The Reality of Special Category States

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The "special category" status accorded to certain states in the Indian Union allowed for much higher per capita central assistance compared to other states to flow unto these states enabling some of them to march ahead and prompting demands from others for this status. But these special category states were backward due to reasons of geography, while for the states which are demanding this status today, issues linked to governance lay at the root of their backwardness. Is it time to revisit the criteria and include others into this exclusive category by excluding those who do not need such assistance any longer?

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Eleven of the 29 states of India comprise what is collectively called the "Special Category States". These states are Arunachal Pradesh, Assam, Himachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura and Uttarakhand. Eight of these states constitute the north-eastern part of India; the three that lie outside the region are Jammu and Kashmir, Himachal Pradesh, and Uttarakhand. By and large, these impoverished and mostly resource-starved states lay at the periphery of India's economic development. They were created at different points of time in the history of independent India[1] to accommodate the socio-economic as well as the ethnocultural aspirations of their respective peoples who were handicapped in various ways. These handicaps arose not simply from the remoteness of their locations or the inaccessibility of their hilly terrains with sparsely populated habitation, nor due to their historical circumstances alone. They were caused also by the shortage of capital and natural resources within their boundaries, lack of any viable physical and social infrastructure for economic growth and development, high cost of production with low availability of resources and hence low economic base, coupled with high transport costs leading to high delivery cost of public services. Centuries of economic deprivation and neglect coupled with isolation from the mainstream of Indian states had resulted in widespread poverty, unemployment and economic backwardness of the people living within their territories. They have in fact been victims of the combined burden of history, geography, economics and governance. Even the resources that nature has endowed them with could not be harnessed and utilised for their development due to the pathetic state of their infrastructure and its continued neglect over decades.

India's economic achievements could hardly make any impact within these states that lay at the bottom of our economic ladder and disparity between these and the other states of India had only continued to increase over the years. Even the economic reform process that benefited the other states could offer little to improve this situation. As pointed out by Ahluwalia (2000), interstate disparities in growth rates of gross state domestic product (GSDP) had in fact increased after the reforms of 1991 across the states in India. The reform process of course had given a much needed push to accelerate the growth of the country and propel its economy into a high growth economy. But as shown by various authors, the process of economic reforms has not promoted balanced regional development (Ahluwalia 2002). It had, instead, mostly benefited the already prosperous or well-governed states rather than the laggards and that the reform-orientated states had generally performed better than other states since the process was started in 1991 (Bajpai and Sachs 1999). The poorer states have always been ill-equipped to profit from the reforms because of various impediments like their "less attractive social, economic, and probably, political conditions" (Baddeley et al 2006). Kurian (2000) noticed widening regional disparities among the states in general and between the forward and the backward states in particular. The better-off states, by virtue of their higher income, better physical and social infrastructure, higher per capita transfers and private investments, were much better placed to take advantage of the globalisation and liberalisation process and moved ahead. As a result, richer states became even more richer compared to the poorer states. All these indicate that whenever the disparity level increases across the states, the special category states can be expected to be the worst sufferers in terms of economic growth and development. Sachs et al (2002) also found that there was marked divergence in the growth and income levels among the Indian states during the period 1980-98, as well as during both the pre-reform and post-reform sub-periods. This divergence was most noticeable within the poorer group of states. Ghosh and Dasgupta (2009) also asserted that economic liberalisation had accentuated the widening regional disparity rather than mitigating it and that "regional disparities have intensified not in spite of the country's development strategy, but largely because of it". Referring to the political implications of interstate disparity, they observed that "coalition politics while setting regional questions on the national agenda has not in itself been able to reverse the centralising aspect of the economic reforms paradigm of the union government".

Economic neglect and lack of development generally create inequality and disparity and these reach an unsustainable level when there is a failure of governance whose primary responsibility is to address the causes of such disparity. In the absence of governance, extreme inequality and disparity often lead to violence and militancy. Predictably, coupled with other deep-rooted issues arising from tribal or other ethno-cultural identity contestations, such development-disparity paradigm had stoked the sinister fire of insurgency in many of these states, leading to decades of political unrest and mindless violence and bloodshed. A few states like Himachal Pradesh, Sikkim and Uttarakhand were spared this sinister cycle of violence and disruption where visible economic progress and other mitigating factors did not allow militancy and terror to raise their ugly heads. But most of the other special category states had during some or the other time during their history had to struggle against militancy and violence that had stubbornly kept their development at bay; some, like Tripura and Mizoram, were able to resolve these problems and marched ahead, while others still continue to struggle against an enemy that is largely invisible. Jammu and Kashmir is of course another story, perhaps more complex than the other states due to reasons associated with the history of its accession to India and due to the international dimensions involved.

Special Category Status

The special category status is granted to a state by the National Development Council (NDC) on the recommendation of the Planning Commission. The Planning Commission had laid down the criteria for this status according to which the special category status is granted to states characterised by certain common features that demand special considerations. A Planning Commission note[2] details these criteria:

"These features include: (1) hilly and difficult terrain, (2) low population density and/or sizeable share of tribal population, (3) strategic location along borders with neighbouring countries, (4) economic and infrastructural backwardness, and (5) non-viable nature of state finances. States under this category have a low resource base and are not in a position to mobilise resources for their developmental needs" irrespective of their per capita income. Many of these states were previously administered as small union territories (like Mizoram, Arunachal Pradesh and Himachal Pradesh which was earlier a part of erstwhile Punjab) or constituted from one or more districts of erstwhile states (like Nagaland, Meghalaya, Tripura carved out of Assam and Uttarakhand carved out of Uttar Pradesh); thus "necessarily involving creation of overheads and administrative infrastructure that was out of proportion to their resource base". The note further adds that "The decision in this regard is taken by the NDC which is the sole body competent to do so. This decision is based on the integrated consideration of all the factors listed above and the peculiar situation of the State and cannot be reduced into a mechanically applied formula."

