regions. This reflects a broader national policy shift toward reducing regional disparities and improving the welfare of states with urgent needs, such as those affected by economic inequality and infrastructural deficits.

During the 14th and 15th Finance Commission periods, there has been a rising importance of grants due to a shift in India's fiscal policy. The focus on grants, especially for addressing regional disparities, indicates a commitment to inclusive development, ensuring that all states, regardless of their economic status, receive necessary resources to meet their developmental goals. This shift aligns with broader goals of social equity, with financial transfers increasingly directed toward states that require additional resources to overcome challenges such as poverty, infrastructure deficits, and the impacts of climate change.

The comparative trends in Finance Commission grants and non-FC grants from 2009 to 2023 are presented in Table 3. During 2011–12 to 2013–14, the share of Finance Commission grants fluctuated between 28 percent and 32.6 percent. The gradual increase in FC grants during this period can be attributed to a shift toward more targeted fiscal support. The government recognized the need to address state-specific development challenges

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more effectively, leading to a rise in FC grants during 2013–14. These grants were aimed at specific interventions such as infrastructure projects or poverty alleviation, which became more urgent during this time.

Table 3. Share of Finance Commission grants and non-grants in India.

Year	FC grants to total grants	Non-FC grants to total grants
2009-10	47087 (31.2)	103886 (68.8)
2010-11	48909 (29.9)	114588 (70.1)
2011-12	52199 (28.0)	134217 (72.0)
2012-13	48395 (25.6)	140286 (74.4)
2013-14	67133 (32.6)	138819 (67.4)
2014-15	71447 (21.6)	259358 (78.4)
2015-16	84579 (26.0)	241317 (74.0)
2016-17	95550 (26.8)	260541 (73.2)
2017-18	92244 (22.7)	313713 (77.3)
2018-19	93704 (21.3)	346165 (78.7)
2019-20	123710 (23.1)	410858 (76.9)
2020-21	184063 (28.6)	459778 (71.4)
2021-22	207435 (33.3)	415193 (66.7)
2022-23 (A)	172760 (19.7)	705011 (80.3)
2023-24(RE)	140429 (17.4)	665546 (82.6)

Source: Calculated from union finance commission reports (10 to 15).

During 2014-15 to 2016-17, there was a notable shift in the share of FC grants, which dropped to 21.6 percent in 2014-15, with non-FC grants comprising 78.4 percent of the total. This decline in the share of FC grants was accompanied by an increase in their absolute value, reflecting higher fiscal allocations from the central government. The focus shifted towards non-FC grants; however, FC grants still played an important role in addressing state-specific fiscal needs, such as poverty alleviation and disaster recovery.

During 2017-2021, the share of Finance Commission grants fluctuated between 22.7 percent and 28.6 percent. While the absolute value of FC grants continued to rise, their relative share of the total grants did not see significant growth. However, non-FC grants remained the dominant transfer mechanism. The increase in Finance Commission grants in 2020-21 (28.6 percent) can be attributed to the fiscal response to the COVID-19 pandemic. It was a significant emergency funding for states to address health, economic, and infrastructure challenges. This period highlighted the importance of FC grants in responding to sudden, unanticipated fiscal needs.

During 2021-2024, the share of Finance Commission grants peaked at 33.3 percent in 2021-22. This increase could reflect a policy shift toward prioritizing equitable growth and addressing regional disparities through targeted financial support. During 2022-23 and 2023-24, the share of Finance Commission grants declined significantly to 19.7 percent and 17.4 percent, respectively. This shift indicates a move toward increasing non-FC grants or enhancing general tax devolution. Non-FC grants accounted for 80-82 percent of total grants during this period. These grants, favored by the government for their flexibility and program-based funding mechanisms, are adapted to address specific state needs such as infrastructure development, poverty alleviation, and disaster management.

