



## Conceptual Clarity on Special Category Status

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Special category status for states was introduced in 1969 and was granted to 3 states namely, Assam, Nagaland and Jammu & Kashmir. The Special Category Status (SCS) essentially pertains to determine the allocation of central assistance for State Plans in India, which is based on a formula known as Gadgil formula, named after the person, D.R. Gadgil, who devised the formula. It was adopted for the distribution of plan assistance during 4<sup>th</sup> and 5<sup>th</sup> Five Year Plans.

Prior to fourth Five Year Plan, the allocation of Central Assistance to the State Plans was based on a schematic pattern with no definite formula for allocation. The Gadgil formula emerged from the demand for a transparent and objective formula-based horizontal sharing of resources between the States. During the tenure of the Fifth Finance Commission, the same formula was also adopted by the Finance Commission which then conferred special status to the above mentioned 3 states on the basis of harsh terrain, backwardness and social problems prevailing in these states. As per Gadgil formula a special category state would get preferential treatment in federal assistance and tax breaks. The special category states have been provided with significant excise duty concessions in order to help these states attract large number of industrial units to establish manufacturing facilities

within their territory. The main idea behind according special status to a state is to facilitate the growth and development of improvement in IMR, birth rate, population control, female literacy status, tax effort and fiscal mechanism and improving per capita income.

The existing formula was revised for the first time in 1960 to include 5 more states under special category. The newly included states were Arunachal Pradesh, Himachal Pradesh, Manipur, Meghalaya, Mizoram. This modified formula then became the basis for allocation in the 6<sup>th</sup> and 7<sup>th</sup> Five Year Plans. In 1991, the formula was revised and renamed Gadgil-Mukherjee formula adding the name of the then Deputy Chairman of the Planning Commission and was approved by the National Development Council (NDC). This formula has been in operation since the Eighth Plan Period.

While distributing the Central Assistance to State Plans, the main methodological features of the formula consist of the following (i) From the total Central Assistance, Funds are set apart for externally aided schemes.

(ii) From the balance specific amounts are allocated to the Special Area Programmes i.e. for the Hill Areas, Tribal Areas, Border Area, N.E.C. and other programmes.



(iii) From the balance, 30% is allocated to the Special Category States.

For the general category States, the following weightage on variables are assigned

- (i) Population : 55 percent
- (ii) Per Capita Income: 25 percent
- (iii) Fiscal efforts : 5 percent
- (iv) Special problems : 15 percent

The NDC has defined the special problems under seven heads, namely coastal areas, flood and drought prone areas, desert problems, special environmental issues, exceptionally sparsely and densely populated areas, problem of slums in urban areas, special financial difficulties for achieving minimum reasonable plan size. During the post 2000 period, the formula was once again reviewed and the component of 'performance' by the respective states was adopted. The weightage under the head was 7.5 percent. Within this, 2.5 percent of the allocation was based on tax efforts of the States, 2 percent for fiscal management of State level and 1 percent for understanding population control measures. Special attention was also paid to the improvement in female literacy and according 1 percent allocation was set aside taking female literacy into account. Timely completion of externally funded projects and land reforms undertaken accounted for the remainder of the 7.5 percent figure.

The main reason for categorising between general and special category states is the development of the states which face problems due to hilly terrains, international borders etc and has been deprived of robust industrial development and experience persisted problems

of low state finances. There is no objective criteria and weight for distribution among the special category states. The main considerations are the level of allotment in the previous years, resource positions of the States and also development needs etc. In such cases the formula for resource sharing does not apply.

Under the SCS, till 2004-05, 90 percent of the central assistance used to be treated as grant and remaining 10 percent was considered as interest free loan with rationalization of public expenditure based on growth enhancing sectoral allocation of resources. In general category states, the ratio used to be 30:70. Since 2005-06 and with the advent of 'big bang' Centrally Sponsored Scheme (CSS), the differential of central transfers happened in terms of certain conditionality. While the loan component has been reduced substantially for both general and special category States, the general states are required to provide for matching grants under such scheme guidelines. For example, under the Sarva Shiksha Abhiyan (SSA) for general category States, 65 percent of the total expenditure is borne by the Centre and the State is required to provide for the rest of the 35 percent, belying which its subsequent transfers get affected. However under SCS, the financial norm is 90:10. Similarly, under the Indira Awas Yojana (IAY) the Centre-State funding norm is 75:25 for general States but is 90:10 under SCS. For certain schemes such matching grants are generally not required at all under SCS. There exists no hard budget constraint for SCS states as the central transfer is high. Currently, there are 12 States falling under the category. However, there still remains a strong necessity of developing all these states at par with others.

The latest dispute is regarding the issue of conferring a special category status to the State of Bihar. The Bihar Government has been strongly



demanding the SCS as it argues that such status would enable increased Government expenditure and hence would be able to attract private investment via the Keynesian 'crowding in' mechanism, which is necessary to increase overall investment in the State. Currently the State Government expenditure is a major component of the total expenditure in the State and hence forms a major part of GSDP of Bihar. However, while speculations are high as to whether Bihar would be eligible for SCS. It has already been announced by the Planning Commission that allocation towards the Backward Regions Grant Fund (BRGF) would be raised for the State. In the meanwhile, the Inter Ministerial Group on redefining the Special Category State had rejected Bihar's plea to be considered as a Special State. The Group of Ministers cited that Bihar can get rid of present backwardness through proper utilization of its geographical and human resources assets. Following Bihar 5 other States namely Goa, Rajasthan, Jharkhand, Chhattisgarh and Odisha have also been demanding this status due to extreme poverty, economic backwardness, non-compatible terrains and also the presence of Naxalites within the State territories due to which no proper development has happened within the States. To quote the Odisha Chief Minister Mr. Naveen Patnaik on objective behind seeking the Special Category Status (SCS), "The first objective to seek more liberal funding from the

Central Government further strengthens our efforts for the accelerated development of Odisha. The second objective is to seek tax breaks that Special Category States are entitled to with a view to attract private investment in labour intensive sectors to create more job opportunities for the people of Odisha and to further expedite development of the State" (TOI, 5<sup>th</sup> April, 2013)

While the Centre has chosen to give a muted response to the demands with similar reactions from the NDC for a long time and speculations are high among stakeholders, the current Finance Minister while presenting, his Union Budget 2013-14 has hinted towards setting up a Committee to look into the matter of redefining "Special Category". Hope, Odisha's demand will be fruitful in the coming days either in the form of liberal funding or to seek tax breaks that special category states are entitled for the development of underdeveloped areas like KBK. I personally feel KBK deserves more attention than few areas of Bihar or Bundelkhand.

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