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Co- operative Federalism: National Perspective (Centre- State Financial Relations)

Tapan Kumar Shandilya
Principal,
Deptt. of Economics,
T.P.S. College,
Patna (Bihar)

Abstract

The devolution of resources from the union to the States is a salient feature of the system of federal finance of India. Apart from their share of taxes and duties, the state Governments receives various grants and loans from the centre for various development and non-development purposes. In India, federal financial transfers are made through three channels. They are: Finance Commission, Planning Commission (NITI Aayog) and Central Ministries. The Finance Commission transfers are most important of these three. To fulfil the need for a systematic and flexible mechanism of transfer of resources from the centre to the states. Article 280(I) of the constitution of India provides for the appointment of a finance commission, and thereafter at the expiry of every five years or early, as the president of India may consider necessary. It makes recommendations to the president as to: (1)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 as the respective share of such proceeds. (2) The principles which should govern the grants-in-aid of the revenues of the States in need of such assistance out of the consolidated fund of India. (3) Any other matter referred to the commission by the president in the interest of sound finance. The terms of reference have differed from Commission to Commission, depending upon the circumstances and requirements.

In a nutshell, this article intends to solve the Centre- state conflicts and promote Co-operative federalism consistent with the national integration. How to promote better Co-ordination and Co-operation between the centre and state is a rocking problem of the time and the solutions discussed here in will certainly go a long way to facilitate the smooth functioning of Co- operative federalism.

Keywords: Horizontal Fiscal Balance, Vertical Fiscal Balance, Fiscal Equalisation, Vertical Devolution, Horizontal Devolution, Revenue Deficit, Normative Projection, Fiscal Consolidation, Co-Operative Devolution.

Introduction

The present position of Centre- State financial relations in India is the result of long period changes and adjustment leading to the enactment of the Government of India Act, 1935, which put emphasis on the autonomy of the provinces in the country. The Indian constitution, which was adopted on 26th January, 1950, was basically erected on the foundation has been federal supremacy with States autonomy. The constitution of India has divided the functions and resources between the Centre and the States in such a way that the Centre is more fortunate than the States because the former has elastic sources of revenue to meet the inelastic functions, whereas the States have inelastic revenues and elastic functions, This gives rise to the problem of non-correspondence between functions and resources of the centre and State Governments. It is more complicated because of the fact that all the states have to discharge similar functions and they are assigned the same resources. But the irony of the fact is that all the States are not equally advanced and prosperous. So there is the problem of fiscal imbalances of two kinds, i.e., problem of vertical fiscal imbalance and the problem of horizontal fiscal imbalance. The emergence of financial disequilibrium necessitates the transfer of funds the Centre to the States. There is not only the problem of resolving the mal-adjustment of resources and needs between the federal and the State Governments but also of harmonizing income with needs of the different States. We have also to ensure that economic equilibrium is achieved for the nation as a whole.

"There is need of leveling up so that backward areas are pushed up and the inequalities in the level of services provided in the different States are resuced."[1] "No doubt, there is imbalance between function and resources of the two layers of the Government and between the units as well. Mrs. Ursula Hicks has rightly observed, "The national Government will tend to have more than it needs while the States will not be able to perform their duties without a considerable amount of help. This imbalance is, in fact, typical of almost all federations, it is naturally more serious for the poorer States who have less opportunity of raising revenue and for this reason it tends to be a more acute problem in a developing federation than in an advanced one."[2]

Horizontal fiscal balance has been defined as a situation where each State in a Federation has the capacity to provide services at a standard, comparable to that of others, provided that it imposes taxes and charges at a comparable standard. But here in our country there is an unusual thing which we find in the remark of Michael D. Reagon, "In less coluurful language, The proposition is that we suffer from a fiscal mismatch. That is to say. It is relatively much easier for the national government to increase its tax revenge each year. And expenses for public services rests primarily at the doors of the lower jurisdictions.[3] "There is fiscal imbalance in our country which presents some irritants, some disquieting features leading to centre-State conflicts.

