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Role of Fiscal Decentralization in Achieving Inclusive Growth in India

Dr.Virendra Pratap Chaurasia[1]*

[1] Assistant Professor, Economics, Government Girls P.G. College, Zila Praishad Chauraha, Aliganj, Banda, U.P., Pin- 210001, Affiliated to Bundelkhand University, Jhansi, India.
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*Corresponding Author: virendraauphd@gmail.com

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Abstract

Fiscal decentralization, the devolution of fiscal powers from the national government to sub-national and local governments, is a global phenomenon that has garnered significant attention due to its potential impact on economic growth. According to **Oates, W.E. (1972)**, sub-national and local governments possess an information advantage over the central government, and decentralization enhances the efficiency of resource allocation, thereby contributing to economic growth and the reduction of income inequality across jurisdictions. Since individuals in different regions have varying preferences, the transfer of power to sub-national and local governments makes it possible to better align the provision of public services, such as health, education, rural infrastructure, and agriculture-related activities, with the demands of the local population. One critical dimension of fiscal decentralization is revenue-sharing mechanisms, which determine how revenue is collected and distributed between central and local governments. The design of revenue-sharing systems varies widely across countries, influencing the degree of fiscal autonomy and intergovernmental fiscal relations. Using comprehensive data, including GDP growth, poverty rates, income distribution among various income groups (p0p50, p90p100, p99p100), GDP per capita and fiscal decentralization (Expenditure Decentralization and Revenue Decentralization), this study explores their interconnections using correlation matrix. The research unveils significant insights into the relationship between fiscal decentralization, poverty, income distribution, and economic growth in India. Conversely, positive correlations surface between GDP per capita and the income shares of the top 10 percent (p90p100) and the top 1 percent (p99p100), indicating disproportionate benefits for wealthier segments, signaling income inequality concerns. The negative correlations between fiscal decentralization and poverty rate further highlight that greater expenditure decentralization associates with reduced poverty rates.

Keywords: *Fiscal Decentralization, Inclusive Development, Income Inequality, India, Economic Growth, Local Governance.*

1. INTRODUCTION

Fiscal decentralization basically refers to the transfer of fiscal powers and responsibilities from the national government to sub-national and local governments. This global phenomenon has garnered significant attention for its potential to influence economic growth by improving economic efficiency in allocation of resources and public expenditure **(Oates, 1972)**. Over the past thirty years, numerous developed and developing nations have embraced decentralized fiscal systems as a means to achieve robust economic growth. Since the 1990s, a number of empirical studies have been conducted to explore the relationship between fiscal decentralization and economic growth. Analysts argue that several factors, including the extent of decentralization, the political environment, institutional structure, and various other variables, can exert influence on economic growth within a decentralized system.

After the initiation of the economic reform process in 1991, the Indian economy experienced rapid growth, as evidenced by annual GDP growth rates, which rose from 1.1 percent in 1991 to 9.8 percent in 2007. India emerged as one of the fastest-growing economies among developing countries during this period. However, this increase in growth was not consistent but characterized by regular fluctuations and brief periods of rising per capita GDP growth and employment rates. Consequently, questions persisted regarding the inclusiveness of this growth process. While there is a general consensus regarding the decline in poverty rates and improvements in basic parameters of the human development index, there remains a significant policy challenge in addressing growing disparities in socio-economic and demographic dimensions **(Mohan, R. et al., 2018)**.

According to the 2018 Global Inequality Report, which utilizes the share of pre-tax national income share held by the group (p90p100, p0p50 and p99p100) as a measure of inequality, India witnessed an increase in the income share of the top 10 percent, rising from 34 percent in 1991 to 48 percent in 2007 and further to 56 percent in 2015. In contrast, the share of the bottom 50 percent declined from 22 percent to 15 percent during the same period. Consequently, India ranks second among countries with the highest income inequality.

The argument put forth by Kuznets and others underscores that while growth is a necessary condition, it is insufficient on its own to reduce disparities and inequalities. Without policy interventions and continuous targeted monitoring, growth can bypass the poor and marginalized groups, limiting its impact on poverty reduction and, ultimately, impeding overall economic growth. Hence, inclusive growth has become a prominent agenda alongside the pursuit of sustainable development in recent policy formulations. Inclusive growth has been adopted as a policy objective in India since the 11th Five Year Plan, and similar approaches have been observed in recent policy formulations across developing economies. Although there is no conclusive definition or measurement of inclusive growth, the concern is closely related to improvements in the distribution of growth benefits and access to opportunities **(Ifzal, Ali and Hyun Hwa Son, 2007)**.

In this article, we will analyze the role of fiscal decentralization achieving inclusive growth in India. The study evaluates inclusive growth by examining economic growth alongside its implications for reducing income equality and poverty, thereby offering a comprehensive assessment of progress. The paper's structure is as follows: Section 2 conducts a thorough review of the existing literature on fiscal decentralization and its influence on economic growth. In Section 3, we delve into fiscal decentralization in India, while Section 4 explores the relationship between fiscal decentralization and inclusive growth. Section 5 scrutinizes the connections between fiscal decentralization, economic growth, poverty, and income distribution. Lastly, Section 6 presents concluding remarks of the study.

2. LITERATURE REVIEW

The relationship between fiscal decentralization and economic growth has been a subject of extensive debate and exploration in recent public reforms, attracting attention in both developed and developing countries. In theory, fiscal decentralization is presumed to enhance the efficiency of public goods provision and production, ultimately promoting economic growth. However, the empirical literature on this relationship presents an intricate and somewhat inconsistent narrative across various regions and contexts.

Recent academic inquiries have generated a substantial body of research, with over 60 published works investigating the impact of fiscal decentralization on a range of economic indicators, with a significant focus on economic growth (Canavire-Bacarreza et al., 2019). These studies encompass a global perspective, employing diverse datasets and methodologies. For instance, research by Davodi and Zou (1998) drew data from 46 developed and developing countries, while Lin and Liu (2000), Zhang and Zou (1998), and Jin and Zou (2005) centered their investigations on Chinese provinces. Akai and Sakata (2002) utilized state-level data from the United States, Thornton (2007) examined data from 19 OECD countries, and Ganaie et al. (2018) and Xavier et al. (2022) focused on data from India. Notably, the empirical findings from these studies exhibit a lack of uniformity, contributing to the complexity of this research area. Some empirical findings related to impact off fiscal decentralization on economic growth is presented in table 1.