It may be mentioned the special category status is not something that is given to a state according to any provision in the Indian Constitution, neither was there ever any attempt to amend the Constitution to this effect. Like the Planning Commission and the subsequent invention of non-lapsable funds for the states in the North East, this is an extra-constitutional arrangement.

For integration of the economic and social fabric of the country as a whole, it is essential to reduce disparities that exist between different regions in the country. Drivers of growth differ from state to state, though certain key drivers – like fiscal policy, credit availability, capital investments on physical infrastructure like roads and power plants and social infrastructure like education and health – can easily be identified. The constitutional mechanism of the Finance Commission and the extra-constitutional mechanism of the Planning Commission, which was created by a resolution of the Government of India in March 1950, seek to address the problem of striking an equitable balance between the socio-economic growth of individual states and the disparity that exists between them. The Finance Commission strives to achieve this by transferring resources from the richer to the poorer states through the agency of the central government, while the Planning Commission seeks to do so by allocating central resources through its five-year plans to meet the needs of the individual states by ensuring higher per capita allocation to the poorer states.

Under Article 275 of the Constitution, every state is entitled to a share of all central taxes in the union list which are pooled together to form what is known as the divisible pool of central taxes. These are shared between the centre and the states as per recommendations of the Finance Commission constituted once in five years under Article 280 of the Constitution. Article 275 thus provides a mechanism for automatic devolution of resources of the centre to the states. The finance commissions also determine the inter se share of each individual state depending on a number of factors with the objective of removing inter-regional disparities and promoting better fiscal management. Currently, under recommendations of the Thirteenth Finance Commission, 32% of all sharable central taxes are transferred to the states and the shares of individual states are determined by a formula that gives appropriate weightages to the population and area of each state, differences in fiscal capacities between states and the discipline exercised by them in managing their finances.

Apart from a share in the central taxes, states also receive money by way of grants from the centre, given for both plan and non-plan purposes. Among the plan grants there are separate grants for the state's own plan schemes, central plan schemes and also for the centrally-sponsored schemes (CSSs). The non-plan grants are covered by recommendations of the finance commissions under Article 275 and include the statutory grants to finance the non-plan revenue deficit of the states, for modernisation of administration as well as for relief for natural calamities and other public purposes. Plan transfers do not have any such statutory authority and are often discretionary in nature, made under Article 282 of the Constitution which enables grants to be given for any public purpose. The final source of funds for the state is of course borrowing; states borrow from the market and financial institutions. They also can borrow from the centre, though such borrowings have of late been much reduced.

Special category states are special primarily as far as their plan assistance from the Government of India was concerned. The Constitution provides for uniform rule in all the states, but it allowed special provisions for the protection of distinct cultural identities, traditions and customs of certain ethnic groups and for accommodating the economic interests and political aspirations of the indigenous peoples. Special category states naturally come under these provisions. Most of these are inhabited by tribal people with their distinct social institutions, economic relations, languages, traditions and customs. The Constitution does not include any provision for creation or categorisation of any state of India as a special category state. Yet recognising that certain regions in the country are historically more disadvantaged than the others in terms of socio-economic progress and therefore are in need of additional state support so as to remove the traces of any such historical disadvantage, the status was bestowed upon three states – Assam, Jammu and Kashmir and Nagaland – for the first time in 1969. The Fifth Finance Commission recommended a liberal dose of central assistance under the various five-year plans for these states.

Central Plan Assistance and Gadgil Formula

Expenditure of the states (or the union) is classified as plan and non-plan expenditure; plan expenditure pertains to expenditure allocated by the Planning Commission to meet the requirements of the states' annual plans and five-year plans which are supported by central assistance. States are entitled to get the following types of central assistance for their annual plans and five-year plans:

(a) normal plan assistance for central plans and state plans;

(b) additional plan assistance for implementation of externally assisted projects; and

(c) additional plan assistance for CSSs like Mahatma Gandhi National Rural Employment Guarantee Scheme, Sarva Shiksha Abhiyan, National Rural Health Mission, Integrated Child Development Services, Total Sanitation Campaign Pradhan Mantri Gram Sadak Yojana, Indira Awaas Yojana, Mid-Day

Table 1: Criteria and Weightage under Original Gadgil Formula, Modified Gadgil Formula and Formulae as Revised in October 1990 and in December 1991 for Allocation of Central Assistance for States' Plans[3]

Criteria (Weightage %)	Original Gadgil Formula (1969)	Modified Gadgil Formula (1980)	NDC Revised Formula (1990)	NDC Revised Formula (1991)
A Special Category States (11)	30% share of 3 states excluding North Eastern Council	30% share of 8 states excluding North Eastern Council	30% share of 10 states excluding North Eastern Council	30% share of 11 states excluding North Eastern Council
B Non-special category states (17)				
(i) Population (1971)	60	60	55	60
(ii) Ongoing major irrigation and power projects	10	0	0	0
(iii) Per capita income of which	10	20	25	25
(a) According to the deviation method covering only the states with per capita income below the national average	10	20	20	20
(b) According to the distance method covering all the states	0	0	5	5
(iv) Performance of which	10	10	5	7.5
(a) Tax effort	10	10	0	2.5
(b) Fiscal management	0	0	5	2
(c) National objectives	0	0	0	3
1 Population control	0	0	0	1
2 Elimination of female illiteracy	0	0	0	1
3 On-time completion of externally-aided projects	0	0	0	0.5
4 Success in land reforms	0	0	0	0.5
(v) Special problems	10	10	15	7.5
Total	100	100	100	100

Meal Scheme, National Rural Drinking Water Mission, etc, which are operated throughout India.

