

## Extra Reading Material on Center-State Relations

### Jatin Gupta

#### Center-State Legislative relations

**Practice Question:** *What are major grievances of the states w.r.t legislative relations between the center and the states? Are there signs of constitutional biasness?*

#### Issues in legislative relations

- Some States have expressed reservation to the existing system of division of legislative powers and sought a fresh look. Over a period of time, they felt, the **Union has enriched its powers at the expense of the States**. Changes in technology have resulted in new subjects which have landed under residuary powers.
- States have also expressed concerns over transfer of entries from List II to List III
- Another point of friction is in respect of reserving bills for assent of the President passed by State Legislatures. There is a *scope for abuse of discretion based on political consideration*.
- An issue which has caused concern among the States in recent times is the impact of the Union executing international treaties and agreements involving matters in the State List (Article 253). *A new dimension to the problem has been added by the Supreme Court declaring [Visakha v. State of Rajasthan (1997)] that citizens can seek relief in courts on the basis of international conventions or treaties if the country has ratified them and they are not inconsistent with the law and Constitutional provisions*

#### Recommendations of expert bodies

- In matters of concurrent or overlapping jurisdiction, a process of mutual consultation and cooperation has to be put in place. It must be evolved as a convention or rule of practice rather than a rigid Constitutional requirement.
- Ordinarily, the Union should occupy only that much field of a concurrent subject on which uniformity of policy and action is essential in the larger interest of the nation leaving the rest for State action.
- Whenever the Union proposes to legislate on a matter in the Concurrent List, there should be prior consultation. An analysis of the views of the State Governments and the comments of the Inter-State Council should accompany the Bill when it is introduced in Parliament.
- Residuary powers except matters relating to taxation, should be placed in the Concurrent List

#### Financial relations between the center and the states

From the division of subjects between the Union and the States, it is clear that there is an asymmetry between the taxation powers and the functional responsibilities. While the Centre is assigned with taxes with higher revenue potential, States are assigned with more functional responsibilities. **To address the issue of a gap in the resources assigned to States and their expenditure responsibilities, the Constitution provides an institutional mechanism in the form of a Finance Commission and other enabling provisions for the transfer of resources from the Centre.**

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**Article 280** mandates the setting up of a Finance Commission at the expiration of every fifth year or at such earlier time as the President of India considers necessary.

The duties of the Finance Commission as prescribed under this Article are:

- a) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them and the allocation between the States of the respective shares of such proceeds,
- b) the principles which should govern the grants-in-aid out of the Consolidated Fund of India,
- c) the measures needed to augment the Consolidated Fund of a State to supplement the resources of the panchayats and municipalities in the State, and
- d) any other matter referred to the Commission by the President in the interests of sound finance.

Under Article 281, every recommendation made by the Finance Commission together with an explanatory memorandum as to the action taken thereon is required to be laid before each House of Parliament.

### **Principles of Fiscal federalism**

1. Parity between the responsibilities assigned and the resources available
2. Sources assigned should be elastic in nature
3. Equality in transfers: Both vertical and horizontal
4. There should be methods to set accountability of the units
5. Lower levels should be allowed to raise the resources independently

### **Problems in fiscal relations**

The Sixth Finance Commission observed *"When the emphasis is on social justice, there is no escape from realignment of resources in favour of States, because services and programmes which are at the core of a more equitable social order come within the purview of the States under the Constitution"*

In a common memorandum submitted to the Thirteenth Finance Commission States have demanded an increase in their share of Central taxes from 29.5 % cent to 50% from divisible pool of taxes

1. Vertical imbalance in resource sharing. States have 63% of fiscal responsibility but 37% of resources
2. Growing central expenditure on functions in the state list via Centrally Sponsored Schemes
3. Regional imbalances encouraging special packages for certain states creating a bitter feeling among states
4. Enforcement cost of central legislation is being paid by the states
5. States are not allowed to borrow from the outside.
6. Center often imposes stringent conditions on states to raise further funds within the country if they have an outstanding loan to pay to the center

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7. Politicization of transfers under Article 282
8. Before making the pay commission awards Center does not consult the states but but they bear the burden equally
9. Regular delays with respect to providing states with royalty in major minerals.
10. The problem have been confounded as states are asked to make fiscal devolution to the third-tier of government.
11. Cesses and taxes imposed by the center are enjoyed by the center alone: The introduction of new cesses and surcharges has neutralised the higher tax devolution recommended by the successive Finance Commissions.