The gradual increase in FC grants between 2011-12 and 2020-21 indicates a growing recognition of the need for targeted development interventions to address regional disparities. However, the consistent dominance of non-FC grants reflects a broader preference for flexibility and specificity in funding mechanisms. Non-FC grants, focused on special interventions, allow the government to address a wide range of state-specific challenges, from infrastructure deficits to immediate crises such as natural disasters or public health emergencies.

Table 4. Share of tax revenue during the 10th to 15th Finance Commissions in India.

Particulars	10th FC	11th FC	12th FC	13th FC	14th FC	15th FC
Share of central tax	206343	376318	613112	1448096	3948188	4927000
Non-plan revenue deficit	7583	35359	56856	51800	194820	294514
Local bodies	5381	10000	25000	87519	287436	436361
Relief expenditure	4728	8256	16000	26373	55097	122601
Upgradation and special grants	2610	4973	7100	27945	-	49599
Total share	226645	434906	718068	1641733	4485541	5830075

Source: Calculated from union finance commission reports (10 to 15).

The financial allocations and projections for different Finance Commissions (FCs) in India, from the 10th to the 15th Finance Commission, are detailed in Table 4. A significant increase is observed between the 12th and 13th Finance Commissions, from ₹613,112 crores to ₹1,448,096 crores. This sharp rise in funds allocated to states and local bodies occurs through this mechanism. The Non-Plan Revenue Deficit has increased from ₹7,583 crores in the 10th FC to ₹194,820 crores in the 14th Finance Commission. This indicates a growing gap between revenue generation and expenditure needs of the central and state governments. The increase in the deficit reflects fiscal pressure.

The allocation for local bodies starts at ₹5,381 crores in the 10th FC and increases substantially to ₹2,87,436 crores by the 14th Finance Commission. This indicates a significant focus on empowering local bodies through decentralization. There is a massive increase in funding for local bodies, particularly from the 13th FC onwards. It demonstrates the growing importance of decentralizing resources for local governance and development.

Relief expenditure shows a steady increase over the years, from ₹4,728 crores in the 10th FC to ₹55,097 crores in the 14th Finance Commission. This increase reflects the growing need for funds allocated for disaster relief, social protection, and emergency responses across the country due to natural calamities and other exigencies.

The growth of the non-plan revenue deficit signals mounting fiscal challenges. However, revenue growth might not be keeping pace with the increasing expenditure requirements, especially in terms of non-plan and welfare expenditure.

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The jump between the 12th and 13th Finance Commissions is quite pronounced, with substantial increases across almost all categories. The 13th Finance Commission has focused on addressing regional disparities and increasing the role of local bodies.

Table 5. Share of Union Taxes among South Indian States.

Southern States	1995-2000	2000-05	2005-10	2010-15	2015-20	2020-21	2021-26
	10 FC	11 FC	12 FC	13 FC	14 FC	15 FC	15 FC
Andhra Pradesh	8.465	7.701	7.356	6.937	4.305	4.111	4.047
Karnataka	5.339	4.93	4.459	4.328	4.713	3.646	3.647
Kerala	3.875	3.057	2.665	2.341	2.5	1.943	1.925
Tamil Nadu	6.637	5.385	5.305	4.969	4.023	4.189	4.079
Telangana	0	0	0	0	2.437	2.133	2.102
South Indian States	24.31	21.07	19.78	18.57	17.98	16.02	15.8

Source: Reports from 10th FC to 15th FC.

The share of Union taxes allocated to the South Indian states from the 10th FC (1995-2000) to the 15th Finance Commission (2020-2021) is presented in Table 5. The share of Union taxes received by South Indian states has progressively decreased. The share received during 1995-2000 was 24.31 percent, which dropped to 16.02 percent in 2020-21. It is expected to decrease further to 15.80 percent during the projection period 2021-2026. The growth trajectories of the South Indian states might be stabilizing or slowing down relative to other states, especially those in Bihar, Uttar Pradesh, and Madhya Pradesh, which have higher population growth and lower income levels.