The normal central plan assistance is given as per a formula which is known as Gadgil formula since 1969, after D R Gadgil, the then deputy chairman of the Planning Commission. Apparently the Gadgil formula was adopted to introduce into the discretionary nature of the plan assistance some semblance of rationality that effectively curbed the absolute discretion the centre enjoyed over such transfers. This formula has been revised from time to time and is now called the modified Gadgil formula or the Gadgil/Mukherjee formula for determining the central assistance to a state (after Gadgil and Pranab Mukherjee, then deputy chairman of the Planning Commission). Under this formula adopted since 1991, the central plan assistance is given to the states based on a combination of criteria having different weightages that varied from plan to plan. The successive stages of evolution of the formula with the different weightages allotted to its different criteria are summarised in Table 1 (p 50).

Origin of the Gadgil Formula

The origin of the formula can be traced back to 1965, when the need for a set of principles was emphasised by some chief ministers for allocation of central assistance to states for the Fourth Five-Year Plan. The minutes of the NDC meeting on December 1967 noted that though there was lack of unanimity among the chief ministers of various states about the criteria, yet "there was a general feeling that States like Assam, Jammu and Kashmir and Nagaland would, in any way, have to receive special treatment". It may be mentioned here that even Article 275(1A) of the Constitution recognised the need for special treatment to Assam and made provisions for separate grants to be given to that state. In the light of the views expressed by the NDC, the Planning Commission evolved the following guidelines:

(i) Every state should receive a quantum of 70% of the total amount to be distributed in proportion to its population.

(ii) The balance should again be distributed but after taking into account

> (a) the special needs of Jammu and Kashmir, Assam and Nagaland to enable them to have a modest and reasonable Plan, (b) the special needs of some states which are required to contribute large amounts of expenditure on continuing schemes of irrigation and power of national importance, and (c) the need for accelerated development of certain backward regions like hill areas, etc.[4]

It is interesting to note that the resources of all the states taken together at that time were estimated to be only Rs 826 crore against the proposed outlay of Rs 2,103 crore, thus leaving a gap of nearly Rs 1,280 crore to be financed by the centre during the Second Five-Year Plan (1956-61), against which the actual normal central assistance (NCA) given amounted to Rs 1,058 crore. Assam and Jammu and Kashmir claimed only Rs 51 crore out of this, i e, 4.8% of the total share. Nagaland did not exist as yet and it would be created only in 1963. The share including that of Nagaland went up to 6.8% of total central assistance during the Third Plan (1961-66). During 1968-69, at the time of creation of the special category states, however, these three states together claimed a share of 9% of the total normal central plan assistance provided to all the states during that year. It was 19.3% during the entire Fourth Plan period. The share of the special category states in total central assistance thus was doubled immediately after their creation; this share would gradually rise further to one-third of the total normal central assistance for all states.

Till 1957, Naga Hills was a district of Assam. In response to the demands of the Naga Peoples Convention, the chief political party in Nagaland, in December 1957, the Naga Hills district was brought under the union administration as Naga Hills-Tuensang Area (NHTA) under the Ministry of External Affairs. The demand for its statehood gradually started getting stronger since then. Finally, by virtue of the 16-point agreement between the Naga Peoples Convention and the then prime minister of India in July 1960, the administration of Naga Hills was placed under an interim regional council under the Nagaland (Transitional Provision) Regulation 1961. This interim body was dissolved and Nagaland was formally declared as the 16th state of the Indian Union on 1 December 1963 (Upadhyay 2005). In the 16-point agreement, it was mentioned that

To supplement the revenues of Nagaland, there will be a need for the Government of India to pay out of the Consolidated Fund of India grants in aid as follows:

(1) Lump sums as may be necessary each year for the development programme in Nagaland;

(2) A fixed recurring sum (annual subvention) for meeting the cost of the administration of Nagaland.[5]

Thus the plan transfer was not specifically mentioned in the agreement. But after formation of the state, it started receiving plan assistance along with Assam and Jammu and Kashmir. It was long recognised that such assistance was inadequate to address the problems of these states, and in response to such recognition, all three were accorded the special category status in 1969. Article 275(1A) of the Constitution also recognised the need for special assistance for these states.

