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Does delegation of fiscal policy to an independent agency make a difference? Evidence from intergovernmental transfers in India

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Abstract

One area of fiscal policy in which several countries have delegated responsibility to an independent agency is the distribution of national resource transfers across regional and local governments. Such delegation is expected to promote equity and efficiency, and mitigate distortions created by political incentives. This paper tests whether delegation to an independent agency indeed makes a difference by contrasting the impact of partisan politics on two types of fiscal transfers to states in the Indian federation over a period of time, 1972–1995. The pattern of evidence shows that, while the transfers that are determined by the central political executive are indeed distributed to favor particular states that are politically important for the central ruling party, the transfers that are delegated to an independent agency serve to constrain such partisan impact.

JEL classification: D72; H77
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1. Introduction

Normative theories of fiscal federalism postulate that intergovernmental transfers should be determined by equity and efficiency considerations, to support local governments in providing differentiated public goods to heterogeneous populations, while ensuring an even distribution of

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basic services across all regions (Musgrave, 1959, 1983; Oates, 1972; Gramlich, 1977).[1] However, empirical evidence shows that political variables representing electoral incentives of public agents are significant determinants of the variation in fiscal transfers to sub-national jurisdictions within countries (Inman, 1988; Grossman, 1994; Pereyra, 1996; Worthington and Dollery, 1998; Porto and Sanguinetti, 2001; Case, 2001; Johansson, 2003). In addition to political manipulation of intergovernmental transfers, direct spending through central government programs has also been shown to favor those regions that are politically important for the center. One of the more consistent empirical findings across countries is that regions with higher political representation per capita receive greater government spending per capita (Wright, 1974; Porto and Sanguinetti, 2001; Ansolabehere et al., 2002). Another finding is that regional voting patterns in past elections matters for the distribution of public spending (Schady, 2000; Miguel and Zaidi, 2003; Stromberg, 2002; Cole, 2004).

In recognition of the potential for political manipulation of national resources, several federations around the world have attempted to create independent bodies that are responsible for determining inter-regional resource allocations in accordance with economic efficiency and equity objectives.[2] This creates an opportunity to test the general hypothesis of whether delegation of fiscal policy to an independent agency indeed makes a difference in curbing political influence.[3] This paper provides some answers to this question from the large federation of India, by contrasting political effects on a particular instrument of inter-regional resource transfer when the decision-making authority lies with a political body versus when it lies with an independent agency.

The Indian federation provides a valuable laboratory for this purpose because of the existence of two agencies that determine general-purpose federal transfers to state governments: one is a political body made up of the executive heads of the central and state governments, while the other is a quasi-judicial body, expected to be independent of partisan influence, and invested with legal authority drawn from the constitution. Both agencies make decisions over an identical fiscal instrument—transfer of resources to states in general aid of state budgets, untied to any specific spending program. Using disaggregated data on transfers and political variables for a panel of 15 major Indian states from 1972 to 1995, we find a pattern of evidence that shows that, while the transfers that are determined by the political agency are indeed distributed to favor particular states that are politically important for the central ruling party, the transfers delegated to an independent agency serve to constrain such partisan impact.

The paper argues that if the distribution of general-purpose fiscal transfers among the Indian states is politically motivated, states that are governed by the same political party (or coalition of parties) as that governing at the center would be favored with additional resources. Party identification between the state and central governments is important for the targeting of this fiscal instrument because the center can make political gains only indirectly through the

[1] A more recent literature focuses on the inefficiencies created by local taxation due to inter-jurisdictional tax competition and mobility that creates a valuable role for central taxation and regional distribution via grants-in-aid (Inman and Rubinfeld, 1996, provide a review).

[2] The Commonwealth Grants Commission in Australia is the best example from among the older federations of the world. However, it is in the newer federations in Asia and Africa that decision-making over intergovernmental transfers are increasingly being delegated to an independent agency, such as the National Finance Council in Malaysia, the Revenue Mobilization Allocation and Fiscal Commission in Nigeria, and the Finance Commission in India (which is studied here).

[3] While considerable empirical research exists for the effects of delegating monetary policy to an independent central bank, our understanding of this issue for fiscal policy is limited by lack of empirical evidence.

performance of its party members at the helm of the state. General-purpose transfers in India are an intrinsic and fungible part of state government budgets, to be spent at the discretion of the political party controlling the state government, and flow systematically through bureaucratic agencies. Thus, when a state is able to spend more because of additional transfers, voters are unlikely to distinguish that this additional public spending is due to the targeting of their state by central political agents and instead likely to credit their incumbent state government for the additional services. Hence, the best the central ruling party can do to make political gains with this fiscal instrument is to target transfers to states where its own party members are in power, in the hope of strengthening its party position in the state, and its overall party reputation. Correspondingly, additional transfers to states governed by rival political parties would allow these rival parties to make political gains from additional spending, so central political agents would try to keep transfers to these states as low as possible.

Consistent with this argument, we find that states governed by the same political party governing at the center are likely to receive substantially greater fiscal transfers from the political agency determining transfers. In striking contrast, we find that these co-partisan states receive *lower* transfers from the independent agency, which instead favors those states governed by the national ruling party's competitors. The partisan impact on pooled transfers, adding together the two types of general-purpose transfers, is statistically indistinguishable from zero. We argue that this pattern of results shows that the independent agency acts as a check on politically motivated distribution of resources by the national political executive. The mandate of the independent agency is to provide equalizing transfers, with greater resources allocated to fiscally disadvantaged states. If non-affiliated states are politically disadvantaged and likely to have fewer national resources directed towards them, whether through intergovernmental fiscal transfers or direct spending by the central government, then the independent agency would direct greater transfers to them not because of any political motives of their own but because they happen to be the resource-poor states.

We also find that the national political executive targets transfers to a particular type of co-partisan state. Transfers determined by the political agency are greater to those co-partisan states where the party controls a smaller proportion of districts or seats allotted to the state in the national legislature. If the ruling party controls less than half of the state's seats in the national legislature, then an affiliated state receives additional transfers that are more than 30% of the sample average of discretionary transfers. If proportion of seats controlled by the ruling party is an indicator for party popularity, then states where the party controls a high proportion of seats can be characterized as "core support" states and, correspondingly, where the party controls a low proportion of seats can be characterized as "swing" states, following a large theoretical and empirical literature (Cox and McCubbins, 1986; Lindbeck and Weibull, 1987; Dixit and Londregan, 1998; Case, 2001; Cole, 2004; Miguel and Zaidi, 2003). Our results therefore show that affiliated states that are "swing" receive more transfers and that "swing" status matters only in interaction with the party identity of the state government.