Andhra Pradesh's share has decreased significantly from 8.465 percent in the 10th FC to 4.047 percent in the 15th Commission (2021-2026). Andhra Pradesh's population base shrank, leading to a lower share in tax allocations. The bifurcation of Andhra Pradesh into two states resulted in a division of resources. While Telangana began receiving its own share, Andhra Pradesh's share from the Union tax pool was recalibrated, leading to a substantial decrease in the state's allocation.

Karnataka's share has decreased from 5.339 percent in the 10th FC to 3.647 percent in the 15th Finance Commission. The state's relatively higher per capita income (compared to poorer states) and its more stable population growth could contribute to a smaller share of Union taxes, as states with higher income levels and slower population growth receive less support. States like Telangana and Bihar, with higher populations and greater fiscal needs, are likely receiving more resources, which reduces Karnataka's relative share.

Kerala's share has decreased from 3.875 percent in the 10th FC to 1.925 percent in the 15th Finance Commission. Its high human development indicators, such as literacy rate, healthcare, and life expectancy, reflect its relatively advanced status. Kerala, being a developed state with robust social welfare systems, might not require as much financial assistance from the Union, especially compared to poorer and more populous states.

Tamil Nadu's share has decreased from 6.637 percent in the 10th FC to 4.079 percent in the 15th Finance Commission. Tamil Nadu's population growth has slowed down, and its income levels have steadily increased, potentially reducing its share of Union taxes under the Finance Commission's formula. States with larger populations and lower income levels are prioritized. Tamil Nadu's relative prosperity is less likely to benefit from the redistributive mechanism that rewards poorer states.

Telangana, formed in 2014, initially received zero allocation until the 14th Finance Commission (2015-2020), and its share began at 2.437 percent. By the 15th Finance Commission (2021-2026), its share slightly declined to 2.102 percent. Telangana's financial base and needs were not well-defined in its early years. The relatively small allocation could be due to its smaller size and evolving resource requirements. It is noteworthy that Telangana's share has not grown significantly, despite its relatively younger population and potential for economic growth.

The declining share of Union taxes in South Indian states could be seen as penalizing high-performing states. A smaller demographic base, which translates to lower allocation under the Finance Commission's formula, places a greater emphasis on population size. South Indian states tend to have better fiscal discipline and higher tax collection rates, which might make them less dependent on Union resources. However, the Finance Commission's formula is designed to achieve redistribution by addressing disparities between richer and poorer states. Poorer and more populous states are prioritized to reduce regional inequalities. While this can be seen as penalizing the performance of South Indian states, it also aligns with the principle of equitable growth, ensuring that underdeveloped states have the resources they need for development.

Table 6. Inter-state share given by the Finance Commission.

Distribution basis	10th FC	11th FC	12th FC	13th FC	14th FC	15th FC
Andre Pradesh		7.701	7.356	6.937	4.305	4.111
Karnataka		4.93	4.459	4.328	4.713	3.646
Kerala		3.057	2.665	2.341	2.500	1.943
Tamil Nadu		5.385	5.305	4.969	4.023	4.189
Telangana	-	-	-	-	2.437	2.133

Source: Calculated from union finance commission reports (10 to 15).

The inter-state share of funds allocated to various states by the 10th to the 15th Finance Commissions is given in Table 6. Andhra Pradesh's share has generally decreased over time from 7.701 percent in the 11th Finance Commission; it decreased to 4.111 percent by the 15th Finance Commission. The share dropped notably between the 10th and the 13th Finance Commissions, falling to 4.305 percent in the 14th Finance Commission. The decline in Andhra Pradesh's share can be attributed to various factors, including its changing demographic or economic performance and the reorganization of the state in 2014 (formation of Telangana).

Karnataka's share decreased steadily from 4.93 percent in the 11th FC to 3.646 percent in the 15th Finance Commission. The gradual reduction in Karnataka's share could be due to factors such as improvements in fiscal management, economic growth, or population-related factors. The 13th FC's increase may be linked to specific fiscal or demographic criteria that benefited the state.