In 1968, the Fifth Finance Commission was constituted by the Government of India to recommend the devolution of taxes and grants to the states for the period 1969-74. It submitted its report in 1969, where it noted huge disparities existing among the 17 Indian states. The richest state had a per capita income of Rs 619 and the poorest Rs 292 only; the largest had a population of nine crore and the smallest only four lakh. It expressed concern that the need for equalisation among the states demanded a more positive redistributive policy than simply dividing the grants on the basis of population – by taking the reality of the rich and poor states into account. In considering the Finance Commission transfers, it also, for the first time, considered the Planning Commission transfers to look at the totality of funds at the disposal of the states, and recommended much higher amounts of transfers to Assam, Jammu and Kashmir and Nagaland:

> we wish to indicate that we have, in assessing the revenue receipts and expenditure of the states and applying the principles and general conditions explained in the preceding paragraphs, particularly kept in view the special problems of the states of Assam, Jammu and Kashmir

> and Nagaland. We have tried to treat their needs and requirements, with as much care and consideration as possible. The grants which we are recommending for these States are of a much larger magnitude that would ordinarily be justified in case of other States of similar size or having similar resources. We hope that these three states also will, on their part, make efforts to increase their resources and exercise better fiscal management and proper economy consistent with efficiency and take steps to improxtve the returns on their investments so that their financial position may steadily improve and in course of time they may be enabled to have more adequate revenues to improve their social and administrative services.[6]

Of the total Finance Commission grants of Rs 637.85 crore for the entire period between 1969 and 1974, these three states claimed a share of 39.75% of the total; Assam was allotted 101.97 crore, Jammu and Kashmir Rs 73.68 crore and Nagaland Rs 72.62 crore. Except Odisha, and to some extent West Bengal, no other state received as high a grant.[7] Thus as far as non-plan grants were concerned, these three states became rather "special". The Planning Commission would soon follow suit. The 26th meeting of the National Development Council held in April 1969 noted:

> …since the report of the Fifth Finance Commission was still awaited a clear picture of Centre's own liabilities was not available, but notwithstanding this, the Central Government had agreed, on the recommendation of the Planning Commission, to keep their contribution to the State Plans at Rs 3,500 crores.[8]

The minutes of the same meeting further noted that the

> Deputy Chairman [Gadgil] referred to the principles for the distribution of Central assistance to States which had been evolved at the meeting of the NDC Committee of State Chief Ministers held in September 1968. It was agreed that the requirements of the States of Assam, Jammu and Kashmir and Nagaland be met through an ad hoc lump assignment out of the total Central assistance and that the balance should be distributed as follows: 60 per cent on the basis of population, 10 per cent on the basis of per capita income only to the States below the national average, 10 per cent on the basis of tax effort in relation to per capita income, 10 per cent on account of continuing major irrigation and power schemes and the remaining 10 per cent on consideration of the special problems of the States.[9]

Thus the needs of these three states – Assam, Jammu and Kashmir and Nagaland – were given priority over the needs of other states by the Planning Commission as well. Both in respect to the plan as well as non-plan grants, they were receiving much higher amounts compared to the other Indian states and in that sense these states were treated as special. This, then, was the genesis of the Gadgil formula and of the special category status accorded to these three states in 1969.[10] The major contribution of the Gadgil formula has been to bring in discipline, transparency and objectivity in the plan transfers that severely attempted to limit the arbitrary discretion the centre had hitherto enjoyed over these transfers. Of course the centre would devise another way of exercising its discretion through the mechanism of the so-called CSSs.

The Numbers Increase

Before the Gadgil formula was applied, the states used to get more resources from the centre as loans and less as grants, plan and non-plan combined, leading to increasing indebtedness of the states. This situation was substantially changed since the Fourth Plan onwards, after the central assistance started getting distributed as per the Gadgil formula.[11] When the Gadgil formula was applied for the first time in 1969, there were altogether 17 states, and only three among them were treated as special category states. During the Fifth Plan period, the total number of states increased to 22, and all but the original 14 were treated as special category states. As and when new states were created, by carving them out of Assam or by giving statehood to erstwhile union territories, except Goa, all were created as special category states. The reasons were obvious; all these states were small states, and had small populations. Therefore they will not enjoy the advantage a state with a large population would get from the higher weightage given to population in the Gadgil formula. This practice of adding the newly created states to the list of special category states continued till 2001, when only one state, Uttaranchal (now Uttarakhand) out of the three states created in 2000 was added to the list of special category states by a decision of the 49th meeting of the NDC on 1 September 2001, 18 months after its creation, but the other two, Jharkhand and Chhattisgarh, were treated only as general category states. The agenda note for meeting had detailed the case for Uttarakhand:[12]

> The predominantly hill districts account for about 90 per cent of the total area of the newly created State of Uttaranchal, while more than 2/3 of the population of the state resides in the hill areas. Almost 1/3 of the total area in Uttaranchal is either rocky/snow covered/glaciated or otherwise unproductive degraded land. About 3 per cent of the population of the state is tribal.

It further adds that

> Uttaranchal is a geo-politically sensitive area. While in the North the state has international borders with China, in the East the region is bound by Nepal. Uttaranchal is a difficult area in terms of geography, accessibility and sustainable growth rates. The mountain environment is fragile although it is rich in biodiversity. Unit expenditure of initially providing an average standard of services in such hill regions is higher, and unit cost of operation and maintenance is also very high. Uttaranchal region is vulnerable to many types of disasters. Special arrangements would be necessary to improve administrative, organisational and technical capabilities in the area of disaster preparedness and disaster management.

Examining the finances of the state, the agenda papers note that the state had a non-plan revenue deficit of Rs 1,738 crore in 2000-01 while its interest liability alone was Rs 450 crore. It lacked resources to meet its committed expenditure on accounts of salary, pension and interest payments and would require heavy investments to make it financially viable in the long run, as the benefits of such investments would flow only after a sufficiently long time interval.[13]

Himachal Pradesh that was a union territory was accorded full statehood in 1971. Three more north-eastern states were carved out from Assam in 1972: Manipur, Meghalaya and Tripura. Sikkim became an Indian state in 1975. Mizoram and Arunachal Pradesh which hitherto were union territories were accorded full statehood in 1987 and Uttarakhand was carved out of Uttar Pradesh in 2000, and was made the 11th special category state in 2001.