By using the existence of delegation in a specific area of fiscal policy–intergovernmental fiscal transfers–that is expected to be heavily influenced by political factors, this paper has implications for the broader issue of the role of institutional interventions in mitigating the effects of political opportunism. It therefore provides lessons for institutional design to address other areas of fiscal policy with costly political distortions. Specifically, it contributes a new idea to the literature on the impact of budgetary institutions on fiscal discipline which has studied the impact of delegation to different decision-makers *within* the government, such as centralization of authority in Ministers of Finance over budget aggregates (Von Hagen, 1991, 1992; Alt and Lowry, 1994;

Poterba, 1994). Following in this vein, Eichengreen et al. (1999) have suggested delegation of decisions over debt ceilings to an independent agency as a policy option for countries with fiscal instability. This paper provides empirical evidence to inform such innovative ideas for institutional solutions to politically difficult policy issues.

In the next section, we provide some details of the Indian fiscal and political institutions, focusing on the nature of the independent agency and the dynamics of electoral competition. Section 3 develops the argument for how political considerations can be expected to influence intergovernment transfers in India, based upon the nature of the country's fiscal and political institutions. Section 4 describes the data and presents and interprets the empirical evidence. Section 5 concludes.

2. Fiscal and political institutions in India

2.1. Fiscal institutions

The Indian states are constitutionally assigned broad fiscal powers, the nature of which is typical of federal nations, with the central government responsible for macroeconomic stability, international trade and any policies with extensive spillovers across state boundaries. Expenditure responsibilities for most public goods, such as in agriculture, irrigation, rural development, industries, basic health and education are assigned to the states, while social assistance programs, such as food subsidies, are concurrently shared with the center.[4] Between 1960 and the present state governments have been undertaking around 50–60% of total government expenditures in India (Rao and Singh, 2000).

Relative to their expenditure responsibilities, the revenue generation powers of state governments are more limited, with high yielding taxes such as personal income tax, corporation taxes and customs duty assigned to the center. State governments collect tax revenues from agricultural income, from property and capital transactions, and from the production and sale of commodities. Between 1960 and the present state governments collected around 30% of total revenues (Rao and Singh, 2000).

The constitutional assignment of expenditure responsibilities and revenue authority between the central and the state governments in India is intentionally imbalanced to give the central government a role in regional redistribution.[5] A large part of state expenditures is financed by general-purpose transfers, including both grants and share in centrally collected taxes, and loans from the central government. General-purpose grants to state governments constitute about 35% of state revenues (Rao and Singh, 2000). Fiscal deficits of state governments are largely financed by loans from the central government, constituting more than 65% of total borrowing by the 15 major states in the sample studied here. There are two central agencies determining general-purpose transfers from the center to the states—(i) an independent agency, the Finance Commission, whose membership is non-political and determined by constitutional rules, and (ii) a

[4] Even with subsidized food programs, where food is usually procured centrally and then distributed to the states, it is the state government that actually distributes the food to citizens. That is, the machinery of the state government is responsible for implementing most public service programs in India.

[5] Detailed analysis of the history of fiscal federalism and inter-government transfers in India, with exhaustive references, can be found in Rao and Chelliah (1991) and Rao and Singh (2000, 2001). The main reason behind the imbalanced assignment of revenue authority and expenditure responsibility was to provide the central authorities with a fiscal instrument to promote unity among the disparate nationalities residing within one country. Overall fiscal control at the center was expected to reign-in regional secessionist tendencies and promote regional equality.

government agency with political representation, the Planning Commission, which is chaired by the Prime Minister.

Article 280 of the Indian Constitution of 1950 mandates the appointment of a Finance Commission every 5 years, with the primary purpose of determining the sharing of centrally collected tax proceeds between the central and state governments, and the distribution of grants-in-aid of revenues across states. The terms of reference (TOR) of successive commissions can be expanded by order of parliament, but must include the determination of tax devolution and grants-in-aid. The overarching objectives of Finance Commission transfers are described in every TOR in terms of promoting economic efficiency and regional equity.

The rules of membership are detailed in the Finance Commission Act of 1951—it is to consist of a Chairman and four other members who are either qualified to be Justices in High Courts, or have technical expertise in public financial matters. The appointments are formally made for a fixed term by the constitutional head of India, the President, upon the recommendation of the Prime Minister's office, in consultation with parliament. Once appointed, the members of the commission cannot be replaced at the discretion of the political executive. The commission has general powers of summoning and requisitioning, and its recommendations with regard to tax devolution and grants-in-aid are legally binding and cannot be overridden by the central cabinet of ministers or the legislature.

Although the constitution only provides for one body to determine transfers to the states, another central agency consisting of technical experts, the Planning Commission, also makes regular transfers to states. The Planning Commission was set up by a Resolution of the Government of India in 1950, as a government agency within the central executive, with the Prime Minister as chairman. Its purpose is to supplement the annual budget process with a medium and long-term planning process to determine the allocation of national resources across competing needs. Its technical members are appointed directly by the Prime Minister and serve as advisors to the government, working under the general guidance of the National Development Council, which is chaired by the Prime Minister and includes all central cabinet ministers and state Chief Ministers. In particular, the formula for distribution of Planning Commission transfers across states is determined by the National Development Council and its political representatives.

Hence, while transfers made by the Planning Commission are amenable to the discretion of explicitly political agents, transfers made by the Finance Commission are at least designed to be protected from political discretion through constitutional rules. Whether these constitutional rules indeed make a difference is, however, an empirical question, because the members of the Finance Commission are ultimately appointed upon the recommendation of the Prime Minister, and are therefore open to some degree of central political control.[6] However, since new commissions are appointed according to a constitutionally established cycle, the tenure of the Finance Commission is not congruent with the electoral cycle that changes the executive government.

In the sample of 15 major states studied here, from 1972 to 1995, tax devolution and grants by the Finance Commission makes up about 24% of state revenues. Planning Commission transfers

[6] We scrutinized the membership of individual Finance Commissions from 1951 to the present and found that every one of them included one Justice (either sitting on a State High Court or the Supreme Court of India, or retired from one) and one technical expert with no political experience. However, the remaining members tended to have had a political career either in the national or state legislatures, or to have held senior positions in central or state administrations. In addition, there have been a few instances in which an individual member has resigned in the middle of the tenure of the commission to accept a post in a state or central government. These instances might lead us to suspect the actual independence of the commission from the political process, but there does not appear to be a systematic bias towards either the central or individual state governments from the identity of the members.

