

ABSTRACT

Fiscal transfer from a higher tier to the lower tier of Government is often criticized for creating an adverse incentive for the latter to raise revenue from its own sources to the full capacity. This paper attempts to validate this criticism using empirical study. A Panel Data model has been employed, across 28 Indian states over the time period of 2002-03 to 2009-10, so as to verify the negative impact on States' own tax efforts created by transfers from the various sources like the Central Government, Planning Commission and the Finance Commission. It has been observed that while the transfers from the Centre and from the Planning Commission significantly and negatively affect the states' own tax efforts, the Finance Commission's transfer has a positive and significant impact.

Key words: Fiscal transfer, Tax effort, Adverse incentive