### **Other reasons for poor finances of States**

1. Populist tendencies of state governments including providing freebies
2. State taxes are less elastic in nature
3. Corruption in administration results in inefficiency
4. State PSUs are in a bad state and loss making in most cases
5. States have utilized their tax potential properly
6. Regular **Pay commission awards** announced by the Central Government

### **Why states feel GST is against federalism**

- Even in the constituent assembly debates Ambedkar said that **sales tax** would be the main source of revenue for the states and hence no limit should be put on the same.
- Veto power: States have only 2/3 of the voting rights and a decision requires 75% majority, effectively giving veto power to the Centre.
- Revenue neutrality principle affected: GST shifted many goods previously taxed at 14.5% by states to 12% or 18%, reducing state shares to 6% or 9%. Further, at present, only **32 commodities fall under 28% category, compared to 229 initially.**
- Substantial part of the IGST not shared: IGST constitutes around 55 per cent of collection. However, Rs 2.4 Lakh crore remains undistributed in 2021-22, impacting fund starved states.
- Favourable sharing for centre: States' GST share increased only by 5.31% from 2017-18 to 2021-22 while Centre's share increased by 7.91% indicating an unfavourable distribution for the states.
- Disparities among states: It harms producer states and rewards consumer states. States like Tamil Nadu, heavily invested in manufacturing, are facing problems with their reliance on GST. Further, southern states accounting for over 25% of direct tax and 26% of the GST collection, get the lowest amount (16%) from the divisible pool.

### **How GST promotes cooperative federalism**

- Sharing of power: The Centre let go of its exclusive power to tax manufacture of goods (i.e. Excise) and provision of services (i.e. Service Tax), and the States gave up their exclusive power to tax sale of goods (sales tax / VAT).
- GST council: The States have been given a voice in the GST Council, participating in over 1500 consensual decisions on tax policy and rates over the course of 49

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meetings.

- Shared governance: GST Council's recommendations are not binding and both centre and states have simultaneous and equal power to make laws on GST.
- Support to states: Four tax rates (5%, 12%, 18%, 28%) were introduced to minimise impact of state revenues. Moreover, the concern about their potential revenue loss was allayed through revenue neutral principle and continued compensation grants.

### Punchi commission recommendations on financial relations

- All future laws should provide the cost sharing as RTE (explained below)
- TOR should reflect the additional burden of the states w.r.t implementation of the Pay commission awards
- Part of spectrum sale and natural resources to be shared with the states
- FC division of the MoF should be made a permanent department serving the FC
- Set up an interstate commerce commission

### Good practice for observing fiscal federalism

Recently, the Government of India has taken a number of initiatives to build a structure of legally enforceable rights and entitlements to ensure uniform service delivery across States and to ensure accountability on the part of the Government at all the levels.

The Right of Children to Free and Compulsory Education (RTE) Act, 2009 has mandated provision of free and compulsory education to all the children in the age group of 6 to 14 years. **The Act also contains provisions relating to the responsibilities of the Central Government, State Governments and local authorities.**

**The RTE Act mandates the Central Government to provide grants-in-aid to States towards meeting a percentage of expenditure as may be determined from time-to time in consultation with the States. Under section 7(4) of the RTE Act,** the Central Government may make a request to the President to make a reference to the Finance Commission to examine the need for additional resources to be provided to any State Government so that the said State Government may be provided its share of funds for carrying out the provisions of the Act. The RTE Act has broken new ground in clearly delineating the functional and financial responsibilities of the Central and State Government. There is no such clear delineation of financial responsibilities in other Central legislations, where the States are entrusted with their implementation. All future Central legislations should provide for cost sharing as in the case of the RTE Act. Existing Central legislations where the States are entrusted with the responsibility of implementation should be suitably amended providing for sharing of costs by the Central Government.

Article-252:- two or more states can request centre to legislate on state subject

Article-262:- Mention about resolution of inter state river water dispute

Article-263:- Inter state council

Article-266(1):- Talks about Consolidated fund of India

Article-279A:- GST Council

Article-275:- Grants-in-Aid

Article-280:- Finance Commission

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#### Cooperative Federalism

Cooperative federalism is the concept that reflects the relationship between centre and state where they both come together and resolve the common problems with each other's cooperation.

*"The States and National Governments are regarded as mutually complementary parts of a single governmental mechanism all the whose powers are intended to realise the current purposes of government according to their applicability to the problems in hand."*

This concept puts in a view that the national government and the state governments are partners in their governance. It is also considered as a new form of federalism. This new concept is influenced by the factors which are given as follows:

- The **emergence of the concept of welfare state**, which is strongly based on the public opinion, has made the local units more dependent on the national governments for adequate resources.
- National decisions have taken precedence over the points of Centre-State division of powers on issues such as **terrorism and climate change**.