Table 1
General-purpose intergovernmental transfers in India

	Decision-making authority for distribution criteria	Share in state revenues and borrowing [a]
Constitutional transfers: tax sharing and grants determined by an independent agency	Finance Commission, an independent agency whose membership and powers are determined by the Constitution, and cannot be easily overridden by the cabinet or the legislature	24% (of revenues)
Discretionary transfers: grants and loans determined by political agents (grants/loans = 30:70)	Planning Commission, a central government agency appointed by the central executive to serve in an advisory capacity, and work under the general guidance of the National Development Council, chaired by the Prime Minister, and including central cabinet ministers and state chief ministers	6% (of revenues), 51% (of borrowing)

[a] Numbers are the sample average for 15 major states over the period 1972–1995.

are devolved to states as a combination of grants and loans, which is institutionalized to approximate a 30:70 ratio, that is, 30% of total transfers are devolved as grants and 70% as loans. Grants by the Planning Commission constitute about 6% of state revenues and loans constitute more than 50% of state borrowing. Table 1 provides a summary description of these agencies and the general-purpose transfers they make to states.[7]

The distribution of both Finance and Planning Commission transfers across states is supposed to be formula-driven, but these distribution formulae are complex and strictly apply only to some portions of transfers, therefore leaving room for discretion within both agencies. Successive Finance Commissions have put different weights on the criteria of tax derivation, population, per capita state domestic product, and a variety of measures for relative poverty and "backwardness" of states. The overall objective of the Finance Commissions has been to provide greater resources to states that are disadvantaged in terms of generating own public resources, or have greater need for public spending (the web page of the Finance Commission, http://fincomindia.nic.in/). Plan transfers have been devolved according to different versions of the Gadgil formula established in 1969, which puts the greatest weight on state population, but discussions within the Planning Commission have also reflected similar concerns for redistribution to resource-poor states.

The deliberation process of the Finance Commission and Planning Commission are similar—each solicits suggestions from state governments, in addition to requiring them to submit specific details about their finances and fiscal needs. Each agency claims to function independent of political manipulation, making their decisions solely on the basis of economic criteria. However, as noted earlier, the formal decision-making authority of the two agencies

[7] In addition, individual central ministries make specific-purpose transfers (consisting of both grants and loans) and provide matching grants for sector projects, such as in health and education, some of which are processed through the Planning Commission. These specific-purpose grants constitute less than 10% of total state revenues and the loans constitute less than 5% of total state borrowing (Rao and Singh, 2000). In a previous version of this paper, Khemani (2003) showed that political effects on such specific purpose transfers can be distinguished from that on general-purpose transfers that become a part of state budgets.

differs fundamentally—while the Finance Commission is legally independent of other central government agencies and makes decisions about tax-sharing and grants to states that are binding on the central government, the Planning Commission is a central government agency, working in an advisory capacity and under the general guidance of the central political executive.

If the central government makes decisions of resource transfer to regional governments based on political considerations, we would expect the evidence for this to be reflected in the pattern of distribution of discretionary transfers executed by the Planning Commission. If constitutional rules for the transfers of the Finance Commission do not make a difference, then we would expect similar political considerations to be reflected in these transfers. However, if the constitutional rules do make a difference, then we expect Finance Commission transfers to reflect the overall objectives of economic efficiency and regional equity, and not the political objectives of the central government.

2.2. Political institutions

Government in India has been a Westminster-style parliamentary democracy since the adoption of a constitution in 1950, with direct elections based on universal adult suffrage to the Lok Sabha, or the House of the People, the lower house at the national level, and to the Vidhan Sabhas, the individual legislative assemblies at the state level. The country is divided into 4061 single-member districts for state assembly elections, which are grouped together, separately within each state, to form 543 single-member districts for the national assembly. The number of national districts allotted to a state is proportional to its population so that there is no real variation across states in per capita representation at the center.

The party, which wins a majority of national districts distributed in any manner across the states,[8] is invited to form the national government, headed by a Prime Minister and a cabinet of ministers. In the event of a single party not winning more than 50% of Lok Sabha seats, a ruling coalition is formed among different parties on the basis of a vote of confidence in parliament. Analogous to the national executive, the party or coalition of parties with a majority of seats in an individual state's legislative assembly forms the state-level executive government headed by a Chief Minister and a state cabinet of ministers. Thus, the political leaders of national and state governments are affiliated through membership in political parties that compete in both national and state elections.

There exists a large political science literature analyzing party competition in India from which we derive the following brief description.[9] A single political party dominated electoral competition in the early years of India's democracy, namely the Indian National Congress (hereafter referred to as the Congress), largely due to the historical legacy of being the leader of the independence movement against British colonial rule. However, in the late 1960s, the Congress party began to face stiff challenges from rival political parties in state assembly elections, several of which were emerging regional parties with limited national standing. These regional parties began to replace the Congress as the governing party at the state level. Since the 1980s state politics has been characterized by frequent turnover in government—it is not

[8] That is, a party does not have win a critical number of votes in each state in order to win the districts allotted to a state in the national legislature. Districts are won on an individual basis.

[9] Some of the references providing good overviews and recent developments are Brass (1990), Manor (1994) and Yadav (1996).

uncommon for a party that wins a landslide of seats in a state Vidhan Sabha in one state election and to be routed in the very next election.

The Congress lost control of the national parliament for the first time in the national elections of 1977, when a new national-level opposition political party was forged through alliances between political leaders previously belonging to disparate political groups. However, it came back to power in an early election in 1980. It similarly lost control of the national parliament in the 1989 elections to a new political party created for the explicit purpose of organizing a unified opposition to the Congress, only to return quickly to power in 1991 with early elections. By the 1990s, seat control in the national parliament became increasingly fragmented across different political parties, including regional parties with their power bases at the state level. Since 1989, multi-party competition for the national parliament appears firmly established, with national parties like the Congress and BJP (Bharatiya Janata Party) leading coalition governments that depend upon the support of regional political parties.

The spending instruments available to state governments have direct impact on people's lives, such as provision of education, health, water services and construction of local roads. There are three large chunks that account for the bulk of central government spending—defense, debt-servicing and various agricultural subsidies that are actually distributed through state governments (Varshney, 1995). Thus, the politically influential fiscal instruments available to the center, subsidies, depend upon the states' political machinery for distribution. If a party loses control of a state government, it loses control over public instruments to buy political support through targeted provision of benefits. Hence, it is not surprising to note that, if a party comes to power in a state (by winning a majority of seats in the state legislature), then in the next national elections that party also tends to win seats to the national legislature from that state.[10] Additional spending by state governments might then yield benefits in the form of additional seats for the political party in power in the state, in both state and national elections. Thus, parties can be expected to care about their control of state governments and indeed are known to do so in the Indian political literature (Chhibber, 1995).

