Tax efficiency in selected Indian states

Conference paper

pp 91–104 | Cite this conference paper

Advances in Public Economics

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This paper attempts to measure pure tax efficiency of fifteen major Indian states (Andhra Pradesh, Assam, Bihar, Haryana, Gujarat, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamilnadu, Uttar Pradesh and West Bengal) for the period 1980-81 to 1992-93 in a manner that allows this efficiency to vary both across time as well as across states. It is discovered that there is a moral hazard problem in the design of central grants in that higher grants by the central government to the state governments reduce efficiency of tax collection by these states. The less poor states are more efficient in tax collection. The rankings of states by tax efficiency for the various years do not converge. An index of aggregate tax efficiency is calculated and it appears that this index has been stagnating. It is argued that the weight placed on tax effort in

the formula determining central grants to state governments should be increased to improve tax efficiency of state governments.

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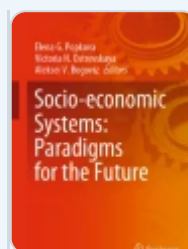
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