Kerala's share decreased from 3.057 percent in the 11th FC to 1.943 percent in the 15th Finance Commission. Kerala's declining share might reflect the state's changing position in terms of fiscal discipline, infrastructure needs,

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and other criteria. Kerala's high human development index and relatively better infrastructure could have led to a lower share in more recent Finance Commissions due to the need for resources.

Tamil Nadu's share showed a slight decrease from 5.385 percent in the 11th FC to 4.189 percent in the 15th Finance Commission. Tamil Nadu's share has fluctuated slightly, reflecting its relatively stable economic performance and consistent fiscal management. The slight decrease could be due to the state's improved infrastructure, economic growth, or demographic performance.

Telangana's share was received at 2.437 percent in the 14th FC and 2.133 percent in the 15th Finance Commission. As a newly formed state, Telangana's share started with a moderate allocation in the 14th FC. Its share gradually decreased in the 15th Finance Commission due to evolving fiscal discipline, infrastructure needs, and other developmental criteria. The state is still in the early stages of development, which could influence its share allocation in future Finance Commissions.

The general trend for Andhra Pradesh, Karnataka, Kerala, and Tamil Nadu has been a gradual decrease in their share over time. This could be due to their relative improvements in terms of economic development, fiscal discipline, and infrastructure, which have led to a reduced need for central transfers compared to other states.

The inter-state share allocation by the Finance Commissions has evolved based on the economic, fiscal, and demographic needs of the states. Andhra Pradesh, Karnataka, Kerala, and Tamil Nadu have experienced a decline in their share, reflecting either improvements in their own development or shifts in the criteria used by the Finance Commissions. Telangana has received a moderate allocation since its formation, with a slight decline in the latest Commission (15th FC). Over time, the Finance Commissions have adapted to new priorities and challenges, resulting in a redistribution of resources among states, with some newer and smaller states receiving more support.

Table 7. Share of tax devolution during the 14th and 15th Finance Commissions in Southern India.

Distribution basis	14th FC		15th FC		Devolution for 2020-21 Rs. in Crores
	Share out of 41 percent	Share in divisible pool	Share out of 41 percent	Share in divisible pool	
Andre Pradesh	1.81	4.31	1.69	4.11	35,156
Karnataka	1.98	4.74	1.49	3.65	31,180
Kerala	1.05	2.50	0.80	1.94	16,616
Tamil Nadu	1.69	4.02	1.72	4.19	35,823
Telangana	1.02	2.43	0.87	2.13	18,241
Total	41	100	41	100	8,55,176

Source: Calculated from union finance commission reports (10 to 15).

The devolution of funds to southern states during the 14th and 15th Finance Commissions is presented in Table 7. The total devolution in 2020-21 was ₹8,55,176 crores, with the total share of the 41 percent divisible pool remaining constant for both the 14th and 15th Finance Commissions. Andhra Pradesh's share slightly decreased from 1.81 percent to 1.69 percent between the 14th and 15th Finance Commissions. However, its share in the divisible pool (in absolute terms) remains relatively stable, with a minor reduction from 4.31 percent to 4.11 percent. This results in a devolution of ₹35,156 crores during 2020-21. The state's significant share in the total devolution pool shows a slight reduction in percentage terms.

Karnataka experienced a significant decline in its share, decreasing from 1.98 percent in the 14th Finance Commission to 1.49 percent in the 15th Finance Commission. Its share in the divisible pool has reduced from 4.74 percent to 3.65 percent. Despite this, the actual devolution remains substantial at ₹31,180 crores, reflecting the state's continued importance in the distribution. Kerala's share has also declined significantly, from 1.05 percent to 0.80 percent. Its share in the divisible pool has decreased from 2.50 percent to 1.94 percent. This decline indicates a reduction in Kerala's relative fiscal needs. It still receives ₹16,616 crores for 2020-21.