3. How should we expect politics to influence transfers in India?

The institutional arrangements for general-purpose transfers are such that it is likely to be difficult for citizens in a state to distinguish what part of any change in spending by their state government is due to the actions of their state politicians and what part is due to the actions of central politicians in targeting greater transfers to their state. As discussed in Section 2 above, general-purpose transfers by the Planning Commission are systematic channels of resource transfer to states that happen as a matter of routine every year, and not explicitly politicized instruments for which the central political executive is likely to be directly credited by voters. Indeed, the Planning Commission claims to function as a technocratic agency independent of political control, and the national political executive does not attempt to publicize and take credit for providing greater transfers through this agency. Thus, even sophisticated voters are not likely to have information about how much their state received as general-purpose transfers from the

[10] An example from the state of Andhra Pradesh is illustrative in this context. The Congress party lost control of the state government in Andhra Pradesh in the 1983 state elections to a new regional party, the Telegu Desam. In the next national elections in 1984, even though it won an overwhelming majority of seats in the national legislature, the Congress lost most seats from Andhra Pradesh to the Telegu Desam, despite the latter's novice status in national politics.

Planning Commission, or how much public service delivery in their state depends upon these transfers.

This point might be best demonstrated in contrast to the political visibility of specific purpose transfers for particular types of spending programs such as in health, education, or for the welfare of poor households. Contrary to untied transfers in general aid of state budgets, specific purpose transfers are more likely to be associated with the central political executive by voters because they finance programs publicly announced by the central government. For example, in India, states receive transfers for various “central schemes” in health, education and poverty alleviation, which they are required to spend within the conditions imposed by central ministries. These “schemes” are prominently advertised in central political campaigns, such as drives for universal basic education, or employment guarantee for poor households (Mohan, 2005).

How can we expect politics to impact general-purpose transfers in aid of state budgets that are not as easily “targetable” to individual political constituencies, nor prominently associated with the central political executive? The immediate impact of any additional transfers to a state is to increase the fiscal capacity of the state government for public spending. State governments can use this additional fiscal capacity to optimize their political objectives. Therefore, greater transfers to a state government are likely to boost the political fortunes of politicians in charge of the state. The central ruling political party can hope to gain from this by providing greater resources to those states where its own party members control the state government, both to strengthen the party’s political position in the state and to promote the party’s general reputation among voters which might lead to spill-over benefits in national elections. Following this line of argument to the case of states governed by rival political parties, the center would attempt to keep general-purpose transfers to these states to a minimum to prevent rival state politicians from benefiting from additional transfers.[11]

In the existing theoretical and empirical literature, another political variable has been identified as an important predictor of the distribution of resources across regions—the proportion of votes or districts won by the national ruling party in elections. Dixit and Londregan (1996), Cox and McCubbins (1986), Lindbeck and Weibull (1987) and Snyder (1989) provide competing theoretical predictions for whether a party should target resources to “core supporters”, defined as voters with strong preferences for the party, or to “swing” voters, defined as those with weak party preferences whose voting decision is determined by how much public goods they receive from an incumbent party. The empirical test that has been applied to this theoretical debate is whether parties target regions where the electoral race is tight, or “safe” regions where the party is expected to win a large proportion of votes. Case (2001) interprets empirical findings of greater block grants in Albania to districts where the President received more votes in the past election as evidence of targeting of core supporters. In contrast, Cole (2004) finds that state governments in India supply greater subsidized agriculture loans in election years to those electoral districts where the ruling party had a narrow margin of victory (or loss).

For higher level jurisdictions such as states that consist of multiple single-member electoral districts, the proportion of districts won by a party in a state can be a measure of party popularity, with a high proportion of districts won by the party being indicative of a “core-support” state and a low proportion of districts won being indicative of a “swing” state. Dasgupta, Dhillon and Dutta (2001) categorize Indian states where the national ruling party won close to 50% of districts in state elections as “swing”, and argue that the center should target greater resources to these “swing” states to maximize its electoral objectives. In contrast, Miguel and Zaidi (2003) find

[11] In the earlier working paper version of this study, I provide a simple model to demonstrate this idea (Khemani, 2003).

evidence from Ghana of targeting of "core supporters"—the Ghanaian national ruling party spends substantially more in those administrative districts from where it "swept" the previous elections, that is, where it won all the parliamentary seats allotted to the district.

This paper has argued that the party identity of the state government is likely to be a first-order determinant of whether it receives above-average transfers from the political agency determining such transfers. States governed by rival political parties are not expected to receive additional transfers, irrespective of the proportion of districts controlled by the national ruling party. Among co-partisan states, the national ruling party might pursue finer targeting based on electoral indicators of party popularity, especially if it faces overall resource constraints and institutional constraints on minimum transfers to each region. The political agency could target "swing" states, as measured by those states where the party controls a lower proportion of seats, or not. The paper does not make a priori predictions about whether states where the ruling party controls a larger or smaller proportion of districts will be favored, but does predict that any impact of district share will be significant only in interaction with co-partisan states.

If delegation to an independent agency constrains political influence by placing some resources beyond political discretion, then we should expect that the political variables described above have no impact on transfers determined by this agency, once economic variables relevant to the agency's mandate are taken into consideration. However, if delegation to the independent agency is truly effective in undoing political influence on general-purpose fiscal transfers available to state governments, then rival party states should receive greater transfers from the independent agency because they are fiscally disadvantaged. As described in Section 2, the independent agency in India, the Finance Commission, has the authority to examine fiscal needs of a state in some detail, by commissioning studies and inviting states to submit their own proposals, rather than merely using a set of general economic indicators to guide their allocation. Such detailed evidence considered by this independent commission can therefore reflect the fiscal disadvantage of rival party states due to the central party's political manipulation of other transfer programs. A better measure of the effectiveness of the independent agency would therefore be lack of impact of party identity of state governments on the *total* sum of general-purpose transfers they receive.

4. Data and empirical evidence

4.1. Data

Disaggregated data on the two different types of transfers—constitutional transfers determined by the independent agency, the Finance Commission, and discretionary transfers determined by the political agency, the Planning Commission—are available since 1972 in the Reserve Bank of India Bulletin, a quarterly publication of the central bank of India with annual issues on details of finances of state governments.[12] The data on intergovernmental transfers is combined with political and economic data available from other sources for 15 major states of India over a 24-year period from 1972–1995. The political data is compiled from Butler and Lahiri (1995). State demographic and economic characteristics, and a state-level price index to convert all variables into real terms are available from a data set put together at the World Bank, which is

[12] I am grateful to Bhaskar Naidu of the World Bank's South Asia regional division for providing me with some of this data that had already been compiled in their research groups.

described in detail in Özler et al. (1996). Table 2 provides summary statistics for each of the variables included in the analysis.