In the U.S.A., the essence of intergovernmental cooperation is mainly seen in the conditional grants, which were sent from the Centre to the State for centrally sponsored schemes. Australia has also developed the concept of cooperative federalism by establishing the **Commonwealth Grants** Commission and the Australian Loan Council, 1927 to help the various governments in borrowing.

The constitution puts a rigidity in the spheres of functioning of the states and the center but cooperative federalism provides the necessary flexibility in solving many issues.

**Practice Question:** What do you understand by cooperative federalism? Explain with examples. Does India practice cooperative federalism?

**Practice Question:** Both Centre and State governments must attend to the task of preserving our nationhood through constructive cooperative federalism. Comment

#### Cooperative Federalism

When we look at our Constitution, several provisions and features have been deliberately designed to promote the concept of Centre-State cooperation.

- **Article 252(1)** provides for delegation of powers by two or more states to Parliament so as to enable it to legislate with respect to a matter in the State List in relation to such states.
- The Constitution provides for a scheme of **tax sharing between the Centre and the State**. This means that the Centre should share some taxes collected with the States.
- Apart from the scheme of tax sharing, there is another way of transfer of revenue from the Centre to the State and that is the **system of grants-in-aid**.

Concept of IGST is mentioned in 269A and concept of GST council is mentioned in 279A. GST has been implemented by 101st CAA in 2016. GST council consist of 33 members whose chairperson is finance minister of India.

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- To reduce the rigidity, which may arise from the Centre-State division of administrative power, the Indian Constitution makes **provisions for the intergovernmental delegation of administrative power**.
- **Article 312** introduces an important feature to the Indian Constitution, which provides that besides having separate services for the Centre and State, the Centre can create certain services common to both the Centre and State.
- **Article 261(1)** lays down that full faith and credit should be given throughout the territory of India to public acts, records and judicial proceedings of the Union and of every State. This is to give them a nation-wide application.
- **Article 263** provides that the President may by order appoint an Inter-State Council if it appears to him that the public interests would be served by the establishment of a Council.
- **Zonal Council have been introduced in India by the State Re-organisation Act, 1956.** These Zonal Councils were created to promote the mechanism
- A reference can be made to NITI Aayog which was set up mainly to promote the cooperative federalism and giving the State more freedom to design the developmental plans.

In **State of Rajasthan v UOI, 1977**, it was quoted that according to Granville Austin, the Constitution of India was perhaps the first constituent body to embrace from the start what A.H. Birch and others have called cooperative federalism. India has been exercising the concept of cooperative federalism for the longest time.

### Need for cooperative federalism in 21<sup>st</sup> century

- Environmental challenges, such as climate change, are global in nature and do not respect state borders.
- Pollution and conservation issues are often a source of tension between different levels of government.
- Increasing voices of autonomy and separatism are eroding the political and social fabric of federal structures.
- Terrorism, militancy, organised crimes, problem of internally displaced persons, refugees – all these require that the country as a whole comes together and the institutional bodies under state governments help the centre
- Cooperative federalism strengthens the nation by helping it withstand adversity.

### Issues and challenges to cooperative federalism

- Certain provisions of the constitutions themselves mitigate the idea of Cooperative Federalism
- Emergence of a strong central government
- States involvement in foreign policy is very limited
- Inter state water disputes, boundary disputes continue to persist between states

*Q. The concept of cooperative federalism has been increasingly emphasized in recent years. Highlight the drawbacks in the existing structure and the extent to which cooperative federalism would answer the shortcomings. (2015)*

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*Q. Constitutional mechanisms to resolve the inter-state water disputes have failed to address and solve the problems. Is the failure due to structural or process inadequacy or both? Discuss. (2013)*

#### Interstate River water Disputes

- **Article 262** provides an alternate mechanism for the resolution of disputes between the states related to interstate river water or river valley.
- **Cost-effective and less time-consuming** as well as conducive to national unity
- It allows the parliament to exclude the jurisdiction of courts including the Supreme Courts in such matters.