Tamil Nadu's share has increased slightly from 1.69 percent to 1.72 percent. Its share in the divisible pool has also increased from 4.02 percent to 4.19 percent. Tamil Nadu receives ₹35,823 crores, the highest among the states listed, indicating its continued importance and need for financial support. Telangana's share has declined from 1.02 percent to 0.87 percent during the same period. Its share in the divisible pool has reduced from 2.43 percent to 2.13 percent. Telangana still receives a significant ₹18,241 crores for the year, indicating that the state continues to require considerable financial support for its development needs.

The percentage allocation for Andhra Pradesh, Karnataka, Kerala, and Telangana has decreased slightly, while Tamil Nadu experienced a small increase in its share. This reflects a shift in the Finance Commission's focus or criteria, potentially incorporating factors such as fiscal discipline, economic performance, or demographic changes. Although the share percentages have changed, the absolute devolution amounts (in crores of rupees) remain significant, reflecting the large overall devolution pool of ₹8,55,176 crores for the year 2020-21. States like Andhra Pradesh and Tamil Nadu continue to receive substantial allocations (₹35,156 crore and ₹35,823 crore, respectively), despite their share percentages having slightly decreased.

Table 8. State-wise distribution of net proceeds of union taxes and duties: 2024-25 (BE) in Rs. crore.

State	Total Rs. crore	Share in percent	Corporation tax	Income tax	Central GST	Customs duties	Union excise duty	Service tax
Andre Pradesh	50475	4.047	15159	17456	15079	2228	470	1.66
Karnataka	45486	3.647	13658	15731	13589	2008	423	1.50
Kerala	24008	1.925	7209	8303	7173	1060	223	0.79
Tamil Nadu	50874	4.079	15276	17594	15199	2246	473	1.67
Telangana	28216	2.102	7872	9067	7832	1157	243	0.66
Total	124211	100	374512	431330	372606	55064	11607	41

Source: Calculated from union finance commission reports (10 to 15).

The distribution of net proceeds from Union taxes and duties across states for the year 2024-25 (BE) is provided in Table 8. Andhra Pradesh receives 4.047 percent of the total distribution, with a significant portion derived from Income Tax (₹17,456 crore) and Corporation Tax (₹15,159 crore). The state's share of Union Excise

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Duty is relatively small (₹470 crore). Karnataka receives 3.647 percent of the total, with substantial contributions from Corporation Tax (₹13,658 crore) and Income Tax (₹15,731 crore). Its share of Central GST and Customs Duties is also notable. However, it receives a comparatively small amount from Union Excise Duty.

Kerala's share is 1.925 percent, and it receives relatively high amounts from Income Tax and Corporation Tax, but lower amounts from Union Excise Duty. The state's share of Central GST is significant, amounting to ₹7,173 crore. Tamil Nadu receives the highest share among the listed states, with 4.079 percent of the total. Like Andhra Pradesh and Karnataka, Tamil Nadu benefits largely from Income Tax (₹17,594 crore) and Corporation Tax (₹15,276 crore). The state also receives significant funds from Central GST. Telangana, with a share of 2.102 percent, receives a substantial portion from Income Tax (₹9,067 crore), Corporation Tax (₹7,872 crore), and Central GST (₹7,832 crore). The state has a relatively low share of Union Excise Duty.

The largest shares across the states are from Corporation Tax, Income Tax, and Central GST. These three categories are consistently the top sources of revenue for each state, making up the majority of the allocations. Customs Duties also contribute a notable share, particularly for Tamil Nadu, Karnataka, and Telangana. Union Excise Duty and Service Tax account for a much smaller portion of the total allocation, with the states receiving only minimal amounts in these categories.