These 15 states of India account for 95% of the total population. India consists of 28 states at present of which 3 were newly created in 2000, 2 were recently converted to statehood from Union Territories and 8 are designated “special” states, largely because of separatist tensions and are provided with extraordinary central transfers. We exclude the newly created states and the special states, and focus on the 15 major states that have existed since the early days of the federation.[13]

4.2. Empirical specification

The constitutional transfers of the Finance Commission and the discretionary transfers of the Planning Commission both emphasize state population and income (or rather, its inverse, in order to redistribute resources to poorer states) as the main criteria for distribution across states. Various measures of poverty and “backwardness” have also been emphasized, but most often as the ranking of a state’s income level compared to others. Thus, income, population and state fixed effects (capturing the relative position of states along the dimension of economic development) should explain a large part of the variation in these central transfers across states. In addition, variation over time may be explained by year-specific shocks to the center’s available resources for regional distribution, and hence common to all states. Hence, the econometric specification implied by a strict economic model of transfers would be as follows:

$$G_{it} = \gamma Z_{it} + \eta_i + \lambda_t + \varepsilon_{it} \tag{1}$$

where G_{it} are per capita transfers, either constitutional or discretionary; Z_{it} is a vector of state economic characteristics that dominate the distribution criteria, namely, per capita state income and total population; η_i represents state-level fixed effects; and λ_t are year effects included to control for various shocks to the national economy and fiscal resources in any given year.

If the national government is able to use its political discretion in distributing transfers to states, then Section 3 argues that party identity of the state government–whether it belongs to the same party as that at the national level–is a first-order predictor of resources received by the state. Proportion of districts won by the party in past elections can also matter, but only in interaction with affiliated states.

We therefore estimate the following specification to test these predictions:

$$\begin{aligned} G_{it} = {} & \alpha \mathrm{AFFIL}_{it} + \beta \mathrm{AFFIL}^{*}\mathrm{VS} - \mathrm{SEAT}_{it} + \chi(1 - \mathrm{AFFIL})^{*}\mathrm{VS} - \mathrm{SEAT}_{it} + \delta \mathrm{AFFIL}^{*}\mathrm{LS} \\ & - \mathrm{SEAT}_{it} + \phi(1 - \mathrm{AFFIL})^{*}\mathrm{LS} - \mathrm{SEAT}_{it} + \gamma Z_{it} + \eta_i + \lambda_t + \varepsilon_{it} \end{aligned} \tag{2}$$

where AFFIL_{it} is an indicator of political affiliation that equals 1 when the incumbent party (or the leading party of a coalition government, from which the state Chief Minister comes) in state *i* at

[13] These 15 states are: Andhra Pradesh, Assam, Bihar, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. A 16th major state, Jammu and Kashmir, has been excluded because of the political uncertainties in the region that continue to this day. Data on state income, population and the price index for these states is available until 1998. We find that the overall result that the independent agency behaves differently than the political agency is robust to extending the analysis to 1998, but that the estimates on political manipulation by the political agency become more noisy when we include the years 1996, 1997 and 1998. This is likely because these 3 years were characterized by political instability in the national parliament and frequent break-downs of coalition governments. Since the main objective of the paper is to test whether delegation to an independent agency curbs political influence when the national political executive is in a position to wield real influence, we focus our analysis on the period 1972–1995.

Table 2
Summary statistics[a]

Variable	No. of obs.[b]	Mean	S.D.
Finance Commission transfers (constitutional transfers)	352	173.32	64.80
Planning Commission transfers (discretionary transfers)	345	126.39	92.03
Total general-purpose transfers (constitutional + discretionary)	345	301.03	131.47
Real state domestic product	360	4803.73	1807.98
Total population (in thousands)	360	47,396.79	28,163.28
Affiliation (= 1 state and national government belong to the same political party)	360	0.62	0.49
National ruling party's share of seats in the state legislature	360	0.46	0.27
National ruling party's share of seats allotted to a state in the national legislature	360	0.62	0.31
Number of seats allotted to a state in the national legislature	360	33.55	18.91

[a] Fiscal variables and state domestic product are in per capita 1992 rupees.
[b] Data pertain to 360 state–year observations, for 15 states from fiscal years April 1972–March 1996. There are missing observations for some state–years in the fiscal data.

time t belongs to the same party as that governing at the center (or the leading party of a coalition government, from which the Prime Minister comes) at time t, and 0 otherwise; VS-SEAT$_{it}$ is the proportion of seats in the state legislature, the Vidhan Sabha (VS), controlled by the national ruling party; LS-SEAT$_{it}$ is the proportion of seats allotted to the state in the national parliament, the Lok Sabha (LS), that is controlled by the national ruling party. Higher proportion of seats won by a party in a state in either state or national elections is a measure of greater popularity of the party.

The fixed-effects specification implies that, α, the coefficient on political affiliation, is identified from variation within a state from its own average transfer receipts when it is affiliated and not affiliated with the center.

The argument in Section 3 predicts that fiscal instruments over which the central government is able to exercise political discretion would be manipulated to distribute resources across state governments such that:

$$\alpha > 0$$

Among affiliated states if the center targets those states where the party is more popular, or "core support" states to use the terminology of the literature, we would have

$$\beta > 0 \text{ and } \delta > 0$$

That is, "core support" states are captured here as those states where the national ruling party wins a larger proportion of districts in the state and national legislatures. However, the opposite could also be true, that is, the party could give fewer resources to its core-support states. The model predicts that coefficients χ and δ would be statistically indistinguishable from 0 because non-affiliated states receive only minimum transfers, irrespective of the national ruling party's popularity in the state.

Specification (2) is general enough to test our predictions against alternate and competing hypotheses. If the central assumption of our argument that the national ruling party cannot directly control nor claim credit for transfers to states is invalid, then non-affiliated states might receive greater transfers depending on the national ruling party's popularity in the state. If the national ruling party gives more to its core supporters in national elections, then states where it wins a higher proportion of districts in national elections to the Lok Sabha would receive greater transfers, irrespective of party identity of the state government (that is, $\delta = \phi > 0$). Conversely, if the national ruling party gives more to states where it is less popular, this might be captured by $\delta = \phi < 0$, that is, transfers are lower to states where the party controls fewer national districts, again, irrespective of party leadership of the state government.

Dasgupta et al. (2004) argue that the higher the proportion of seats in the *state legislature* won by a state ruling party the more "safe" is electoral competition in the state for that ruling party and the less the political gain to be had from increasing transfers. This argument predicts that among affiliated states, where the state ruling party is the same as the national ruling party, those where the party controls a smaller proportion of seats in the state legislature should receive greater transfers. By analogy, transfers among non-affiliated states, where the state ruling party is rival to the national ruling party, should be greater to those where the national ruling party poses a greater challenge to the state ruling party by controlling a larger proportion of state legislature seats. That is, this argument would predict $\beta < 0$ and $\chi > 0$.[14]

If delegation to an independent agency makes a difference, then we expect to find the coefficients on the political variables statistically indistinguishable from 0 when G_{it} includes only those transfers determined by the independent agency. If delegation truly makes a difference in that it undoes any partisan impact on total general-purpose transfers available to state governments, then we should expect the political coefficients to be statistically indistinguishable from 0 when G_{it} includes the sum of the two types of transfers.