Table-1: Fiscal Decentralization and Economic Growth

Author (Year)	Sample	Period	Findings
Hanif et al. (2020)	15 developing federations	2000-2015	Positive and Significant
Jin and Rider (2020)	China and India	1985-2005	Positive in case of India No effect in China
Canavire-Bacarreza et al. (2019).	70 Countries	1981-2010	Positive and Significant
Ganaie et al. (2018)	India	1981-2014	Spending Decentralization: Positive and Significant, Revenue Decentralization: Negative and Significant
Ding et al. (2018)	China	1980-1999	Positive and Significant
Slavinskaite (2017)	European Union	2005-14	Positive in low-income countries No relationship in High income countries
Pasichnyi (2017)	27 European Countries	1992-2017	Revenue Decentralization- Negative Effect Expenditure Decentralization Positive Effect
Yang, Zhou (2016)	China	1990-2012	U-shaped relationship
Thornton (2006)	OECD-countries	1980-2000	No statistically significant relationship
Jin and Zou (2005)	China	1979-1993 and 1994-1999	1979-1993: Expenditure Decentralization- Negative, Revenue Decentralization- Positive; 1994-1999: Expenditure Decentralization- No Significant Relationship, Revenue Decentralization- Positive and Significant
Rodriguez-Pose and Bwire (2004)	Germany, India, Itlay,	Different Periods	Most Insignificant, with the Exceptions of Mexico, the US, and

	Mexico, Spain, and US	until 2001	Partially, India Where it becomes Negative.
Akai and Sakata (2002)	USA	1988-1996	Positive and Significant
Thimmaiah (2000)	India	1985-86 to 1996-97	Revenue Decentralization: Positive and Significant, Expenditure Decentralization: Not Significant
Zhang and Zou (1998)	China	1980-1992	Negative and Insignificant
Davoodi and Zou (1998)	46 Countries	1970-1989	Developing: Negative, but not Significant, OECD: No Relationship

Source: (Authors own Compilations.)

The table 1 above provides an overview of key studies examining the relationship between fiscal decentralization and economic growth, including the sample, period, and major findings. These findings vary from positive and significant correlations to mixed effects and even negative associations, highlighting the intricate and context-specific nature of the relationship between fiscal decentralization and economic growth. Further exploration of this multifaceted relationship is essential to inform policymaking and ensure that fiscal decentralization aligns with broader economic development goals.

3. FISCAL DECENTRALIZATION IN INDIA

India, a vast and diverse developing nation, is constitutionally defined as a "Union of States" and a "Sovereign, Secular, Socialist, Democratic Republic." It stands as the world's most extensive democratic federal republic, home to 1.3 billion people residing across 29 States and 7 Union Territories, encompassing a landmass of 3.29 million square kilometers. The country operates under a three-tier federal structure, featuring governing bodies at the Union, State, and Local levels. Among these, 29 States and seven centrally administered territories exist, two of which have their legislatures, notably Delhi and Pondicherry. Beneath the State level, India's urban landscape hosts 96 municipal corporations, 1,494 municipalities, and 2,092 smaller municipalities, termed Nagar Panchayats. Furthermore, rural areas are governed by 247,033 panchayats, with 515 at the district level, 5,930 at the block level, and 240,588 at the village level. However, the distribution of power to the local level varies among States, and their involvement in public service delivery remains inconsistent **(Rao. M.G. 2018)**.

Significant economic and size disparities characterize the various States. In 2011, Uttar Pradesh, with 200 million residents, emerged as the largest State, while Sikkim, with a population of 0.6 million, stood as the smallest. The per capita Gross State Domestic Product (GSDP) in 2014-15 demonstrated considerable disparities, with Haryana recording the highest GSDP at Rs. 165,728 (excluding the small state of Goa, which boasted a per capita GSDP of Rs. 304,666), and Bihar reporting the lowest at Rs. 33,954 among the general category States.

The Constitution's Seventh Schedule outlines functions for Union, State, and concurrent lists. It assigns major taxes to the Union, while States primarily handle social services and share responsibility for economic services, resulting in significant vertical fiscal imbalance. The Constitution's framers recognized this issue and established mechanisms for sharing central taxes with the States through grants from the Central Consolidated Fund. An independent Finance Commission is appointed by the President every five years to address this imbalance, recommending the devolution of Central taxes, laying down distribution principles for individual States, and addressing financial matters in the Presidential Terms of Reference **(Rao, M.G. 2018)**.

3.1. Intergovernmental Transfer in India

One of the primary goals of fiscal transfers between the central government and the states in India is to ensure the equalization of essential services. In the Indian context, this objective has been repeatedly emphasized as the foremost purpose of Inter-Governmental Transfers (Bagchi, 2002). Funds are channeled to the states through two primary avenues: Fiscal Commission transfers and grants provided by various ministries. In the past, a substantial portion of Inter-Governmental Transfers for state plans was funneled through the Planning Commission of India. However, since 2015-16, this mechanism has been integrated into the Finance Commission following the dissolution of the Planning Commission. Figure 1 illustrates the institutional framework of Inter-Governmental Transfers in India.

Of these two channels, the Finance Commission route is the predominant one through which most transfers occur. The Finance Commissions are responsible for allocating central taxes among the union and state governments and among the state governments themselves. They also propose transfers to the lower tier of government, i.e., the local governments. The objective is to address vertical and horizontal imbalances across different government levels and states. In addition to taxes, the FC recommends two types of grants: general purpose grants and specific purpose grants to the states.

Since the appointment of the 1st FC in 1951, all subsequent FCs have consisted of renowned experts operating independently within specific contexts. Their mandate is to design an intergovernmental fiscal transfer system grounded in economic principles.