#### Inter-State River Water Disputes Act, 1956

- **Subsequently**, the Parliament enacted the Inter-State River Water Disputes Act 1956, according to which, the Central Government may notify setting up a tribunal upon receiving complaints from the states.
- As a result, several tribunals have been set up under the law, including the **Mahanadi Tribunal, the Godavari Tribunal, the Kavery Tribunal**, etc.
- The idea was to provide amicable resolution to such disputes, but despite these efforts, these tribunals have been largely unsuccessful.
- It consists of a Chairman and two other members, nominated by the Chief Justice of India from among persons who, at the time of such nomination, are Judges of the Supreme Court
- The Tribunal investigates the matter and makes its report, giving its decision. The decision is to be published and is to be final and binding on the parties.
- Jurisdiction of the Supreme Court and other courts in respect of the dispute referred to the Tribunal is barred.

#### Challenges in the functioning of the inter-state river water tribunals

- **Lack of uniformity in their functioning** due to non-uniform application of principles
- Overall **delay in completion of the adjudication**, due to various factors.
- The **State governments have been reluctant to share data** in the absence of which they have not been able to make conclusive awards.
- Several times the **states have refused to comply with the final awards** due to political reasons.
- They consist of **judges who do not have technical expertise** on such matters.
- **Supreme Court's interference** has undermined the role of the tribunals as adjudicators of ISWDs
- Fali S. Nariman identified the **two-layered scheme of adjudication** by a tribunal as the reason for the inordinate delay.



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#### Way Ahead

- Setting up of River boards for the development of inter-state rivers
- Defining a time limit for the tribunals to give their decisions
- Mandatory inclusion of technical experts in the tribunal
- Adopting a negotiation based approach before setting up a tribunal
- A central repository of water data is necessary for informed decision making
- A Single Permanent Tribunal should be set up which would have multiple benches
- Jurisdiction of the Supreme Court and all other courts should be barred in respect of matters

#### Article 263 - Inter State Council

- Article 263 provides powers to the President to set up an interstate council for the resolution of disputes between the Union and the States and to advise upon resolving the common issues concerning both.
- The first Centre-state relation commission recommended the setting up of a permanent Inter-State Council, and subsequently, the president issued an order in 1990 for setting up the same.

#### Composition

- PM as Chairperson,
- 6 Union Cabinet Ministers chosen by the PM.
- CM of states, UTs of Delhi and Puducherry,
- Administrators of all the other UTs.
- ❖ It is supposed to meet thrice a year, and the decisions are supposed to be taken by a **consensus-based approach** and no rigid procedure
- ❖ Additionally, the **Standing Committee of the Council** has also been set up under the chairmanship of the Union Home Minister to provide support to the Council in its functioning.
- ❖ The meetings, proceedings and deliberations of the Council should be held in camera, **away from the publicity** normally associated with the meetings at this level.

#### Significance of Inter-State Council in present times

- It is the only multilateral institution created under the Constitution to discuss the issues between center and states
- It can play a crucial role in resolving the issues in a constructive manner where the states and Union can leave behind their political differences.
- It can prove to be a platform to formulate a common policy on several complex issues, such as Naxalism, Terrorism, and climate change, which require Center-State and interstate coordination.
- The strained relationship between the Union and state governments in a democracy hinders the growth of the nation. In recent times there has been a growing divide



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between the states and the Union government, more specifically the fiscal gap. In the legislative domain, the farm laws and the subsequent repeal, NEET examination, Agnipath scheme are some conflicting issues

#### **Problems and Challenges**

- It has become a victim of bitterness between the National and regional political parties.
- Despite the best efforts, the council has been irregular in its meetings, for example, the meeting in 2016, happened after a gap of 11 years. The year 1997 being the only exception wherein two meetings were held; since 1990 only 11 meetings have been held against the mandate of 96 as per the order. Out of 11, nine meetings were held by and large to discuss the recommendations of the Sarkaria Commission and consensus-building on the same.
- Since the recommendations are not binding in nature, they are often ignored by the Union and the States
- The Secretariat of the Council that is supposed to provide technical support to the Council is understaffed and ad-hoc in character.
- Setting up of multiple bodies such as NITI Aayog, National Development Council, and GST Council, has diluted its importance and powers.

#### **Way ahead**

- The 2nd ARC and the Punchi Commission have recommended revamping the Council to make it an effective forum for promoting cooperative federalism in India.
- The 2nd ARC has recommended that the Council should be provided with a permanent secretariat to strengthen its functioning.
- Punchhi Commission suggested that the ISC should be given either constitutional or statutory status, giving its actions greater authority and respect.
- The FC-XI Report suggested making a constitutional amendment to Article 263 to make the ISC responsible for arriving at decisions on fiscal policies having inter-State or Centre-State ramifications
- While the recommendations of the ISC should not be made binding, it may be considered to impose a positive duty upon the Centre and States to give due consideration to any such recommendations
- In Canada, South Africa and Australia, the solution has been to set up expert bodies with members who have specialised in relevant subject areas.
- Staff from both the Centre and the States should be appointed to the Secretariat of the ISC, in order to inspire confidence and enhance co-ordination. This is the approach followed in Canada.