4.3. Results

Ordinary least squares (OLS) estimates of specification (2), with clustering by state, are presented in Table 3, separately for each type of general-purpose transfers considered in this paper. In column (1), we find that discretionary transfers are directed towards affiliated states as the model predicts and, furthermore, towards those affiliated states where the national ruling party controls a smaller proportion of seats allotted to the state in the national legislature. The coefficients on the interaction of affiliation with the party's seats in the *state* legislature are not significantly different from 0. The results therefore suggest that representation from a state in the *national* legislature is a better signal of changes in party popularity than representation in the state legislature, once we control for the party identity of the state ruling party which assures a certain minimum representation of the party.[15] The central political executive thus appears to target those affiliated states in particular where its party popularity is low, as evidenced by lower proportion of seats in the national legislature from the state.

[14] In their empirical analysis, Dasgupta et al. (2004) argue that the closeness of a state election can be measured by whether the national ruling party barely won or barely lost 50% of the seats in the state legislature. We do not employ an empirical specification with the 50% mark as a natural break-point determining the national ruling party's control over the state legislature, because there are no instances in the sample where the national ruling party could not form the state government because it fell short by just a few seats. In general, 50% would be a natural break-point if the effective number of political parties competing in state elections were 2, but in fact, this number is more than 2 (Chhibber and Nooruddin, 2004).

[15] If we include only the proportion of seats of the national ruling party in the state and national legislatures, without any indicator for the identity of the state ruling party, we find the point estimate on the party's control of state legislature seats to be positive but not significant, suggesting a tension between the positive effect of the seats needed to form a government and the negative effect of popularity as measured by higher proportion of seats. These results are available upon request and not presented here in the interest of brevity.

Table 3
Political determinants of general-purpose transfers (standard errors in parentheses)

Variable	Discretionary transfers	Constitutional transfers	Total transfers
	(1)	(2)	(3)
Affiliation = 1 if state and national government belong to the same political party	91.21(47.47)	−49.41(22.46)	45.39(52.63)
Affiliation * national ruling party's seat share in state legislature	−43.27(26.56)	10.40(16.82)	−32.56(24.33)
(1 − affiliation) * national ruling party's seat share in state legislature	−35.91(59.18)	−20.27(53.47)	−60.54(85.11)
Affiliation * national ruling party's seat share in national legislature	−107.27(56.12)	23.49(23.31)	−86.80(52.34)
(1 − affiliation) * national ruling party's seat share in national legislature	−46.33(32.36)	−7.20(20.21)	−50.14(44.57)
Real state income per capita	0.01(0.01)	−0.003(0.01)	0.01(0.01)
	−0.002(0.002)	−0.00002(0.001)	−0.002(0.002)
Total population	N = 345	N = 352	N = 345
	R^2 = 0.66	R^2 = 0.83	R^2 = 0.78

OLS regressions with robust and clustered standard errors by state, for 15 major states from 1972 to 1995; state and year fixed effects included; dependent variables and state income are in per capita 1992 rupees.

If the ruling party controls less than half of the state's seats in the national legislature, then an affiliated state receives additional transfers that are more than 30% of the sample average of discretionary transfers. If the ruling party controls less than a quarter of the state's seats in the national legislature, then an affiliated state receives additional transfers that are more than 50% of the sample average. In contrast, the coefficients' point estimates suggest that, if the ruling party controls more than three-quarters of an affiliated state's seats in the national legislature, it does not provide additional transfers to the state. That is, the national ruling party targets additional resources particularly to those affiliated states where it does not control a substantial majority of the state's seats in the national legislature. This pattern is supportive of the interpretation that seat share won in the previous national election is a good indicator of party popularity and that when the party's popularity is high it can make only small gains from additional public spending in the state. If the ruling party wins almost all the seats allotted to a state in the national legislature, it suggests that voters in the state are so favorably inclined towards the party, that the party has little additional political support to gain from additional spending. A resource-constrained national government would therefore choose to concentrate its political discretion in targeting funds to those states where it stands to gain more substantially.

As predicted in the paper, non-affiliated states receive lower transfers than do affiliated states, irrespective of the national party's representation in their state legislature and in their state's seats in the national legislature.

The impact of partisanship on constitutional transfers is a striking contrast—politically affiliated states receive *lower* transfers, almost 30% lower than the sample average of constitutional transfers, which is contradictory to the prediction of political manipulation of transfers. This is a surprising result, because the simplest expectation if delegation makes a difference would be for politics to have no impact. We argue that this result should be interpreted as follows: since non-affiliated states are politically disadvantaged and therefore likely to have fewer national resources directed towards them, whether through intergovernmental fiscal transfers or direct spending by the central government, evidence on their fiscal needs that are

Table 4
Including indicator for congress government (standard errors in parentheses)

Variable	Discretionary transfers	Constitutional transfers	Total transfers
	(1)	(2)	(3)
Affiliation = 1 if state and national government belong to the same political party	93.02(49.18)	−47.01(22.12)	49.83(52.55)
Affiliation * national ruling party's seat share in state legislature	−31.96(27.75)	7.23(16.52)	−23.57(26.27)
(1 − affiliation) * national ruling party's seat share in state legislature	−47.99(65.63)	−25.20(52.13)	−79.19(85.04)
Affiliation * national ruling party's seat share in national legislature	−110.21(57.63)	21.90(23.11)	−91.55(55.60)
(1 − affiliation) * national ruling party's seat share in national legislature	−54.31(32.36)	−8.05(23.36)	−59.72(56.97)
Indicator = 1 if state is governed by Congress party	−13.81(20.88)	−4.79(8.09)	−20.30(24.76)
Percent of popular votes received by Congress party in last state election	−0.57(0.52)	0.23(0.31)	−0.38(0.54)
Real state income per capita	0.01(0.01)	−0.003(0.01)	0.01(0.01)
	−0.002(0.002)	−0.00001(0.001)	−0.002(0.002)
Total population	N = 345	N = 352	N = 345
	R^2 = 0.67	R^2 = 0.83	R^2 = 0.79

OLS regressions with robust and clustered standard errors by state, for 15 major states from 1972 to 1995; state and year fixed effects included; dependent variables and state income are in per capita 1992 rupees.

considered by the independent agency as part of its deliberation process (as described in Section 2) is likely to reflect this fiscal disadvantage and thereby prompt the agency to provide them with greater transfers. Thus, greater transfers to non-affiliated states are made by the independent agency not because of political motives but because they happen to be the resource-poor states.