It is to be mentioned that even though the number of special category states increased from only three in 1969 to 11 in 2001, its kitty of 30% of the central plan funds, after setting aside funds for externally aided projects and special area programmes in certain states, remained unchanged – there was no proportionate increase in resources set out for this category as new states were added on. As a result, the share of individual states within the category had to decline. Even when a decision was taken in 1969 to include Assam among one of the three initial states belonging to this category, it was given the benefit of 90% grants and 10% funding available to special category states only from 1 April 1990. From time to time, various states, including Odisha, Rajasthan, Punjab, Chhattisgarh and even Delhi has demanded to be included in this category, but with so many states sharing the same 30% of plan funds, addition of more states would defeat the purpose of creation of this category altogether.

Further, the above scheme has since been vitiated by the direct transfer of central plan grants to the executing agencies in the states under the various centrally-sponsored plan schemes, especially under the "flagship schemes" of the central government. Statutory transfers under Finance Commissions' recommendations constituted only one-third of the total transfers during the First Plan period, this proportion gradually increased to 53% during the Tenth and Eleventh Plan periods. Still about half of the total transfers take place through a non-statutory mechanism of the Planning Commission. The non-discretionary plan assistance to states (under the Gadgil formula and other transfers tied to specific projects) earlier used to dominate the total plan transfers, but the proportion of such transfers in the total transfers have declined progressively, with the result that now the discretionary transfers, most of which are extra budgetary, account for the bulk of such transfers.

As per the 2013-14 Budget, the total central assistance to states is Rs 1.3 lakh crore, of which the normal plan assistance is only Rs 27,636 crore, and about a third of this money would only go to the special category states. This is, however, minuscule compared to the total plan expenditure of Rs 4.2 lakh crore for central and centrally-sponsored plan schemes, of which Rs 1.4 lakh crore would be passed to states in respect of flagship welfare schemes of the centre, not through their budgets, but as direct transfers to the implementing agencies in districts. States have no control over this money; lying outside government accounts, these funds bypass most controls and lack transparency. This is another politically manoeuvred aberration in the Indian financial system and an assault on the principles of fiscal federalism enshrined in the Constitution by diluting and undermining the authority of the states. Over the years such extra-budget direct transfers have increased phenomenally, while the Gadgil transfers have shrunk. Their share in total plan transfers has gradually fallen from 35% during Ninth Plan to only 10% during Eleventh Plan, while the share of direct transfers has increased from 20% to 52% over this period. Consequently the plan transfers to special category states have also contracted. The plan funds routed through the state budgets now constitute less than 30% of the total transfers of states. The normal central assistance has progressively been rendered more and more meaningless in comparison to the direct transfers. Thus the special category status has already lost much of its sheen and if awarded to more states would cease to have any real benefits for anyone.

Scheme of Transfer of Resources

The scheme of central transfer to states by both the Finance Commission and the Planning Commission can be summarised thus:[14]

(i) First the state's balance from current revenues (BCR) (revenue receipts (RR) – non-plan revenue expenditure) is calculated. If BCR is negative, the Finance Commission recommends grants under Article 275 so as to make BCR =0;

(ii) Revenue component of the state plan is financed by the BCR along with additional resource mobilisation (ARM) and central assistance (CA). The total plan revenue resources, PRR =BCR+ARM+CA. As the Gadgil formula allocates central assistance in the ratio of 70% and 30% respectively between loans and grants, for the revenue component of the plan, CA will be 30% of the assistance as per the Gadgil formula.

(iii) No state should have a negative BCR after the Finance Commission devolutions. However, if the assumptions made by the commission do not turn out to be true due to subsequent deterioration of the state finances, then a part of ARM is used to cover the negative BCR reducing the PRR. If ARM cannot cover the negative BCR, then CA for the plan has to be diverted to finance non-plan expenditure, a situation that was prevailing in respect of the special category states. If the negative BCR exceeds the sum total of ARM and CA, then the capital (i e, loan) component of CA will go to finance non-plan revenue expenditure. This was also the case with quite a few states, both from general as well as special categories before the Twelfth Finance Commission.

The BCR projected by the finance commissions have often disappeared later as the financial situation behaved differently than projected and had to be reworked at the time of the annual plan resource meetings. Even these often disappeared later due to the continuous increases in non-plan expenditure on account of ever-increasing liabilities on salary, pension and interest payments. However, with the Fiscal Responsibility Legislations (Fiscal Responsibility and Budget Management Act or FRBMA) in place in all states by now, this situation has been rectified to some extent by forcing the states to contain their non-plan revenue expenditure within the limits imposed by the FRBMA.

Under the formula, during the Eleventh Plan, within the general category states, the individual state's share in total NCA varied between 0.49% for Goa and 19.48% for UP; Bihar (11.06%), West Bengal (8.81%), MP (6.92%) also received higher shares than the other states. Within the special category states, the share of individual states varied between 3.77% for Sikkim and 19.53% for Assam and 19.15% for Jammu and Kashmir, followed by 9.66% for Himachal Pradesh, 9.54% for Uttarakhand, 8.24% for Tripura, 7.93% for

Arunachal Pradesh, 5.91% for Nagaland, 5.84% for Manipur and 4.85% for Meghalaya.[15]

Central Assistance to States

The central plan assistance comes to the states in various forms: central assistance for state plans which includes, apart from NCA and additional central assistance (ACA) for externally aided projects (EAP), special central assistance (SCA) for hill and border areas, etc, for the Backward Regions Grant Fund (BRGF), grants under Members of Parliament Local Area Development Scheme, etc, and the additional central assistance for CSS. The NCA received by the special as well as the non-special category states for their plans during various plan periods is shown in Table 2. Before the Gadgil formula was applied to determine the NCA, the existing states which would later become the special category states used to receive less than 10% of the total NCA for all the states. After the implementation of the formula, their share gradually increased over the successive plan periods to reach more than a third of the total NCA for all the states during the Eleventh Plan. Side by side their numbers also went on increasing, but in respect to NCA, the Gadgil formula did make a difference to special category states (Table 2).