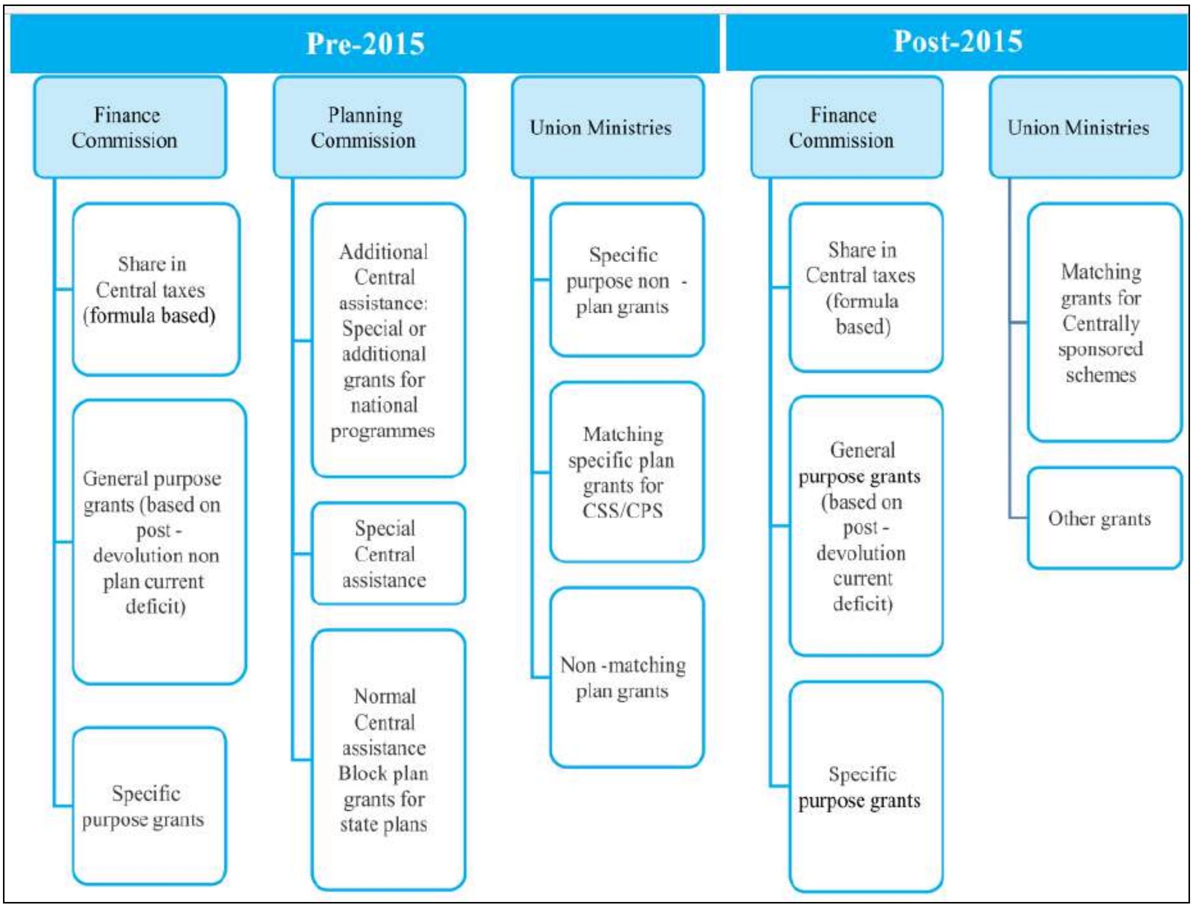

Fig-1: Institutional Structure for Inter-governmental Transfer in India
Source: (Report of 15th Finance Commission.)

3.2. Need For Intergovernmental Transfer

Intergovernmental fiscal transfers from the central government to subnational governments serve three primary objectives. Firstly, they alleviate the vertical fiscal imbalance, compensating subnational governments for the gap between their expenditure needs and their limited revenue generation due to tax constraints.

Secondly, these transfers address horizontal imbalances among subnational governments. Thirdly, they promote consistent nationwide provision of public services and encourage efficient service delivery by subnational governments **(Abiad, A. D. et al., 2020)**.

3.3. Vertical fiscal Gap

The vertical fiscal gap represents the disparity between sub-national governments own-revenue and their expenditures, with significant variation among countries. This gap is closely linked to the level of revenue decentralization, which has generally increased over time due to the enhanced revenue capacity of sub-national governments.

In the OECD, the average vertical gap stands at approximately 40%, but there are notable deviations from this mean, ranging from 6% to 82%. Federations tend to have a lower vertical gap than unitary countries, primarily due to the stronger revenue-raising capabilities of state-level governments in federations **(Report of 15th FC)**.

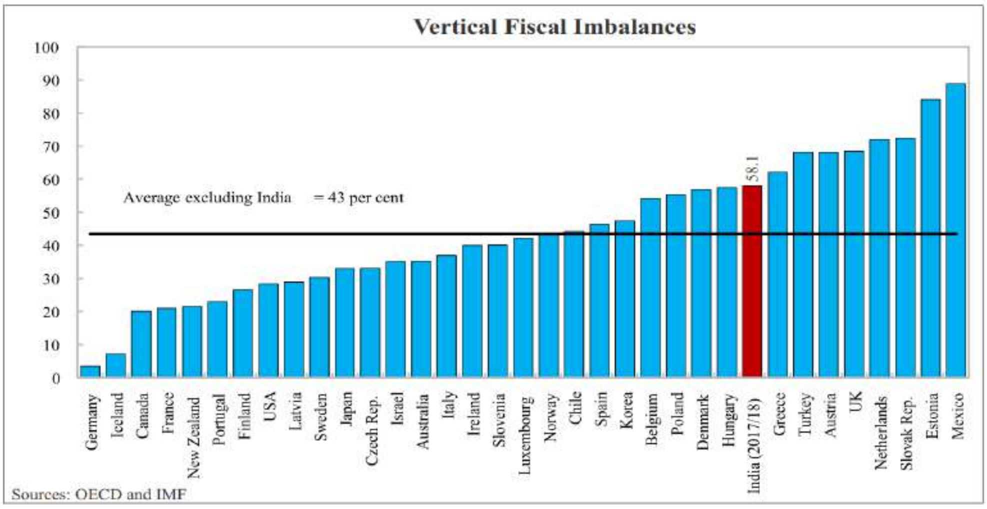

Fig-2: Vertical Fiscal Imbalances in OECD Countries
Source: **(Report of Fifteenth Finnane Commission.)**