No. doubt, this conflict is unfortunately inherent in our federation itself. The Indian Federation has not evolved in the independent States through their own mutual consent have come together to form a federation. In such a case, at the time of joining the union or Federation, Each state takes every care to secure its financial independence and self-sufficiency. Consequently, the area of conflict is reduced and the donor-receiver equation is rectified. But in India the federal structure has come from above, as the States were already functioning as provinces of unified India. The reality is that the whole attitude to federal fiscal transfers was originally developed and used by Sir Otto Niemeyer for a colonial country. Different Finance commissions simply modified the approach here and there but they did not bring any fundamental change in it. They have not formulated any new approach keeping in view the progressive policies of a socialist Welfare State. Even the distribution of financial powers under the new constitution has been very much influenced by the Government of India Act, 1935. Hence, the basis of the sharing of taxes in our country has been out of date and out of time with the changed objectives of public policy and fiscal needs of the country. This is, however, often missed that our federation came into being by devolution, not by aggregation of independent units. This historical burden of strong Central bias seems, as it were, to have loomed large on the farmers of the constitution who chose to resolve the residual powers for the union. So there is imbalance which was expected. "The imbalance, according to the Fifth Finance Commission, between the functional responsibilities assigned to the States and the financial resources allocated to them, which is a general feature of many full-fledged federations, also exists in India"[4] Lakdawala pointed out that "imbalance arises in a federal system either as a result of overlapping tax power or the imbalance between the allocation of functions and distribution of tax powers among the two layers of government."[5] As there is no such overlapping of tax powers between the centre and the States. The imbalance in India is mostly due to the second factor.

There are provisions to correct the fiscal imbalances. The States receive Central Assistance in three forms-shares in taxes and duties, grants and loans and there are three institutional processes through which States receive funds from the Centre, namely, (i) on the basis of recommendations of the Finance Commission, and (ii) in the basis of suggestions of Planning Commission, and (iii) at the discretion of the Central Ministries. The Finance Commission is a quasi- judicial Institution and a statutory body which is constituted only periodically and therefore its assumption remain broadly 'static' during the period. We know that Planning is a dynamic process and as such, continuous appraisal and adjustments are essential. A static Five Year framework of the Finance Commission would not meet the requirements of Planning. So, there is also the second institution, namely, the Planning commission which has been set up by an executive order of the Union Government. The Planning commission advises the Central Government regarding the desirable transfers of resources to the States over and above those recom-mended by the finance Commission. Its recommendations are based on 'dynamic' assumptions and it takes into account the changes in the economic structure. Bulk of the transfer of revenue and capital resources from the Centre to the States is determined largely in the recommendations of these two Institutions. "During the Sixth Five Year Plan (1980-85), about 41 percent of total resources transferred from the Union to the States were done on advice of the Finance Commission and over 43 percent was done on the advice of the planning Commission."[6] The Central Government also makes certain other transfers to the States. These comprised 15 to 16 percent of the total resources transferred during the sand period (1980-85)."[7]

The Constitutional provisions for devolution of resources have been laid sown in Articles 268, 269, 270, 271, 272, 273, 275 and 282. These days Article 282 has become the most important. Under this Article huge annual grants are made to the States for the Five Year Plans. In view of the increasing importance of Article 282, the finance Commission's scope has been limited and the scope of discretionary plan grants has increased. This is a misuse scope of discretionary plan grants has increased. This is a misuse of an enabling provision of the constitution. The application of the provision of this Article should be strictly limited otherwise most of other financial provisions of the constitution will become redundant. It is desirable that Article 282 world be utilised may have arisen on account of some accidental circumstances such a natural calamity in some areas of the country. It may also be utilised for making specific grants for achieving specific national objectives like eradication of leprosy or the development of youth hostels. No doubt, originally the rants under Article 282 were intended for utilistion in emergencies on adhoc basis for specific purposes. But later on with the advent of planning, the

Union government started giving grants, loans, etc., to the States as plan assistance under the same clause. So now plan grant under this Article is not adhoc, rather it has become a normal feature and it has grown from one plan period to another. The Central Assistance which is given on the suggestions of the planning commission has aggravated the fiscal imbalance, consequently. The Union-State financial relation is more strained. The autonomy of the States has been eroded and the States line up before the Union with a begging bowl for blessing. Every Finance commission from the second Finance commission onwards had called satisfied either with the quantum of revenue transferred or their distribution inter-se. Here I would like to quote K.V.S. Sastri. He has remarked, "In any Federation it has proved impossible to effect a clean separation of the finances of the several layers of governments and India is no exception to this. As a matter of fact, it would seem that the federal State fiscal relations in India are much more complex than in any of the three alder major Federations in the world, the U.S.A., Canada, Australia."[8] Similar view has been expressed by Sri Venkataraman when he remarks, "It is true that in no federation have the Central and State Governments seen eye to eye."[9] In this connection Mrs. U.K. Hicks has also the same things to say when she remarks, "As things huge developed, financial relations are more complicated in India than in almost any other Federation, certainly more than they are in the U.S.A., Canada, Australia or Nigeria. A formidable problem of co-ordination is implied."[10] The Fifth Finance commission is its final report has also expressed similar experience," The imbalance between the functional responsibilities assigned to the States and the financial resources allocated to them, which as a general feature of many full-fledged federations also exists in India"[11] the financial responsibilities of the States have increased. The Economic, Social and Development services like Agriculture, co-operation, small and cottage industries, Public Health Education, etc., require local supervision. Naturally, they are the responsibilities of the States which are in direct contact of the people. Bhopal is decidedly near than New Delhi. The country like ours which is vast in area and diverse in character, administration cannot function and planning cannot reach the people in the remote corner of the rural area without the help and co-operation of the regional Governments. Therefore, the State governments have increasing responsibilities in a developing country like ours, especially in view of the adoption of democratic planning in the country. The effective implementation of the plan objectives, the correction of the regional imbalances, the removal of the economic inequality and concentration of wealth and power, ushering in an era of decentralization and dispersal of economic and political powers, promotion of people's participation in the economic programmers of planning, formation of village leadership, etc., fall under the domain of the State Government. These functions are costly affairs and the states have to bear the entire responsibilities.