Table 2: Normal Central Plan Assistance (under Gadgil Formula) to States[16]

	No of Special Category States[17]	Special Category States NCA (Rs Cr)	Special Category States As Percentage of Total NCA	Non-Special Category States NCA (Rs Cr)	Non-Special Category States As Percentage of Total NCA
1st Plan (1951-56)	2	22	6.63	310	93.37
2nd Plan (1956-61)	2	50	4.73	1,008	95.27
3rd Plan (1961-66)	3	172	6.84	2,343	93.16
Annual Plans (1966-69)	3	161	8.97	1,634	91.03
4th Plan (1969-74)	7	682	19.29	2,853	80.71
5th Plan (1974-78)	8	846	16.95	4,145	83.05
Annual Plan (1978-80)	8	866	16.61	4,347	83.39
6th Plan (1980-85)	8	3,547	19.44	14,702	80.56
7th Plan (1985-90)	10	9,625	24.85	29,104	75.15
Annual Plans (1990-92)	10	5,485	23.41	17,944	76.59
8th Plan (1992-97)	10	21,705	23.31	71,419	76.69
9th Plan (1997-2002)	11	36,738	48.29	39,335	51.71
10th Plan (2002-07)	11	60,453	42.37	82,228	57.63
11th Plan (2007-12) (Figures till 2009-10)	11	64,787	36.44	1,12,998	63.56

To put the things in proper perspective, we need to consider not only the NCA, but the total central assistance (TCA) which includes, besides assistance for the EAP which forms a small part of the TCA, the assistance for the CSS mentioned earlier. In Table 4, the TCA received by the special and non-special category of states have been shown along with the statutory transfers under Finance Commission recommendations.

Transfer from Finance Commission

The special category states received not only special consideration from the Planning Commission but also from the successive finance commissions which went on increasing their share of total devolution of resources as can be seen from Table 3.

It is also seen that the share of special category states in TCA including non-plan grants recommended by the finance commissions has increased from a meager 3.52% to about 30% during the Eleventh Plan (Table 4).

Table 3: Transfer of Resources by Finance Commission Recommendations[18]
(Rs Crore)

Finance Commissions (FC)	Period	Transfers to Non-SCS (Rs Crore)	Transfers to SCS (Rs Crore)	% of Total Transfers to SCS	Statutory Transfer as % of Total Transfers
1st FC	1952-57	394	18	4.37	28.9
2nd FC	1957-62	979	70	6.67	31.6
3rd FC	1962-66	1,230	81	6.18	39.9
4th FC	1966-69	1,583	163	9.34	35.9
5th FC	1969-74	4,796	521	9.80	35.9
6th FC	1974-79	8,249	1,359	14.14	44.2
7th FC	1979-84	18,816	2,026	9.72	43.1
8th FC	1984-89	33,906	5,546	14.06	60.1
9th FC	1989-95	1,01,014	18,684	15.61	61.5
10th FC	1995-2000	1,91,648	34,995	15.44	68.6
11th FC	2000-05	3,76,263	58,642	13.48	69.4
12th FC	2005-10	6,46,773	1,08,978	14.42	68.0
13th FC	2010-15	14,93,689	2,12,988	12.48	NA

As already stated, 30% of the centre's gross budgetary support for plan expenditure goes to the special category states. Earlier, plan assistance was given to the general category states by way of grants and loans in the ratio of 30% and 70% respectively. In the case of special category states, however, 90% of plan assistance was given as grants, and only 10% as loans. All the special category states are highly indebted, and their debt: GSDP ratios are far higher compared to the other states or to the national averages. The Twelfth Finance Commission rightly pointed out that the central plan assistance to states had a counterpart in the interest rate charged by the central government on the plan loans given to the states, which was much higher (by about 3%-4%) than the cost of funds to the centre, i e, the market rate of interest, and hence could become a source of funds to the centre at the cost of the states. It therefore recommended that the plan grants should be given as genuine grants and states should be encouraged to borrow directly from the market whenever they need additional resources, subject to their repaying capacities, thus delinking grants from loans in plan assistance. The plan size of each state should also take into account its sustainable level of debt. In other words, the considerations for grants should be different from those of loans. This has bearings also on the fiscal deficit of the centre, since it borrows almost the entire funds needed for meeting the plan expenditure. It therefore recommended that the "Planning Commission should confine itself to extending plan grants to the states, and leave it to the states to decide how much they wish

Table 4: Share of Total Central Assistance under Different Plans to Special and Non-Special Category States[19]

Plan Periods	TCA (Rs Crore) Given to Special Category States	TCA (Rs Crore) Given to Non-Special Category States[20]	Percentage of TCA Received by Special Category States	Percentage of TCA Received by Non-Special Category States
1st Plan (1951-56)	31	849	3.52	96.48
5th Plan (1974-79)	1,005	5,532	15.37	84.63
Annual Plan (1979-80)	924	5,679	13.99	86.01
6th Plan (1980-85)	4,347	21,400	16.88	83.22
7th Plan (1985-90)	11,577	42,731	21.31	78.69
Annual Plans (1990-92)	6,461	27,216	19.19	80.81
8th Plan (1992-97)	26,988	1,04,225	20.57	79.43
9th Plan (1997-2002)	62,872	1,44,831	30.27	69.73
10th Plan (2002-07)	1,23,568	2,51,368	32.96	67.04
11th Plan (2007-12) till 2009-10	1,18,130	2,79,030	29.74	70.26

to borrow and from whom, i e , from the centre or from the open market."