India exhibits a significant and growing vertical fiscal gap compared to most federations due to many states relying heavily on Union transfers rather than own tax revenues to fund their expenses. This discrepancy arises from how expenditure and revenue powers are allocated between the Union and states. Inefficient handling of this gap, leading to vertical imbalances, results in unfunded spending mandates, insufficient public service provision, or excessive state-level borrowing. These disparities are exacerbated during crises like the Covid pandemic, which further widens the gap between sub-national revenues and expenditure commitments. Despite increased tax devolution from the Union, rising fiscal deficits in several states signal expanding vertical imbalances, emphasizing the need for more substantial transfers to states relative to their financial needs and revenue-generation capabilities **(Report of 15th FC)**.

The Constitution assigns both the Union and States the authority to generate revenue through various taxation sources and delineates their expenditure responsibilities across three lists: the Union List, State List, and Concurrent List in the Seventh Schedule. This distribution inherently empowers the Union Government with more extensive and revenue-rich taxation capabilities while allocating greater expenditure responsibilities to the States. According to the 15th Finance Commission's 2018-19 report, the Union Government contributed 62.7% of the combined resources collected by both the Union and States, while the States incurred 62.4% of the total expenditure. This structural vertical imbalance necessitates the orderly transfer of resources from the Union to the States. In the aggregate for 2018-19, States could only generate 44.8% of their total expenditure from their own resources. The remaining 55.2% required financing through vertical resource transfers or by incurring debt.

3.4. Vertical Sharing

Historically, Finance Commissions recommended proportions of Union Government-collected taxes for State devolution. Before the Tenth Finance Commission (FC-X), different percentages applied to income tax and Union excise duties. Post the Eightieth Constitutional Amendment, the divisible pool includes net proceeds of all taxes (excluding cess, surcharge, and collection costs) collected by the Union, which are shared with the States. The allocated State shares in the divisible pool from the last four Finance Commissions are presented in Figure 3.

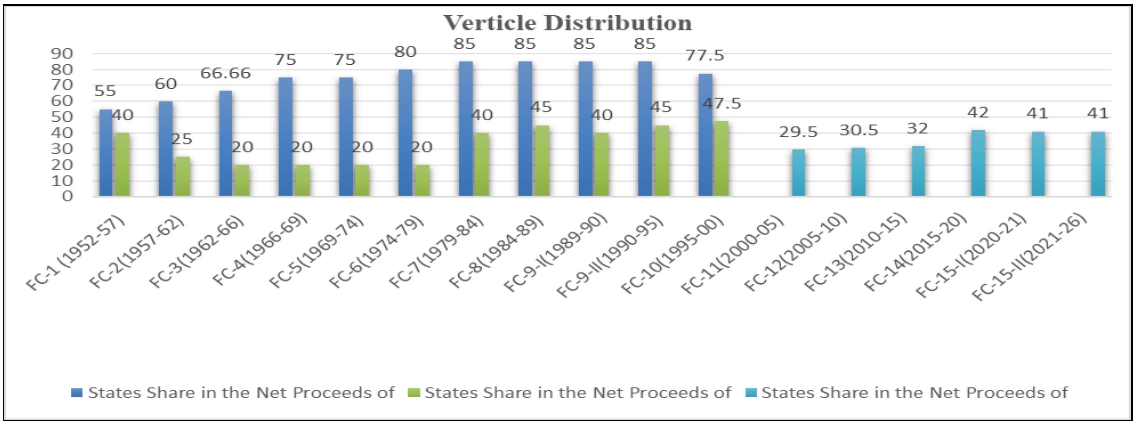

Fig-3: Finance Commissions Transfer to States.
Source: **(finance Commission Various Issue.)**

3.5. Central and States share in Tax Revenue and Impact of Devolution

The comparison of revenue shares between the Centre and states can be conducted in two distinct scenarios: one without central transfers and another with central transfers. This assessment, given that states have a constitutional right to utilize their collected revenue, offers insights into the impact of vertical devolution from the center to the states. The figure 4 portrays the distribution of Central and States' shares in tax revenue from 1990 to 2021. In this period, before transfer the central government's share of total tax revenue fluctuated between 58 and 70 percent, while the states' share of tax revenue ranged from 30 to 42 percent. Notably, the central government's revenue share reached its zenith at 70 percent in the fiscal year 2007-08 **(Panda, M. et al, 2019)**.

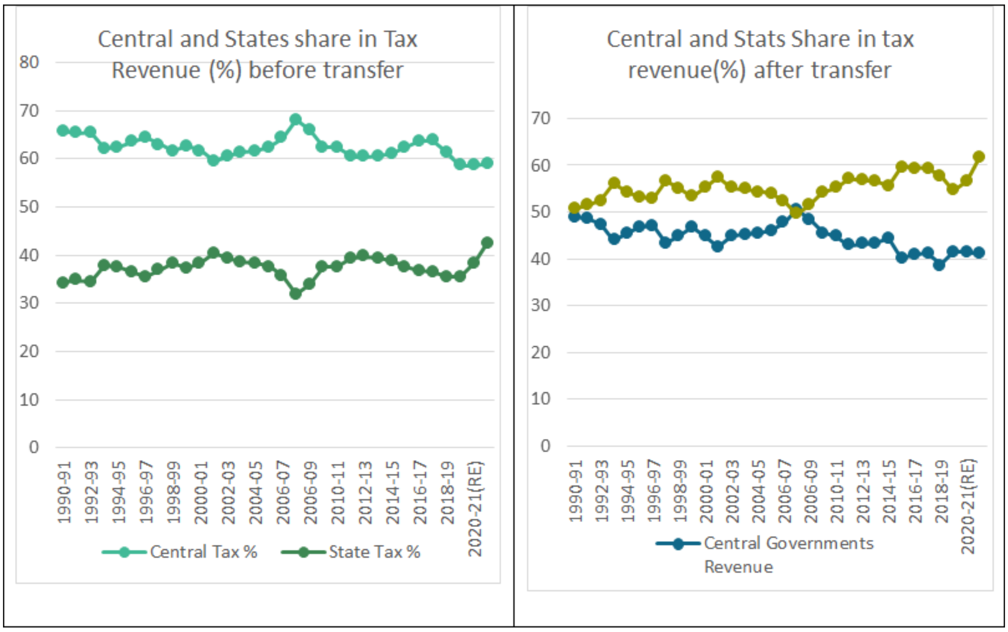

Fig-4: Central and States share in Tax Revenue
Source: **(Indian Public Finance Statistics 2017-18 and RBI handbook on Indian States 2021-22.)**