Aim of the Study

1. To Highlight the Co-operative Federalism in India.
2. To Discuss the Importance of Fiscal Equalisation in India.
3. To Study the Role of Finance Commission/ Planning Commission (NITI Aayog)
4. To Study the 14th Finance Commission Award.
5. To Study the NITI Aayog as Think Tank.
6. To Know the Problems of Federal Finance in India.

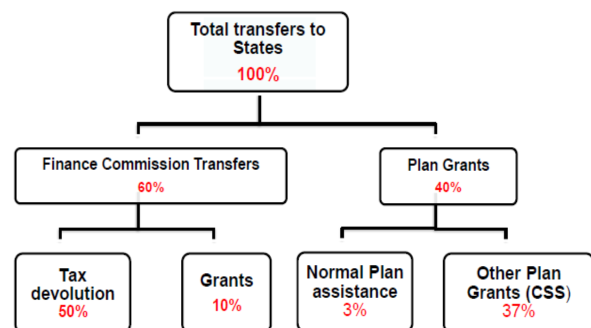
Fiscal Equalisation in India

Since the major elastic sources of tax revenue were allocated to the Central Government, the constitution of India did acknowledge that the resources of the State Governments would prove inadequate for the discharge of their functions. Accordingly, it provided for the obligatory sharing of income- tax receipts (Article 270) and permissive sharing of excise duties (Article 272) between the Centre and the States and grants-in-aid of the revenue to the States (Article 275). Articles 268 and 269 mention item of taxes which are to be allocated completely to the States, whether collected by the Centre or the States.

In addition to such assistance to the States by the Centre, Article 282 of the constitution provides for grants by the Centre to the states for any public purposes. Further, Article 293(1) of the constitution provided for loan assistance by the Centre to the States the Article states …' In fact, this is also a permissive and not an obligation on the part of the Centre.

However, the Constitution did not indicate either the total share of States or the allocation principle with regard to income tax, excise duty or grants-in-aid except that these were to be decided by the Finance Commission (Article 280). Thus, the total share of the States as well as its allocation among them has been governed by the periodical awards of the Finance commission. Both the grants and the loans provided by the Planning commission on the basis of the overall plan needs of both the Centre and the States. Thus, inter-governmental transfers in India are determined by the finance Commission and the Planning Commission.

Vertical Transfer Channels



Approach of the Finance Commission

Fiscal equalisation has not been expressed as an explicitly objective by any of the Finance Commission. However, a reference was made in the terms of reference of the Sixth Finance Commission which states "the Commission shall make recommendations as to the requirements of States which are backward in standards of general administration for up gradient the administration with a view to bringing it to the levels obtaining in the more advanced States.[12]

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Since then it is being mentioned in the terms of reference of the subsequent Finance Commission. In fact, indirect references have often been made by the earlier Finance commission to the desirability of bringing out a reduction in inter-state inequalities. The First Finance Commission listed this aim as one of the main considerations which shaped their recommendations.[13] The Second Finance commission showed its preference for same kind of equalistion when it criticized as inequitable the weight given to the collection factor in the distribution of income-tax revenue.[14] The fourth and Fifth Finance Commissions decided to distribute part of the excise revenue on States.[15] The Sixth Finance Commission have given further recognition to the special difficulties of backward Sates, and for the first time, have given them access to resources on a liberal scale to come up to the national average in important administrative and social services.[16] The seventh Finance Commission did more in this direction.[17] It decided that the shares of the States in the divisible pool of excise be determined by giving equal weight to the population factor, the inverse of the capita State domestic product. The percentage of the poor in each State and a formula of revenue equalization.[18]