Andhra Pradesh and Tamil Nadu receive the highest total devolution, ₹50,475 crore and ₹50,874 crore, respectively, which is in line with their larger economic bases and higher shares of the national population. Karnataka and Telangana have slightly lower shares in comparison to Andhra Pradesh and Tamil Nadu but still receive significant allocations, reflecting their strong economic and industrial bases.

The comprehensive overview of the distribution of central taxes across five Indian states for the year 2024-25 (BE) indicates that the largest share of the divisible pool is allocated to Andhra Pradesh, Tamil Nadu, and Karnataka, with significant contributions from Corporation Tax, Income Tax, and Central GST. Kerala and Telangana receive smaller allocations but still benefit from important revenue streams, especially Income Tax and Corporation Tax. This distribution highlights the central government's fiscal priorities and the financial needs of states based on their economic performance, industrial base, and population sizes.

5. Summary and Conclusions

India's fiscal federalism has evolved significantly through the Finance Commissions from the 10th to the 15th Commissions. It is marked by shifts in the focus of tax devolution and grants. During the 10th FC (2005-2010), the focus was primarily on tax devolution, allocating 91 percent of transfers to tax shares and only 9 percent to grants. The goal was fiscal decentralization, with grants used sparingly for state-specific issues.

During the 14th Commission (2015-2020), there was a notable shift towards greater tax devolution, with grants reduced to 12 percent. However, their total value increased, providing more targeted financial support for states facing unique challenges. During the 15th Commission (2020-2025), grants constituted 19.4 percent of transfers, addressing regional disparities, income inequality, and infrastructure deficits.

Between 2009 and 2023, the share of FC grants varied, reflecting shifting priorities in fiscal operations in India. During 2011-14, FC grants' share ranged from 28 percent to 32.6 percent, focusing on state-specific development issues. During 2014-17, FC grants fell to 21.6 percent, with non-FC grants rising to 78.4 percent. Despite this, absolute FC grants increased, supporting needs such as poverty alleviation and disaster recovery.

During 2017-2021, FC grants fluctuated between 22.7 percent and 28.6 percent, with a spike in 2020-2021 driven by COVID-19 emergency needs. During 2021-2024, FC grants peaked at 33.3 percent in 2021-2022 but decreased to 17.4 percent in 2023-2024, with increased reliance on non-FC grants for flexible, program-based funding.

The growth trends of financial allocations during the 12th to 13th Commission saw a substantial increase in allocations for states and local bodies, from ₹613,112 crores to ₹1,448,096 crores. Local body funding surged from ₹5,381 crores in the 10th FC to ₹2,87,436 crores in the 14th Commission, reflecting a growing focus on decentralization. Emergency allocations increased from ₹4,728 crores in the 10th FC to ₹55,097 crores in the 14th FC, addressing disaster relief and social protection needs.

The regional allocation trends of Andhra Pradesh, Karnataka, Kerala, Tamil Nadu, and Telangana showed a consistent decline in their share of Union taxes from 1995 to 2021. This decline is attributed to their relatively slower growth compared to poorer, more populous states. Andhra Pradesh experienced a significant drop in share after bifurcation in 2014. Karnataka and Kerala also saw reductions due to higher per capita income and stable populations, while Tamil Nadu experienced a slight decline due to its economic stability. Telangana, formed in 2014, began receiving allocations only in the 14th Finance Commission.

From the 11th to the 15th Commission, the inter-state share for these states generally decreased. Andhra Pradesh's share dropping from 7.701 percent to 4.111 percent, and Kerala's from 3.057 percent to 1.943 percent. During 2020-21, the tax devolution to Andhra Pradesh, Karnataka, Kerala, and Tamil Nadu saw decreases in their share of the divisible pool, with Tamil Nadu receiving the highest allocation of ₹35,823 crores, despite a slight drop in its share.

India's fiscal federalism has focused on redistributing resources to poorer states with larger populations while gradually reducing the share of wealthier states, particularly in South India. The increasing reliance on non-FC grants reflects the need for flexible, program-based funding to address specific regional challenges.

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