Following the process of devolution, the dynamics shift significantly. The Centre's share of the total revenue diminishes to a range of 44 to 47 percent, whereas the states' share escalates to a range of 53 to 61 percent. This transformation highlights the reversal of the Center's predominant position over the states prior to devolution **(Panda, M. et al, 2019)**. Figure 4 visually depicts this shift, particularly noticeable from the fiscal year 1990-1991 onward, where the states consistently received a larger share than the Centre, marking a significant decline in the Centre's dominance.

3.6. Horizontal Imbalances and Finance commission Transfers

Population has remained the primary determinant of horizontal devolution, dictating the allocation of funds among all states to ensure comparable welfare-oriented government services. The extent to which population is prioritized has, however, varied between different Finance Commissions.

These commissions have also taken into account additional factors like economic backwardness, income, geographic area, infrastructure, contributions to the central pool, tax efforts, fiscal discipline, among others. Table 2 below outlines the criteria and respective weights employed by the last five Finance Commissions.

Table-2: Criteria for Horizontal Transfers by Different Finance Commissions.

Criteria	11th FC	12th FC	13th FC	14th FC	15th FC
Income Distance/Fiscal Capacity	62.5	50	47.5	50	45
Population (1971)	10	25	25	17.5	
Population (2011)					15
Demographic Change				10	12.5
Area	7.5	10	10	15	
Index of Infrastructure	7.5				
Tax and fiscal Effort	5	7.5			2.5
Fiscal Discipline	7.5	7.5	17.5		
Forest Cover				7.5	
Forest and Ecology					10

Source: (finance Commission Various Issue.)

Recent Finance Commissions (FCs) have been committed to achieving a delicate balance between fiscal requirements, equalization objectives, and performance incentives while taking into account the potential moral hazard risks. The 11th FC was a turning point as it initially reduced the population's weight to just 10%, directing a significant 62.5% towards per capita income distance, a move that notably impacted the shares of high and middle-income states in the distribution of taxes. However, responding to objections from some states that feared being penalized, the subsequent 12th and 13th FCs raised the weight of the population from 10% to a substantial 25%. Simultaneously, they trimmed down the weight assigned to the distance in per capita income as an equalization measure to 50% (12th FC) and 47.5% (13th FC). The 13th FC, in particular, introduced an innovative approach based on the difference between the estimated per capita taxable capacity of each state and the highest such capacity.

The 14th FC brought back the income distance methodology used by the 12th FC, restoring it to a weight of 50%. Notably, the collective weight assigned to performance parameters, such as tax effort and fiscal discipline, has seen a gradual increase over time, growing from 12.5% during the 11th FC to 15% in the 12th FC, and further to 17.5% in the 13th FC. This approach aims to incentivize states to enhance their fiscal situations. Recognizing the significance of demographic changes, the 14th FC adjusted its allocation formula. It reduced the weight allocated to the 1971 population to 17.5% and introduced a 10% weight for the 2011 population. The 14th FC omitted fiscal performance parameters and placed greater emphasis on cost disability factors, including aspects like a state's area and forest cover. The inclusion of forest cover in the formula takes into account the compensation for maintaining forested land for ecological benefits and the opportunity cost of not using the area for other economic activities.

In its most recent recommendations, the 15th Finance Commission has proposed a horizontal devolution formula that features specific weightages. This includes 12.5% for demographic performance, 45% for income distance, 15% each for population and area, 10% for forest and ecology, and 2.5% for tax and fiscal efforts.

4. FISCAL DECENTRALIZATION AND INCLUSIVE GROWTH

The rationale supporting fiscal decentralization primarily revolves around its potential to enhance economic efficiency in public sector resource allocation. This concept aligns with **Tiebout's theorem (1956)**, suggesting that sub-national governments can better cater to diverse regional preferences, especially when taxpayers have the mobility to choose jurisdictions that align with their desired tax expenditure package. These efficiency gains constitute a core objective of fiscal policy alongside income redistribution and macroeconomic stability, as per **Musgrave's principles (1959)**. While extensive literature explores economic growth, the relationship between fiscal decentralization and economic growth remains relatively uncharted territory. The traditional focus of fiscal decentralization literature has been on efficiency, with local governments expected to better address local needs and preferences. However, the impact on regional disparities and income distribution remains a critical question. Decentralization's design and implementation can either improve or exacerbate equity, influencing income inequality through various channels.

Theoretical considerations suggest that sub-national governments in fiscal decentralization should emphasize service delivery, leaving income redistribution to the central government to ensure efficiency. Vertical fiscal gaps, when local services rely heavily on intergovernmental transfers rather than local revenues, weaken local government accountability. Policy options include improving transfer design or reducing vertical fiscal gaps, the latter enhancing local government accountability, and potentially boosting public sector productivity.

In developing nations, such as India, the role of fiscal decentralization in infrastructure, education, healthcare, and social service delivery is pivotal for inclusive growth. Understanding the intricate, context-specific nature of fiscal decentralization remains a challenge, and this comprehension is crucial before delving into the connections between inclusive growth and fiscal decentralization within the broader context of economic growth, poverty reduction, and income inequality.

4.1. Economic Growth in India

India's growth story from 1950 to 2021 is a remarkable journey that reflects the nation's transformation from a predominantly agrarian economy to one of the world's fastest-growing major economies. In the early years after independence in 1947, India's economy faced numerous challenges, including low per capita income, widespread poverty, and limited industrialization.