Each finance Commission had evolved its own method of assessing the relative backwardness of the States. In view of the smallness of the net proceeds of excise, its effect on reduction of inter-state imbalance has been modest. By and large, they have never attempted a critical evaluation of the overall distributional pattern resulting from their recommendations. Nor they have tried to adopt a specific model of equalization on which to base their recommendations.[19] which regard to tax sharing the States' share in income-tax revenue has invariably been distributed on the basis of Sates population and collection of such revenue in each State. At present, the percentage weights given to the population and collection factors are 90 and 10 respectively. The Second Fifth and Sixth Finance commissions had also recommended the same weight age; it was 80 and under the recommendations of the First, Third and the Fourth Finance Commission.[20]

Why Finance Commissions?
Constitution assigns distinct revenue and spending responsibilities to different levels of government
Union Government raises on average about 60 % of revenue, but accounts for about 45 % of spending
States raise roughly 40 % of revenue, but account for 55% of spending (own + Union agency)
Vertical imbalance needs resolution through transfers
The horizontal allocation of these transfers across States also has to be determined
Finance Commissions assigned this dual task as their core function by the Constitution

The size of the devolution of the excise duties has been increasing in the recommendation of the successive Finance Commission from 40 per cent on tabacco, matches and Vegi-table products (The First Finance Commission) it has been enlarged to 40 per cent of excise on all commodities (Seventh finance commission). In addition, the entire collection of electricity duty attributable to each State is being transferred to them since 1979-80. The inter-state distribution of excise revenues, more or less, is based on a formula which makes some explicitly that the objectives of having an equitable distribution to augment on the basis of population. The First Finance Commission felt that the objectives of having an equitable distribution to augment the resources of State could last be achieved only distribution on the basis of population. The Second Finance commission felt it necessary to apply a corrective in favor of those States which were not getting full benefit due to distribution only on population basis. Thus, they worked out State's share 90 per cent on the basis of population and 10 per cent for adjustment purposes. The third Finance Commission followed the principles laid down by the earlier Commission but put emphasis for adjustment to be made on the basis of relative financial weakness disparity in development, percentage of Scheduled Castes, Scheduled Tribes, etc., among the States. The fourth Finance commission felt that population should be a major factor in determining the economic and social backwardness of a State. It distributed the States' share 80 per cent on the basis of population and 20 per-cent on the basis of relative backwardness. The Fifth finance Commission, more of less followed the recommendations of its predecessor except that of 20 per cent two-thirds to be distributed only among states with per capita income below per capita income of all the States and one- thirds on the cases of relative backwardness. The Sixth Finance Commission only increased the weight age backwardness form 20 per cent to 25 per cent. The Seventh Finance commission, however. Departed from the earlier principles and recommended that the share of States in the divisible pool of excise be determined by giving 25 percent weight age each to the population, inverse of the per capita State domestic product, percentage of the poor in each Stare and revenue equalization.[21] Thus, inspire of the work of Seven Finance Commission no definite regional principal has yet been evolved to determine.

1. The total share of the States in the Centre's tax resources and
2. The relative share of each State.

This ended is a very unsatisfactory state of affairs and provide scope each time that a Finance Commission is appointed, for a variety of pressures and pulls to modify the awards of the previous Finance Commission.[22]

In regard to the grants-in-aid, the approach of the Finance commission seems to be most unsatisfactory. Grants-in-aid were recommended by the First Finance Commission only for the seven States after taking into account the budgetary needs of the States, the standard of social services, special obligations imposed on the States and certain broad purposes of national importance. The Commission also recommended a special grant to some States in which school enrolment were below the national average. In fact, it was an attempt in the direction of equalisation of performance laves or primary education in the States. Since the planning Commission provided for the expention of social services, the Second Finance commission did not go into the question of maintenance of minimum social service.[23] The Third Finance Commission recommended additional grants to the States for improvements of their communications. Since then the involvement of the

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Finance Commission in the levels of social services in the states have been discontinued. This discontinuance has been criticized as an abdication of its responsibility.[24]

The Sixth Finance Commission made the most significant departure from the approach of earlier Finance commission of enabling the States that were backward in standards of general administrations to come up to a certain minimum levels. For this purpose the commission identified certain administrative and social services as of crucial importance. However, the seventh Finance commission used the grants-in-aid only as a residual item to fill the revenue gaps of States which are lift in spite of the larger devolution of tax shares and debt relief.

Role of Finance Commissions
Recommend States' share of Union tax revenue: vertical devolution [Article 280(3)] +
recommend the distribution of States' share among States: horizontal devolution
Recommend additional Union grants-in-aid for States if required [Article 275]
Additional Terms of Reference could be added if the President so desires
14th Finance Commission given many additional terms of reference.

The Thirteenth Finance Commission has made a number of recommendations for fiscal consolidation. Some of these recommendations are as follows.