If we pool the two types of transfers then the political impact disappears, as reported in column (3) of Table 3. The point estimates of the coefficients on the political variables and the precision with which they are measured are both reduced, such that they are statistically indistinguishable from 0. This suggests that delegation to an independent agency can undo partisan influence on the distribution of general-purpose transfers within states in India.

What if the results for constitutional transfers are driven by political affiliation of states with powerful political parties that have temporarily lost control of the national legislature, and hence register as non-affiliated for some years? We test for this by estimating whether Congress-controlled states receive the bulk of transfers, even after accounting for political affiliation, since the Congress party has been, by far, the historically dominant party in India. These results are reported in Table 4. We also include the vote share for the Congress party in a state to control for voter tastes. We find no effect of Congress states on the distribution of either type of transfers, and the coefficient for affiliation remains unchanged for both types even after including the indicator variable for Congress states.[16] The lack of significant impact of politics on total transfers is maintained in this augmented specification.

Can state affiliation of individual members of the Finance Commission explain the results for constitutional transfers? There is no reason for the individual affiliations of the members to be

[16] We are unable to reject the null hypothesis that the two Congress influence variables are jointly indistinguishable from zero.

systematically correlated with the political affiliation between the center and the individual states, except if it were in the same direction as suggested by the model of political opportunism—that is, if the central political executive chose members from those states where it wanted resources to be targeted. Any coincidental correlation due to the existence of particular states that have been historically non-affiliated with the center and also happen to be states with a tradition of producing leading national policy-makers is unlikely to be behind these results because they hold even after including state fixed effects. Hence, even if the individual affiliation of Finance Commission members matters, it still does not explain the effect of center-state political affiliation estimated here.

We therefore conclude that the only interpretation consistent with the pattern of results for both types of transfers is that while the one that is more amenable to control by political agents is indeed targeted to politically important states as predicted by a specific political economy story of central resource distribution, the other that is determined by an agency independent of political control, and with constitutional authority, indeed serves as a check on political opportunism.

The evidence that among affiliated states the central political executive targets transfers on the basis of its party's representation in the national legislature instead of in the state legislature is counter-intuitive. Why does it not target those states, for instance, where it has a tenuous grip on power, as measured by controlling a smaller proportion of seats in the state legislature? This prediction by Dasgupta et al. (2004) seems to be intuitively appealing.

The reason is that the effective number of political parties engaged in electoral competition at the state level in India is not always two, but often more than two, so that if a state ruling party controls a smaller proportion of seats in the state legislature it is usually because seat control is fragmented across multiple political parties.[17] In such a situation, several factors might make it difficult for the leading political party in the state government to make political gains from additional spending—(1) the party's control over spending allocation might be weak, if other political parties are powerful; (2) credit for good performance might be shared with other parties in the coalition; (3) voters in the state might be fragmented in party preference (that is, different small groups of voters might have preferences for different parties) making it difficult to sway a large number of voters towards the ruling party through additional spending.[18] In contrast, in elections for the national parliament in a state, there are fewer number of political parties effectively competing. Thus, proportion of seats won by the ruling party in an affiliated state is likely to be a better indicator of the preference of voters for the ruling party.

4.4. Endogeneity issues

Estimating the potential effect of election outcomes on grants is rather obviously subject to an endogeneity problem. If we believe that politicians use election outcomes to determine allocation of public resources, then we must also believe that transfers have an effect on elections, that is,

[17] Chhibber and Nooruddin (2004) calculate the effective number of parties competing in a state using a widely used measure in the political science literature first advocated by Laakso and Taagepera (1979): effective number of parties $= 1/\Sigma(\text{seats}_i)^2$, where seats_i is the share of seats won in the state legislature by each party or independent candidate, denoted by i, in a state election. Among the 88 state–year observations (24% of the sample) for which we have the state ruling party control less than 51% of seats in the state legislature, about 90% are associated with times when the effective number of parties is 3 or more.

[18] Chhibber and Nooruddin (2004) provide evidence that the number of political parties in a state is correlated with parties having a caste base, that is, with different groups of voters having caste-based attachments to different political parties.

election outcomes are influenced by transfers in past periods. We address this by using values of electoral outcomes that are determined before the start of a fiscal year, to predict fiscal transfers during the year. That is, in the regressions, the political variables used for state i in year t are taken from the most recent election before the start of fiscal year t for which the fiscal variables are defined. The assumption is that these electoral outcomes are determined before transfers are made and that the central political executive is likely to obtain political information from these outcomes when making its decisions for fiscal transfers for the year.

It might be argued that unobserved voter tastes and other shocks that affect both the political process of determining affiliation of the state government as well as intergovernment fiscal transfers are driving the correlation between the affiliation indicator and transfers. For example, voters that have preferences for larger governments might vote for particular parties that are big spenders and also in power at the national level. However, the affiliation indicator is only partly driven by changes in state governments and party by changes in national governments that are determined in conjunction with voters in other states.

Ideally, we would like to estimate the effect of changes in affiliation arising only out of changes in the identity of the national government, that is more likely to be exogenous to a state's own voter preferences. But in fact, a lot of the variation in affiliation in the Indian data comes from whether voters in a state elect a particular party, the Congress party or not. The Congress party has dominated national government in India until the 1990s, although it has been frequently unseated from state governments. The Congress was driven out of power from the center by a coalition of opposition parties in the general elections of 1977 and 1990, and the states from where the non-Congress parties won the majority of their seats to the national legislature are also likely to be the states where these opposition parties defeated the incumbent Congress state government and tool control of the state. Thus, a state is likely to be affiliated with the center if its voters elect Congress to the state, except in the years 1977–1979 and 1990 when the opposite is true. Could the affiliation effect be driven by the Congress-effect? In Table 4, we have already presented estimates including indicators for a state government belonging to the Congress party, and vote shares for the Congress in the state, and shown that these are insignificant and have no impact on the other coefficient estimates.

We also argue that the effect of unobserved voter tastes and other shocks are attenuated by the inclusion of state and year fixed effects. The literature on electoral competition in India has emphasized that differences between Indian political parties are not linked to differences in voter taste for fiscal policy, but rather voter taste for party identity along social and ethnic lines which are either region-specific and largely invariant over time, or affected by time-specific shocks (Weiner and Field, 1974; Chhibber and Petrocik, 1989). Electoral competition between these parties has been characterized as revolving around access to the instruments of government and appropriation of public resources by different groups (Chhibber, 1995). This suggests that greater public spending is valuable to all types of voters and a dominant strategy for all political parties.