India's real GDP growth has shown varying trends over the years, ranging from 1.1% in 1991 to 10.3% in 2010. In 2020, it experienced a significant dip of -5.8% due to the COVID-19 pandemic, but rebounded with a growth rate of 9.1% in 2021. In contrast, China consistently displayed robust growth rates, with a low of 2.2% in 1990 and a high of 15.2% in 1984. China's growth remained positive even during global economic downturns.

When compared to advanced economies, India generally outperformed them in terms of GDP growth. Advanced economies had lower growth rates, and some even experienced negative growth during certain years. On the other hand, emerging market and developing economies, as a group, exhibited moderate and relatively steady growth, with India often aligning with this trend.

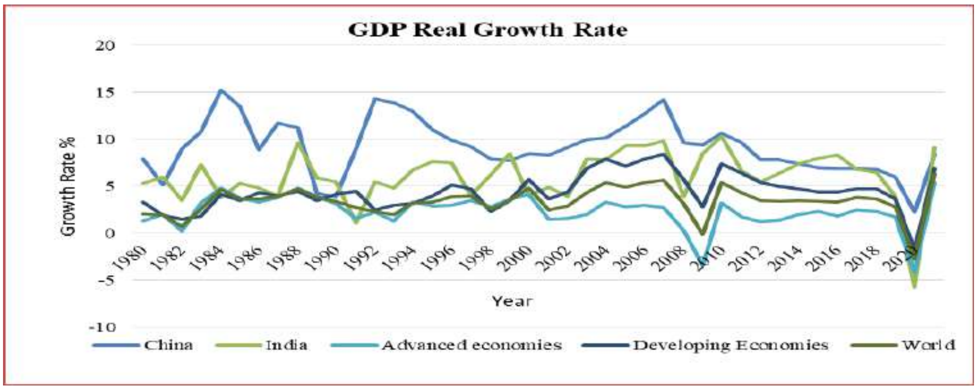

Fig-5: Real GDP Growth Rate of Economies
Source: (International Monetary Fund.)

In the context of the global economy, India's growth rates have generally been higher than the world average. However, India faces challenges such as income inequality and poverty reduction despite its growth. It's essential for India to ensure that this growth translates into improved living standards and reduced disparities among its population.

4.2. Poverty rate in India

The relationship between poverty and economic development in India is complex and multifaceted. While economic growth has led to significant poverty reduction, addressing income inequality, promoting inclusive development, and targeting vulnerable populations remain crucial for achieving sustained poverty alleviation and fostering equitable economic progress in the country.

Table-3: STATE-WISE POVERTY RATE

State/Union Territory	1993-94 (30-day Recall Period)	1999-00 (30-day Recall Period)	2004-05 Based on MRP Consumption	2009-10 Based on MRP Consumption	2011-12 Based on MRP Consumption
	Percentage	Percentage	Percentage	Percentage	Percentage
Andhra Pradesh	22.2	15.8	29.9	21.1	9.2
Arunachal Pradesh	39.4	33.5	31.1	25.9	34.7
Assam	40.9	36.1	34.4	37.9	32
Bihar	55	42.6	54.4	53.5	33.7
Chhattisgarh	.	.	49.4	48.7	39.9
Goa	14.9	4.4	25	8.7	5.1
Gujarat	24.2	14.1	31.8	23	16.6
Haryana	25.1	8.7	24.1	20.1	11.2
Himachal Pradesh	28.4	7.6	22.9	9.5	8.1
Jammu & Kashmir	25.2	3.5	13.2	9.4	10.4
Jharkhand	.	.	45.3	39.1	37
Karnataka	33.2	20	33.4	23.6	20.9
Kerala	25.4	12.7	19.7	12	7.1
Madhya Pradesh	42.5	37.4	48.6	36.7	31.7
Maharashtra	36.9	25	38.1	24.5	17.4
Manipur	33.8	28.5	38	47.1	36.9

Meghalaya	37.9	33.9	16.1	17.1	11.9
Mizoram	25.7	19.5	15.3	21.1	20.4
Nagaland	37.9	32.7	9	20.9	18.9
Odisha	48.6	47.2	57.2	37	32.6
Punjab	11.8	6.2	20.9	15.9	8.3
Rajasthan	27.4	15.3	34.4	24.8	14.7
Sikkim	41.4	36.6	31.1	13.1	8.2
Tamil Nadu	35	21.1	28.9	17.1	11.3
Tripura	39	34.4	40.6	17.4	14.1
Uttarakhand	.	.	32.7	18	11.3
Uttar Pradesh	40.9	31.2	40.9	37.7	29.4
West Bengal	35.7	27	34.3	26.7	20
ALL INDIA	36	26.1	37.2	29.8	21.9

Source: (Handbook on Statistics on Indian States (2022), Reserve Bank of India.)

The table 3 presents state-wise poverty rates in India over several years, highlighting significant fluctuations and variations in poverty levels across different states and union territories. In 1993-94, Andhra Pradesh had a poverty rate of 22.2%, which decreased to 9.2% by 2011-12, indicating substantial poverty reduction. Conversely, states like Bihar and Assam witnessed persistent high poverty rates, although there has been some improvement over the years. States in the northeastern region, such as Arunachal Pradesh, Manipur, and Nagaland, exhibited a mix of high and fluctuating poverty rates. Southern states like Kerala and Tamil Nadu consistently showed lower poverty rates, reflecting better socio-economic indicators.

Chhattisgarh, created in 2000, made notable progress in reducing poverty, while states like Goa and Haryana demonstrated consistently low poverty rates.

However, it is crucial to note that poverty measurement methods evolved over these years, and these figures are based on different approaches, making direct comparisons challenging. Overall, the data underscores the complex and varied nature of poverty in India, with ongoing efforts required to address regional disparities and promote inclusive development.

4.3. Income Distribution in India

The data reflects a growing income inequality trend in India, with the top income earners, especially the top 1% and the top 10%, seeing their income shares expand over the years, while the income share of the bottom 50% has remained relatively stagnant. This income inequality poses challenges for achieving equitable economic development and may require targeted policy interventions to address.