1. The revenue deficit of the Centre needs to be progressively reduced and eliminated followed by emergency of a revenue surplus by 2014-15
2. A target of 68 per cent of GDP for the combined debt of the Centre and States should be achieved by 2014-15. The fiscal consolidation path embodies steady reduction in the augmented debt stock of the Centre to 45 per cent of FDP by 2014-15 and of the States to less than 25 per cent of GDP by 2014-15
3. The Medium Term Fiscal Plan (MTFP) should be reformed and made a statement of commitment rather than a statement of intent.
4. In Case of macroeconomic shocks, instead of relaxing the State's borrowing limits and letting tem borrow more. The Centre should borrow and devolve th3e resources using the Finance Commission tax devolution formula for inter se distribution between States.
5. An independent review mechanism should be setup by the Centre to evaluate its fiscal reform process. The independent review mechanism should evolve into a fiscal council with legislative backing over time.

Total Transfers to States

The Thirteenth Finance Commission has recommended the total transfer of resources from the Centre to the States for the period 2010-15 to the fixed at Rs. 17.76.676 crore. The share of taxes and duties in this transfer is Rs. 14.48.096 crore. The recommended grants for local Bodies for the five year period 2010-15 have been placed at Rs. 87.519 crore. Of this, the share of 'general basic grant' is Rs. 56.335 crore, the share of 'general performance grant' is Rs.1.357 crore.

The existing system of financing relief expenditure mainly revolve around the CRFs (Calamity Relief Funds) maintained at the State level and the NCCF (National Calamity Contingency Fund) at the central level. Both these fund target immediate relief measures and exclude measures for mitigation or post-calamity reconstruction. The CRF is a resource available to the States to meet the expenses of relief operations for a range of specified calamities. The NCCF is a national fund to provide assistance to States for calamities of rare severity, beyond the coping capacities of the States CRFs. While the total amount of assistance for the CRFs is decided by the Finance Commission in the revealed needs of individual States, the NCCF has a dedicated source of funding through a special duty on selected items. the Central government has released Rs. 12.208 crore under the CRF in the four year period 2005-09 against the Rs. 12.547 crore share recommended by the Twenty Finance Commission for the same period. Under NCCF, the period 2005-09 for various calamities, The thirteenth Finance Commission has recommended that the NCCF should be merged into the National Disaster Response fund (NDRF) and the Calamity Relief Fund (CRF) into the State Disaster Response Funds (SDRFs) of the respective States. Contribution to the SDRFs should be shared between the Centre and Sates in the ratio of 75.25 for general category States and 90.10 for special category States. Balance under the State CRFs and the NCCF as on March 31, 2010 should be transferred to the respective SDRFs and NDRF. The total size of the SDRF has been worked out as Rs. 33.581 crore, to be shred in the ratio given above, with an additional grant of Rs. 525 crore for capacity building.

Article 280 of the Constitution of India requires the Constitution of a Finance Commission every five years, or earlier. The 14th Finance Commission (FFC) was constituted by the orders of President on 2nd January, 2013 and submitted its report on 15th December, 2014. For the period from 1st April, 2015 to 31st March, 2020.

14th Finance Commission Award Tax Devolution Under Article 380
Around 62% of shareable pool (Union taxes) already being transferred to States
No room to raise this much. Union needs balance 38% to accomplish it's responsibilities
Compositional shift possible to meet States complaints about tied & conditional grants(CSS)
14th FC could take comprehensive view since TOR not limited to only Non-Plan grants
Raised untied tax devolution to 42%, still leaving 20% of shareable pool for FC+ other grants

The Finance Commission is required to recommend the distribution of the net proceeds of taxes of the Union between the Union and the States (commonly referred to as vertical devolution); and the allocation between the States of the respective shares of such proceeds (commonly known as horizontal devolution).

With regard to vertical distribution, FFC has recommended by majority decision that the the States' share in the net proceeds of the Union tax revenues be 42%. The recommendation of tax devolution at 42% is

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a huge jump from the 32% recommended by the 13th Finance Commission. The transfers to the States will see a quantum jump. This is the largest ever change in the percentage of devolution. In the past, when Finance Commissions have recommended an increase, it has been in the range of 1-2% increase. As compared to the total devolutions in 2014-15 the total devolution of the States in 2015-16 will increase by over 45%.

FFC has taken the view that tax devolution should be primary route of transfer of resources to States. It may be noted that in reckoning the requirements of the States, the FFC has ignored the Plan and Non-Plan distinction; it sees the enhanced devolution of the divisible pool of taxes as a "compositional shift in transfers from grants to tax devolution" (Para 8.13 of FFC Report). Thus, basically the FFC Report expects the CSS, in fact Central assistance to State Plans as a whole, to reduce and be replaced by greater devolution of taxes.

Keeping in mind the spirit of cooperative federalism that has underpinned the creation of National Institution for Transforming India (NITI), the Government has accepted the recommendation of the FFC to keep the States' share of Union Tax proceeds (net) at 42%.