This "dis-intermediation" of the centre in the borrowing process of the states has to a large extent restored the fiscal balances of the centre as well as of the states and has brought down their fiscal deficits. Now the centre only provides grants, and leaves it to the states to raise loans as they wanted. The 90% grants: 10% loans formula for special category states is now restricted only to CSSs and externally aided projects. For general category states, external aid is passed on in the exact mixture of loan and grants in which it is received at the centre.

Summary and Discussion

The special category status refers mainly to the plan assistance to these states given by the centre. The status is bestowed by the Planning Commission. There is no formal declaration, but it is made apparent by the pattern of assistance provided to the special category state so selected and neither is there any formal agreement with the state. Once the status is awarded, the specific assistance pattern follows to the state in perpetuity. There is no stipulation as to what is intended to be achieved by such a status, or the time period within which this is to be achieved. The status once bestowed upon a state carries only rewards but no obligation on the part of the state. Certainly these are not the ideal mechanisms for upliftment and empowerment of a state.

Apart from the plan grants, the special category status also entitles a state to preferential treatment in federal assistance and tax breaks by giving significant excise duty and income tax concessions to industries that would be set up within their territories. These states have been getting higher per capita central plan assistances than the non-special category states. During the Fifth Plan, the per capita transfer for special category states was Rs 415 crore compared to only Rs 84 crore for non-special category states. During the Tenth Plan period (2002-07), these states have received per capita central assistance of Rs 2,403.85 crore (Rs 2,574.98 crore for the north-east states) compared to all-India average of only Rs 683.94 crore; it was 9.65% of their GSDP compared to only 1.94% for the non-special category states in 2007.[21]

Since 1969, the number of such states has increased to 11 and there have been demands from newly formed states as well as from Bihar, Rajasthan and Odisha for according them the special category status, claiming that the criteria devised by the Planning Commission were arbitrary. Such claims have started finding favour with the ruling dispensation in the era of coalition politics and wafer-thin majorities in Parliament.

Without a shadow of doubt, the criteria devised by the Planning Commission were indeed arbitrary. The Planning Commission ought not to have been vested with such extra-constitutional powers that have made it an authority without accountability for spending public funds on schemes whose socio-economic benefits have often been debatable, but which serves the interest of the ruling dispensation. It is through the Planning Commission that the ruling dispensation gets indirect access to public funds to be dispensed to the states under Article 282 which should be used to deal with extraordinary situations, unlike under Article 275.

A body created by an executive resolution like the Planning Commission should not have the authority to decide whether a state should or should not be a special category one – such decision should be left to only the elected representatives of people as befits a democratic system. Its power to channel public funds without accountability had led to arbitrary decisions being imposed upon the nation from time to time, and such arbitrariness and ad hocism have permeated our entire financial apparatus, creating aberrations all along. That the Planning Commission criteria for according the special category status to a state is of no real significance – something that can be easily junked when it comes to politics of convenience – has been amply demonstrated in recent past – in the case of Bihar and Seemandhra.

With an eye to forging an electoral alliance with Nitish Kumar who had made the special category status for Bihar conditional to any such alliance, the centre appointed the Raghuram Rajan Committee that worked out the criteria for backwardness according to which 10 states including Bihar were found "least developed" among the 28 states – and hence eligible for special assistance, besides Arunachal Pradesh, Assam, Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh, Meghalaya, Odisha, Rajasthan and Uttar Pradesh. The report had generated widespread criticism and when that alliance failed to work out, the centre played the same card by proposing to grant a special status to Seemandhra, again with an eye on the impending Lok Sabha elections. Seemandhra, like Bihar or Odisha, does not fulfil the Planning Commission criteria for special category status. There is always more politics here than economics to play with taxpayers' money.

As reiterated by the Thirteenth Finance Commission, the definition of some states as special category states addresses their low resource base and the cost disabilities due to their physical geography, sparse terrain, remoteness and historical circumstances and high costs of providing similar levels of public goods and services as the non-special category states. But the problems of the states that are demanding this status today do not appear to stem from difficult terrain or cost disabilities due to adverse physical geography. On the contrary, both Bihar and Odisha are resource-rich in terms of minerals and have many geographical advantage rather than adversities. The high delivery cost of public services in these states is not because of any natural disadvantages in these states, but because of governance failure in the past.

For attracting industries into a state and thereby to generate employment and income, availability of power and infrastructure are much more powerful incentives than central assistance. Equally important are the availability of skill and an enabling climate of entrepreneurship. Bihar or Odisha have none of these, and more grants are not going to help the cause of their underdevelopment. As regards resources, they are not even able to spend whatever little resources they have even now. Their problem is not scarcity of resources, but lack of institutional capacity, infrastructure, developed market within the state, easy and affordable access to finances and markets and an enabling industrial climate. These are impediments not addressable in the short term. Besides, there remains the issue of direct transfers from the centre. During 2011-12, Rs 8,958 crore, or 90% of total central plan grants to Bihar – nearly one-fifth of its total revenue receipts – were given as direct transfers, over which the state had no control. If these are given as on-budget grants instead, the resource position of all states would improve substantially (Bhattacharjee 2013).