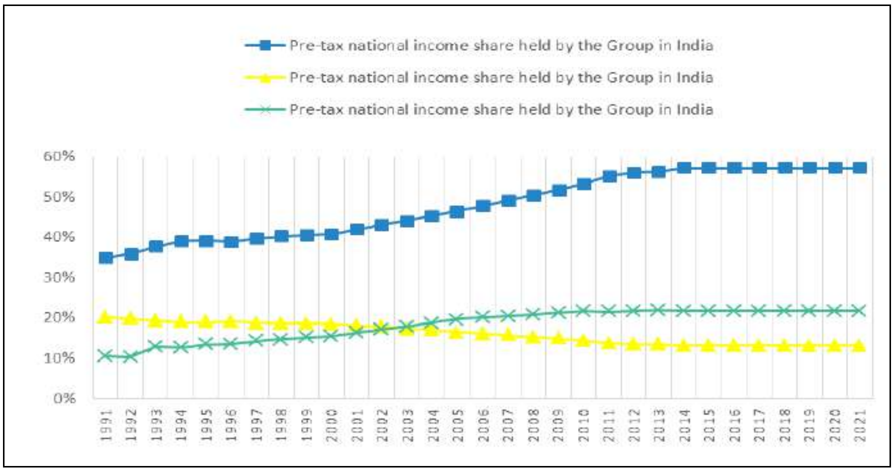

Fig-6: Pre- Tax National Income share held by in India
Source: (World Inequality Database)

p90-p100 (Top 10%) group's share of pre-tax national income has consistently increased over the years. In 1991, they held 35% of the income, and by 2021, their share had risen to 57%. This suggests a growing concentration of income among the top 10% of earners in India. The share of the income held by the bottom 50% of earners has remained relatively stable over the years. In 1991, they held 20% of the income, and in 2021, it remained at 13%. This indicates that the income distribution among the lower half of the population has not seen significant improvement during this period. The top 1% of income earners also experienced an increase in their income share over the years. In 1991, they held 10% of the income, which grew to 22% by 2021. This highlights a substantial rise in income inequality within the top percentile.

5. RELATIONSHIP BETWEEN FISCAL DECENTRALIZATION, ECONOMIC GROWTH, POVERTY AND INCOME DISTRIBUTION

The provided dataset examines the relationship between fiscal decentralization, economic growth, and income inequality, represented by various economic indicators over a period of three decades. Fiscal decentralization, measured by the State % Receipts in total Receipts and State % Expenditure in total Expenditure, shows variations over the years. These indicators reflect the extent to which states have control over their revenue generation and expenditure allocation within the larger fiscal framework.

Real GDP growth, representing economic growth, exhibits fluctuations throughout the years. It is observed that economic growth experiences both positive and negative growth rates, influenced by various economic factors and policies. GDP per capita, expressed in current prices, reflects the income levels of individuals. This indicator demonstrates an overall increasing trend, indicating improvements in income levels over time. Income distribution is assessed through the p90p100, p0p50, and p99p100 variables. These indicators represent the pre-tax national income share held by different income groups. The data shows that income distribution has changed over the years, with varying shares held by different income groups.

Table-4

Pre-tax national income share held by the Group				Poverty headcount ratio at $2.15 a day (2017 PPP) (% of population)	Real GDP growth (Annual percent change)	GDP per capita, current prices (U.S. dollars per capita)	State % Receipts in total Receipts	State % Expenditure in total Expenditure
Year	**p90p100**	**p0p50**	**p99p100**					
1990	0.34	0.20	0.11	50.6	5.50	375.22	57.04	52.55
1991	0.35	0.20	0.10	50.6	1.10	309.18	59.98	55.70
1992	0.36	0.20	0.10	50.6	5.50	323.13	60.63	58.06
1993	0.38	0.19	0.13	47.6	4.80	306.79	62.92	58.77
1994	0.39	0.19	0.13	47.6	6.70	352.30	60.66	57.88
1995	0.39	0.19	0.13	47.6	7.60	380.18	60.07	59.20
1996	0.39	0.19	0.14	47.6	7.50	406.59	60.77	58.50
1997	0.40	0.19	0.14	47.6	4.00	422.20	60.54	59.02
1998	0.40	0.19	0.15	47.6	6.20	419.77	59.29	59.27
1999	0.41	0.19	0.15	47.6	8.50	448.70	57.06	57.41
2000	0.41	0.19	0.16	47.6	4.00	449.79	57.93	58.08
2001	0.42	0.18	0.16	47.6	4.90	457.80	56.19	58.29
2002	0.43	0.18	0.17	47.6	3.90	477.07	56.57	57.23
2003	0.44	0.17	0.18	47.6	7.90	553.38	62.65	58.54
2004	0.45	0.17	0.19	39.9	7.80	635.05	65.45	65.96
2005	0.47	0.16	0.20	39.9	9.30	722.49	64.04	64.62
2006	0.48	0.16	0.20	39.9	9.30	809.57	57.57	59.58

2007	0.49	0.16	0.21	39.9	9.80	1041.19	59.07	60.18
2008	0.50	0.15	0.21	39.9	3.90	1014.39	56.29	58.80
2009	0.52	0.15	0.21	32.9	8.50	1115.83	56.75	56.64
2010	0.53	0.14	0.22	32.9	10.30	1377.11	57.48	56.24
2011	0.55	0.14	0.22	22.9	6.60	1449.60	58.25	55.26
2012	0.56	0.13	0.22	22.9	5.50	1434.02	56.61	57.06
2013	0.56	0.13	0.22	22.9	6.40	1438.06	56.37	58.18
2014	0.57	0.13	0.22	22.9	7.40	1559.86	58.20	58.17
2015	0.57	0.13	0.22	18.7	8.00	1590.17	64.83	62.77
2016	0.57	0.13	0.22	18.1	8.30	1714.28	63.94	63.85
2017	0.57	0.13	0.22	13.4	6.80	1957.97	64.43	64.51
2018	0.57	0.13	0.22	11.1	6.50	1974.38	64.65	64.76
2019	0.57	0.13	0.22	12.7	3.90	2050.16	66.46	66.18
2020	0.57	0.13	0.22	14.7	-5.80	1913.22	66.33	66.33
2021	0.57	0.13	0.22	11.9	9.10	2234.34	64.19	65.09

Source: (Authors Own Compilations)

Analyzing these variables collectively, it is crucial to explore the relationships and interactions among them. The impact of fiscal decentralization on economic growth and income inequality can be investigated by examining correlations and trends within the dataset. Additionally, identifying policy implications and potential areas for intervention can contribute to a better understanding of the dynamics between fiscal decentralization, economic growth, and income distribution in this context.