In recommending horizontal distribution, the FFC has used broad parameters of population (1971) and changes of population since, income distance, forest cover and area.

14th Finance Commission Awards Horizontal Devolution Formula	
Devolved taxes need to be allocated among States based on fair principles.	
Item	Weight (%)
Population(1971)	17.5
Demographic Change	10
Area	15
Income Distance	50
Forest Cover	7.5

The Finance Commission is also required to recommend on 'the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State'.

FFC has recommended distribution of grants to States for local bodies using 2011 population data with weight of 90% and area with weight of 10%. The grants to States will be divided into two, a grant to duly constituted Gram Panchayats and a grant to duly constituted Municipal bodies, on the basis of rural and urban population.

FFC has recommended grants in two parts; a basic grant, and a performance grant, for duly constituted Gram Panchayats and municipalities. The ratio of basic to performance grant is 90:10 with respect to Panchayats and 80:20 with respect to Municipalities.

FFC has recommended out a total grant of Rs. 2,87,436 crore for five year period from 1.4.2015 to 31.3.2020. Of this the grant recommended to Panchayatas is Rs 2,00,292.20 crores and that to municipalities is Rs. 87,143.80 crores. The transfers in the year 2015-16 will be Rs. 29,988 crores.

The Government has accepted the recommendations of the Finance Commission with regard to grants to local bodies. The Finance Commission is also required to 'review the present arrangements as regards financing of Disaster Management with reference to the National Calamity Contingency Fund and the Calamity Relief Fund and the funds envisaged in the Disaster Management Act, 2005 (Act 53 of 2005), and make appropriate recommendations thereon'.

FFC has recommended that up to 10 percent of the funds available under the SDRF can be used by a State for occurrences which State considers to be 'disasters' within its local context and which are not in the notified list of disasters of the Ministry of Home Affairs.

The FFC has noted in Para 10.26 as follows:

"*The financing of NDRF has so far been almost wholly through the levy of cess on select items, but if the cess are discontinued or when they are subsumed under the Goods and Services Tax (GST) in future, we recommend that the Union Government consider ensuring an assured source of funding for NDRF*".

In view of the above, with regard to disaster relief, the Government has decided that the percentage share of the States will continue to be as before, and that the flows will also be of the same order, as in the existing system; and that, once GST is in place, the recommendation of FFC on disaster relief would be implemented in the manner recommended by the Finance Commission.

The Finance Commission is also required to make recommendation regarding the principles governing grants-in-aid of the States' revenues, by the Centre. As noted by the FFC in Para 11.28, while calculating grants to the States they "have departed significantly from previous Finance Commissions, by taking into consideration a States' entire revenue expenditure needs without making a distinction between Plan and Non-Plan". Taking thus into account the expenditure requirements of the States, the tax devolution to them, and the revenue mobilization capacity of the States, the FFC have recommended "Post-Devolution Revenue Deficit Grants" of a total of Rs. 1,94,821 crores, for the five year period. The States of Andhra Pradesh, Assam, J&K, Himachal Pradesh, Kerala, Manipur, Meghalaya, Mizoram, Nagaland, Tripura and West Bengal (a total of 11 States) have been identified for receiving these revenue deficit grants.

To summarize, the Grants-in-Aid to the States total to Rs. 5.37 lac crores is given in the Table given below:

Grants-in-Aid to States

(Rs. crore)

1	Local Government (all States)	287436
2	Disaster Management (all States)	55097
3	Post-devolution Revenue Deficit (11 States)	194821
	Total	**537354**

As stated above, the compositional shift recommended by the FFC would substantially impact Central Assistance. In this regard, the FFC Report states as follows:

"Plan revenue expenditure of States is financed by States' own resources, borrowing and

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Plan grants from the Union. The Plan grants include normal Central assistance, which is untied, additional Central assistance for specific-purpose schemes and transfers, special Plan assistance, special Central assistance, Central Plan schemes and CSS. For the purpose of our assessment of Plan revenue expenditure of States, we have included expenditure incurred on State Plans and States' contribution to CSS. This excludes Union expenditure on CSS, central Plan schemes and North Eastern Council Plan schemes and externally aided projects financed through grants from the Union. We have estimated the 2014-15 base year Plan revenue expenditure (as defined above) for each State, applying an annual growth rate of 13.5 per cent over 2012-13 and 2013-14. For the purpose of our projection period, we have assumed an annual growth rate of 13.5 per cent over base year estimates for all the States, implying that the Plan revenue expenditure will increase at the same rate as the GDP growth rate."