The recent move made by the Central government to reconstitute the Council seems like a step in the right direction, but it cannot bear fruits in absence of a political will from both the states and the Centre.

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#### **Examples from other countries**

- The Australian states came together in 2005 to set up the council for the Australian federation to jointly represent their interests in Canberra.
- The premiers of Canada's 13 provinces and territories meet as part of the council of the federation.

#### **Zonal Councils**

Five Zonal Councils were set up under the States Reorganisation Act, 1956. In the northeast, the North Eastern Council (NEC) was set up under the North Eastern Council Act, 1971.

#### **Issues and challenges**

- Absence of an independent secretariat: One of the main reasons for failure of Zonal Councils is the absence of their own competent, independent secretariat (except that of the NEC).
- Centralization with no role of states: From 1957 to 1963 the five Zonal Councils were functioning with the help of five separate secretariats as intended by the Act. From 1963, the Secretariat staff, other than the Secretary, of all five Zonal Councils has been centralised at Delhi. With centralisation, the Secretariat of the Zonal Councils has virtually become a part of the Ministry of Home Affairs.
- Declining trend of meetings: During the seven year period from 1957- 63, 33 meetings of different Zonal Councils were held (average being 4.7 meetings per year). During the period from 1963 to 1985 about 51 meetings were held (average 2.2 per year).
- Too many agenda points: Too many items in the agenda and meetings at infrequent intervals have also diluted the effectiveness of the meetings

#### **Immunity from Mutual Taxation**

The Constitution provides for immunity of property of one government from taxation by another. Matter is dealt with in Articles 285 and 289 of our constitution.

The property of the Union shall except a Parliamentary law should be exempt from all the taxes imposed by a State or by any authority within a state. (Article 285(1))

Similarly, property of a State is immune from Union taxation (Article 289(1)). Exemption however does not extend to all Union taxes, as held by our Supreme Court, but is only confined to such taxes as are levied on property. A state is therefore not immune from customs duty, which is imposed not on property, but on the act of import or export of goods.

#### **Freedom of Inter-State trade and commerce**

Article 301-307 relates to freedom in matters of inter-state trade and commerce. Refer to provisions of Article 301 and 303(1).

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But they are subject to exceptions under Article 302, 303(2), 304(b) and 304(a).

#### **Competitive Federalism**

Competitive federalism is a concept where centre competes with states and vice-versa, and states compete with each other in their joint efforts to develop India. The policy of one-size-fit-all is replaced with different policies of various states based on their own priorities within the state. Competitive federalism follows the concept bottom-up approach as it will bring the change from the states.

As a concept, competitive federalism originated in countries such as the US. The meaning of competitive federalism as espoused by the Liberty Foundation in the US would entail a system that allows States to compete with each other over a broad range of issues to provide citizens with the best value goods and services at the lowest cost.

#### **Benefits of Competitive Federalism**

- Better service delivery and governance
- Disciplines the states in the matter of fiscal space
- Governments have to continually reform themselves to outdo other
- Promotes innovation by the states

#### **Problems with Competitive Federalism**

- Promotes competition between the unequals and thus unhealthy competition
- As a concept is more applicable to countries like USA
- Generate state's consciousness

#### **Competitive federalism in India in recent times**

- In India, the government replaced the Planning Commission by establishing NITI Aayog, with one of the mandates to develop competitive federalism in India.
- Now, state governments do not look towards the centre for policy guidance and fiscal resources completely. The centre has increased the share of states in central tax revenue from the earlier 32% to 42%.
- The government also declared that the states will have freedom to plan their expenditure based on their own priorities and the states are free to change centrally sponsored schemes.
- The concept of competitive federalism is driving the Indian states to rush in for reforms to make processes easy for doing business in their state and expediting the pending project clearances.
- The concept of getting states to compete for investment is not a novel idea. We had observed this phenomenon between Andhra Pradesh and Karnataka, actively pursuing investors to help build out their main technology hubs of Hyderabad and Bengaluru.
- Swacch Bharat index, Good Governance Index are some recent examples of initiatives promoting competition between states