5.1. Correlation Matrix

The correlation matrix provided offers valuable insights into the relationships between various economic indicators, shedding light on the dynamics within the dataset (see Table 5).

Table-5 : Correlation

	ED	**RD**	**PCGDP**	**GGDP**	**Poverty**	**p0p50**	**p90p100**	**p99p100**
ED	1.00	0.89	0.61	-0.02	-0.61	-0.59	0.60	0.58
RD	0.89	1.00	0.47	-0.09	-0.48	-0.40	0.41	0.36
PCGDP	0.61	0.47	1.00	0.05	-0.97	-0.95	0.95	0.85
GGDP	-0.02	-0.09	0.05	1.00	-0.05	-0.14	0.14	0.21
Poverty	-0.61	-0.48	-0.97	-0.05	1.00	0.96	-0.96	-0.88
p0p50	-0.59	-0.40	-0.95	-0.14	0.96	1.00	-1.00	-0.96
p90p100	0.60	0.41	0.95	0.14	-0.96	-1.00	1.00	0.97
p99p100	0.58	0.36	0.85	0.21	-0.88	-0.96	0.97	1.00

Where;

- ED= Expenditure Decentralization
- RD= Revenue Decentralization
- PCGDP = GDP per capita, current prices (U.S. dollars per capita)
- GGDP = Real GDP growth (Annual percent change)

Poverty: Poverty rate

- p0p50 = Pre-tax national income share held by the bottom 50 percent population
- p90p100= Pre-tax national income share held by the Group top 10 percent population
- p99p100 = Pre-tax national income share held by the Group top 1 percent population

Source: (Authors Own Calculation)

The negative correlations between revenue decentralization (RD) and poverty (-0.48 to -0.61) suggest that higher levels of revenue decentralization are associated with lower poverty rates. This could be because decentralization allows local governments to tailor poverty alleviation programs to their specific needs, potentially leading to more effective poverty reduction efforts. The negative correlations between expenditure decentralization (ED) and poverty (-0.40 to -0.59) similarly indicate that higher levels of expenditure decentralization are linked to lower poverty rates. When local governments have control over expenditures, they may allocate resources more efficiently, focusing on programs that directly benefit the poor.

Surprisingly, RD has a positive correlation with income inequality. This means that as revenue decentralization increases, income inequality tends to increase as well. The explanation is that local governments with more revenue-raising powers may not always use those resources to reduce income inequality, but instead focus on local development projects or infrastructure, which might primarily benefit the wealthier segments of the population. ED shows a similar positive correlation with income inequality. Increased expenditure decentralization is associated with higher income inequality, which could be due to local governments prioritizing projects or services that disproportionately benefit higher-income groups.

Furthermore, the correlation between GDP growth and these income distribution indicators is relatively weak. This implies that economic growth alone does not consistently correlate with changes in income distribution. Regarding fiscal decentralization, both Education Expenditure (ED) and Revenue Decentralization (RD) exhibit positive correlations with GDP per capita. This suggests that regions with greater fiscal autonomy tend to have higher per capita incomes.

6. CONCLUSION

This research paper has explored the multifaceted relationship between fiscal decentralization, economic growth, poverty rate and income inequality in the Indian context.

India's federal structure, comprising states and union territories, offers a unique setting to investigate how fiscal decentralization influences the nation's pursuit of inclusive growth. Analyzing the data presented in the correlation matrix, we find interesting patterns. The strong negative correlation between GDP per capita and the income share of the bottom 50 percent (p0p50) underscores the pressing issue of income inequality in India. It highlights the challenge of ensuring that economic growth translates into improvements in the living standards of the most vulnerable populations. Conversely, the positive correlations between GDP per capita and the income shares of the top 10 percent (p90p100) and the top 1 percent (p99p100) suggest that India's economic prosperity disproportionately benefits its wealthiest citizens. This income skew underscores the need for policies that prioritize equitable wealth distribution.

The analysis revealed that fiscal decentralization in India has shown promising results in reducing poverty. It allows local governments to address local challenges with context-specific policies and interventions, which, in turn, contribute to the overall reduction of poverty rates. However, it is important to note that fiscal decentralization may not always translate into reduced income inequality. There are instances where local governments may prioritize projects that benefit the wealthier segments of the population, leading to increased income inequality.

Furthermore, our analysis reveals that fiscal decentralization, as measured by Expenditure Decentralization (ED) and Revenue Decentralization (RD), is positively correlated with higher GDP per capita. This suggests that regions with greater fiscal autonomy tend to experience greater economic prosperity. However, this must be coupled with effective mechanisms to ensure that decentralization does not exacerbate existing income disparities. In the quest for inclusive growth, India faces a complex challenge. Achieving a balance between fiscal decentralization, economic growth, and income redistribution is essential. While fiscal decentralization can empower local governments to address regional needs effectively, it must be accompanied by policies that bridge the income gap and prioritize the welfare of marginalized populations.

In conclusion, the role of fiscal decentralization in achieving inclusive growth in India cannot be understated. The dynamics between decentralization, poverty reduction, and income distribution are multifaceted and context-dependent. As India continues its quest for equitable and inclusive development, understanding these dynamics is essential to harness the full potential of fiscal decentralization for the benefit of all citizens. Policymakers should remain committed to leveraging fiscal decentralization as a tool for poverty alleviation, while ensuring that it contributes to a more equitable distribution of wealth across the nation. In this way, fiscal decentralization can play a transformative role in the nation's journey toward inclusive growth.

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