14th Finance Commission Awards Grants
Avoided any sector or State specific grants
Only three grants: disaster relief, local government, and a revenue deficit grant
Revenue deficit an important equalizing grant
Expenditure need projected so no State left behind below 80% of all States per capita spending in 2019 -20
Deficit = Expenditure need –own revenue (normative projection) -tax devolution
Revenue deficit grant of Rs1,94,821 crore to benefit 11 states with projected deficits

Based on the above, over 30 Centrally Sponsored Schemes have been identified which ought to have been transferred to the States because expenditure on them has already been taken into account as State expenditure, in arriving at the greater devolution of 42% to the States. However, keeping in mind that many of these schemes are national priorities, and some are legal obligations (such as MGNREGA) and in order to underline the Central Government's continued support to national priorities, especially with regard to schemes meant for the poor, most of these are proposed to be continued. The Government has decided that only 8 Centrally Sponsored Schemes be delinked from support from the Centre.

Certain programmes of the Government will have to continue unaltered as they are either legal/Constitutional obligations, or are privileges available to the elected representatives for welfare of their constituents. Further, and more importantly it is proposed that the Union Government may continue to support certain programmes which are for the benefit of the socially disadvantaged in an unaltered manner from its own resources.

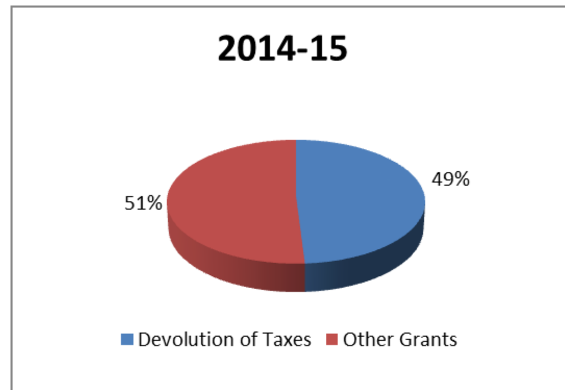
In respect of various centrally sponsored schemes, the sharing pattern will have to undergo a change with States sharing a higher fiscal responsibility for scheme implementation. Details of changes in sharing pattern will have to be worked out by the administrative Ministry/Department on the basis of available resources from Union Finances.

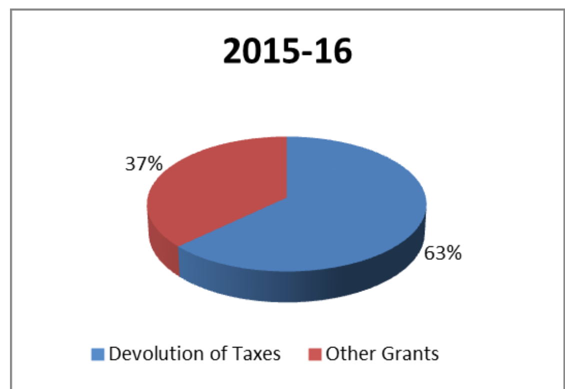
Other Recommendations of the FFC

In addition to the recommendations regarding Vertical, and Horizontal devolution and grants, the FFC has made certain other recommendations. These relate to cooperative federalism, Goods & Services Tax, Fiscal Consolidation Roadmap, Pricing of Public Utilities and Public Sector Enterprises. The recommendations of the Finance Commission will be examined by the Government in due course in consultation with the concerned stakeholders.

Comparative Picture of Fiscal Transfers in 2014-15 & 2015-16 Budgets

Total Transfers as % of Sharable Pool	
2014-15	62%
2015-16	63%
14th FC Total	63%





Approach of the Planning Commission (Now Niti Aayog)

In view of the particular type of equalization needed in India, the approach of the Planning Commission is even more important than that of the Finance Commission. The States are called upon to share with the Centre almost equal responsibility for financing plan outlays. However, the financial resources available to the states are highly inadequate to meet their needs of plan finance. Thus a transfer of resources is inevitable of the States are to carry out their development programmers.

Until the beginning of the Fourth Plan, there were no definite principles for inter-state distribution of plan assistance. In fact, the nature of this assistance was such as to create inflexibility in its use and inequity in allocation.

The size of the State Plan outlays was determined mainly by the amount of 'own' resources and partly barfly by other factors such as the carry

over form an earlier plan or the progress multipurpose river valley projects. The distribution of Central assistance did not specifically benefit the poor States.