In any case, for the central objective of this paper–to test whether delegation to an independent agency makes a difference–concerns about unobserved voter tastes are unlikely to create a problem. It is in fact hard to explain the opposite effect of partisanship on discretionary and constitutional transfers by appealing to correlation of unobserved voter tastes for public goods with both political affiliation and the size of central transfers. Both types of transfers are general-purpose transfers, and hence fungible for the state government. The form of the empirical test undertaken here for the impact of delegation to an independent agency is therefore robust to omitted variable bias due to unobservable underlying voter preferences.

4.5. Other political explanations?

The pattern of evidence cannot be reconciled with other types of political economy models in the literature such as a Weingast, Shepsle and Johnsen (1981) type story of universalistic legislatures and "pork-barrel" politics, where individual legislators bargain for greater resources to spend in their constituencies, which would predict that all states, both affiliated and unaffiliated, tend to get greater transfers when they have more legislators from the central ruling party in either or both the state and the national parliaments. We find that partisan identity of the state government is a critical determinant of politically motivated transfers.

Another variable that has been important in the wider international political economy literature on intergovernmental transfers is per capita representation of regions in the national legislature. As discussed in Section 2, since national electoral districts in India are distributed across states in proportion to their population, there is no real variation across states in per capita representation. But what if states with a larger absolute number of districts in the national legislature are the ones receiving the greatest transfers? There is large variation across states in this dimension, with the sample average number of seats being 34, and the sample standard deviation being 19. The largest state, Uttar Pradesh, contributed over 80 seats to the national legislature over the period under study, while the smallest state, Haryana, contributed only 9–10 seats. Since there is little or no variation over time within a state in the number of seats allotted to it in the national legislature, we estimate the impact of state representation in the national legislature without state fixed-effects. These results are reported in columns (1) and (3) of Table 5 for each type of transfer. There is no

Table 5
Including absolute representation and election effects (standard errors in parentheses)

Variable	Discretionary transfers	Discretionary transfers	Constitutional transfers	Constitutional transfers
	(1)	(2)	(3)	(4)
Affiliation = 1 if state and national government belong to the same political party	146.23(57.77)	94.83(48.32)	−28.87(18.52)	−52.36(21.92)
Affiliation * national ruling party's seat share in state legislature	−28.11(38.55)	−41.80(26.35)	18.02(17.31)	11.10(16.66)
(1 − affiliation) * national ruling party's seat share in state legislature	86.19(88.63)	−29.30(60.44)	−2.13(87.49)	−17.09(52.74)
Affiliation * national ruling party's seat share in national legislature	−157.27(69.07)	−108.59(55.73)	−16.28(15.04)	22.80(23.02)
(1 − affiliation) * national ruling party's seat share in national legislature	−83.79(49.08)	−45.26(32.00)	−32.95(28.64)	−6.71(19.33)
Indicator = 1 in state election year		−5.43(9.02)		−12.32(5.29)
Affiliation * state election year		−7.81(11.13)		14.89(7.46)
Number of seats allotted to the state in the national legislature	1.38(1.72)			
Real state income per capita	0.004(0.01)	0.01(0.01)	−0.02(0.004)	−0.003(0.01)
Total population	−0.002(0.002)	−0.002(0.002)	−0.001(0.001)	−0.0001(0.001)
	No state fixed effects	Includes state fixed effects	No state fixed effects	Includes state fixed effects
	N = 345	N = 345	N = 352	N = 352
	R^2 = 0.43	R^2 = 0.67	R^2 = 0.70	R^2 = 0.83

OLS regressions with robust and clustered standard errors by state, for 15 major states from 1972 to 1995; year fixed effects included; dependent variables and state income are in per capita 1992 rupees.

evidence of targeting of those states that have greater absolute representation in the national legislature. Interestingly, when we take away the state fixed effects, the impact of co-partisanship for discretionary transfers becomes much larger, suggesting that some of the state effects are masking the very political effects we are trying to capture. Without state fixed effects, we also see clear evidence of the equity objectives of the Finance Commission—it makes greater transfers to poorer states, in terms of income per capita.

Columns (2) and (4) of Table 5 report results from testing whether the effect of partisan affiliation is driven by the timing of state elections (which are not entirely captured by year effects because there is variation across states in when elections are held). The timing of state elections could be correlated with state expenditures, central transfers and with the affiliation indicator. In fact, central governments may be providing greater transfers to affiliated states in an election year to influence electoral outcomes. In order to test for such electoral cycles and the robustness of the affiliation effect to the inclusion of the election cycle, we tried different specifications including the electoral cycle by itself and in interaction with the affiliation indicator. We find no significant effect of elections on transfers under political discretion, which is not surprising given the lack of evidence on large budget cycles around election times in the Indian states.[19] However, for constitutional transfers, we find a small negative effect of the election year in non-affiliated states, which implies that the additional transfer they receive in non-election years from the independent agency is slightly reduced in an election year.

5. Conclusion

Recently, there has been a surge in empirical evidence that national politicians make decisions of regional resource allocation based upon the optimization of their electoral objectives, in addition to any normative considerations of equity and efficiency. In order to mitigate these political compulsions, several federations around the world have attempted to create independent constitutional bodies that are responsible for determining federal transfers to sub-national jurisdictions. This paper tests whether delegation to an independent agency indeed makes a difference by contrasting the impact of political variables on different types of intergovernmental transfers to states in the Indian federation.

The empirical results indicate that when national political agents have decision-making authority over the distribution of resources across states, then the distribution of intergovernmental transfers is influenced by political considerations. Furthermore, the pattern of evidence is consistent with a particular model of electoral competition among rival political parties. National political parties provide greater resources to affiliated state governments, and among affiliated states greater resources are targeted to those states where the party controls only a small proportion of seats in the national legislature, rather than to states that are core support bases as measured by greater support for the party in previous elections.

The effect of partisan politics on transfers that are determined by an independent agency is strikingly contrary to the partisan effect on discretionary transfers. Constitutional transfers to affiliated states are significantly lower than to non-affiliated states. We argue that this result is consistent with the mandate of the independent agency to provide equalizing transfers, with greater resources allocated to fiscally disadvantaged states, and is not the outcome of deliberate political strategy. If non-affiliated states are *politically* disadvantaged and likely to have fewer

[19] Khemani (2004) finds no large increases in spending or deficits in states around election times. Only the *composition* of taxes and spending changes, in a pattern that is suggestive of targeting special interest groups.

national resources directed towards them, whether through intergovernmental fiscal transfers or direct spending by the central government, then greater constitutional transfers would be directed to them not because of political motives but because they happen to be the resource-poor states.

In sum, if the two sets of transfers are pooled, the partisan impact disappears. This evidence suggests that while more discretionary transfers are amenable to serve political objectives, delegation of transfers to an independent agency indeed makes a difference and can undo the partisan effect on resources available to state governments.

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