Over the years, the perception about the role of the government has also undergone a remarkable transformation. From being the controller of all economic activities, it has become a facilitator of those activities. Side by side, the principles of federalism in Indian democracy has taken stronger roots; with the concept of a single party with absolute majority at the centre becoming a thing of the past, the balance of power that was skewed earlier in favour of the centre has now shifted towards the states, increasing their bargaining power. This facilitated increasing resources to be transferred to the states, some of which have been able to leverage this to their advantage and grow fast. As the states thus started becoming more powerful, there were demands for creation of smaller states by breaking up of the larger and largely ungovernable states in response to the aspirations and agitations of people inhabiting areas within these states that hitherto were neglected for various reasons. From 1972 onwards, the creation of more special category states followed as a result of the increasing aspirations of these people. Some special category states thus created have indeed registered much higher rates of growth than were ever thought to be possible under their earlier dispensations and some may even attain levels of development comparable to the advanced states. The question is would they still be treated as special category, or should they make way for other backward states to be treated as special?

It is perhaps time to take a relook at the whole arrangement regarding the award of special category status to a state and its continuation in perpetuity. Given the emphasis that is being placed in good governance, accountability and transparency, equity and efficiency all over, it will serve the purposes of development much better if the status is reviewed and a target-based time-bound approach is adopted for assistance from the central plan funds. Once the targets are achieved, the assistance may continue for a further term and in the event of failure the assistance can be diverted to another state that is in need of development. A target-oriented formula-based approach for assistance instils accountability, improves performance, removes complacency and helps a state move rapidly forward by providing incentives for better performance. It also makes the field more level for all players, with open entry and exit to the special status for all.

NOTES

1 Assam, Jammu and Kashmir and Nagaland were accorded the special category status in 1969, Himachal Pradesh in 1971, Manipur, Meghalaya and Tripura in 1972 when they were created, Sikkim in 1975, Arunachal Pradesh and Mizoram in 1987 and Uttarakhand in 2001.

2 Note submitted by the adviser, Financial Resource Division, Planning Commission dated 16-11-2006 to the member (AS) and deputy chairman of the commission. Also stated in the Rajya Sabha in response to Unstarred Question No 1614 dated 03/12/2009.

3 Quoted from a background note appended to semi-official letter No 4/9/96-FR/DCH/3670 dated 24 February 1997 forwarded by Madhu Dandavate, the then deputy chairman, Planning Commission to Prakash Singh Badal, the then chief minister of Punjab.

4 Twenty-fifth meeting of the NDC, Summary Record of Discussions, Planning Commission, Government of India, May 1968.

5 Para 11, 16-Point Agreement, July 1960.

6 Report of the Fifth Finance Commission, Para 6.46.

7 Para 6.50, ibid.

8 Minutes of the 26th meeting of the National Development Council, 1 April 1969, Para 9, Planning Commission, Government of India.

9 Para 10, ibid.

10 Central assistance was provided to special category states as 90% grant and 10% loan from the beginning of the Fourth Five-Year Plan except Assam and Jammu and Kashmir which were covered under the pattern of central assistance of 30% grant and 70% loan as in the case of non-special category states; the 10%-90% formula was applied only in respect of the hilly areas of Assam and Ladakh region of Jammu and Kashmir. This was extended to the entire area of these two states by a decision of the NDC in October 1990 only. (File No 12/ 1/2005-FR, Financial Resources Division, Planning Commission, Government of India and also Letter No 19(2)/PF.I/92 dated 21/12/1992 of the Ministry of Finance, Dept of Expenditure, Plan Finance- I Division, Government of India.)

11 M P Goswami (2007), "Emerging Trends and Issues in Centre State Financial Relations" in Anil Kumar Thakur and Md Abdus Salam (ed.), *Indian Public Finance and Twelfth Finance Commission*, Deep and Deep Publications, pp 69-70.

12 Agenda Item No 4: "Placing Uttaranchal on the List of Special Category States", 49th meeting of NDC dated 01/09/2001.

13 The issue of Uttarakhand was examined by the full Planning Commission in its meetings held on 27 and 29 June 2001, chaired by the prime minister.

14 This scheme has been detailed in Vithal and Sastry (2001).

15 Eleventh Plan document, Vol I, p 142.

16 Data for First to Fourth Plans have been taken from the Report of the Seventh Finance Commission and the Minutes of the 25th meeting of the National Development Council, Annexure II, Planning Commission, Government of India, May 1968; for Fourth-Eighth Plans, data have been taken from Vithal and Sastry (2002). Ninth, Tenth and Eleventh Plans data have been compiled from the combined finance and revenue accounts of the union and states prepared by the Comptroller and Auditor General of India for the respective years.

17 Till 1969, there was no special category state. But the states that would later become so have been indicated in this column till 1969.

18 For data relating to First to Sixth Finance Commissions, *Report of the Seventh Finance Commission*, pp 172-75; for the rest, *Reports of Eighth to Thirteenth Finance Commissions*.

19 Data for First Plan have been taken from Vithal and Sastry (2002); rest from the combined finance and revenue accounts of the CAG of India for the respective years.

20 Union territories grants are not included, unlike in Table 3.

21 Eleventh Five-Year Plan, Planning Commission, Government of India, p 152.

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