In order to simplify the procedure for release of Central assistance, to avoid adoption of standard schemes unsuited to local conditions and needs as well as to ensure equity among that in future there would be no schematic patterns of assistance. In 1969, the Planning commission evolved a rational objective formula. The accepted forum is also known as Gadgil formula. The formula states:

"After providing for the requirements of the States of Assam, Nagaland, and Jammu and Kashmir, the Central assistance to the remaining States for the Fourth plan be distributed to the extent of 60 per cent on the basis of their population, 10 per cent on the basis of tax effect in relation to per capita, income, and that another 10 per cent be allotted in proportion to the commitments in respect of major continuing irrigation and power projects. The remaining 10 per cent, it is decided, should be distributed among the States so as to assist them in tackling certain special problems, like those relations to the metropolitan areas, floods, chronologically draught affected areas and tribal areas."[25]

However, when evaluated from the standpoint of inter-state equalization and co-ordination of Central and State Government' efforts, the formula does not appear to be an improvement over earlier arrangements.[26] If it is an improvement, it is only in sense that the weight given to the equalization objective has now become definitive.[27]

The Committee appointed by the Prime Minister in Center State Financial relations recommended that instead of wholesale revision of the Gadgil formula, the Central Assistance should be divided into parts; that available without any transfer of centrally sponsored schemes to be distributed on the basis of Gadgil formula and the Amount available as a result of transfer of Centrally sponsored schemes to States on the basis of formula linked to population. The formula has been evolved on the basis of income adjust total population multiplied by the inverse of precipitate income. It is popularly known as income Adjusted Total Population (IATP). However, both the Gadgil formula as well as IATP formula given undue emphasis to the population basis of assistance. The population criterion is a neutral criterion and does not serve the equity objective. The promotion of planned regional development has been major objectives of our planning and the Central assistance has to play a positive role in reducing inter-state disparities in economic development. (However, during the period 1951-79 the per capita plan outlays of the poorer States have deteriorated. For the period the highest per capita plan outlay of Rs. 1.660 was for Punjab and the lowest of Rs. 479 was for Bihar. The outlay for Punjab was Rs. 329 more than the state average whereas, it was Rs. 255 below for Bihar.)

It has also been shown by many studies that Finance Commission transfers Suring the period 1956-57 have not been very progressive. I.S. Gulati and K.K. George have demonstrated that during the whole period up to Fifth Plan the per capita statutory transfer to 4 States with the lowest per capita income was less than to 5 States with the highest per capita income. The six middle income States also received less than the 5 States with the highest per capita income,[28] Similar trend continued with the award of Sixth Finance Commission. A. Bagchi in has study has shown that 3 states with the lowest per capita income received smaller amounts per capita than the 5 states with the highest per capita income.[29] It has been further corroborated by a recent study of the National Institute of Public Finance and Policy. The study has shown that Institute of Public Finance and Policy. The study has shown that some of the poorer States like Bihar, Madhya Pradesh and Uttar Pradesh have not substantially lower per capita transfers than the all states average both during the Annual Plan and the Fourth Plan period.[30] Thus the system of devolution and grants-in-aid adopted by the Finance Commissions, while progressive in the sense of evolving, generally, funds per capita which from a larger proportion of lower per capita revenues, has not been systematically designed to lift up the poorest States.[31] As a result, inspire of the award of successive Finance Commissions, disparities in the standards of important services have been widened.

NITI Aayog is a Government of India policy think-tank established by Prime Minister Narendra Modi to replace the Planning Commission. The stated aim for NITI Aayog's creation is to foster involvement and participation in the economic policy-making process by the State Governments of India. It has adopted a "bottom-up" approach in planning which is a remarkable contrast to the Planning Commission's tradition of "top-down" decision-making. One of the important mandates of NITI Aayog is to bring cooperative competitive federalism and to improve centre state relation. This is well reflected when Indian Prime Minister appointed three sub-groups of chief ministers for making recommendations in three important areas (centrally sponsored schemes, skill development and Swachh Bharat). NITI Aayog will provide opportunities, that the previous Planning Commission structure lacked, to represent the economic interests of the State Governments and Union Territories of India. NITI Aayog is a group of people with authority entrusted by the government to formulate/regulate policies in social and economic issues with experts in it. India's Finance Minister Arun Jaitley made the following observation on the necessity of creating NITI Ayog: "The 65-year-old Planning Commission had become a redundant organization. It was relevant in a command economy structure, but not any longer. India is a diversified country and its states are in various phases of economic development along with their own strengths and weaknesses. In this context, a 'one size fits all' approach to economic planning is obsolete. It cannot make India competitive in today's global economy."

Major Highlights

1. The new National Institution for Transforming India (NITI) will act more like a think tank or forum and execute programs by taking the States along with them. This is in sharp contrast with the defunct Planning Commission which imposed five-year-plans and allocated resources while running roughshod over the requests of the various States.

2. NITI will include leaders of India's 29 states and seven union territories. But its full-time staff – a deputy chairman, Chief Executive Officer and experts– will answer directly to the Prime Minister of India, who will be chairman.
3. The opposition Congress IS mocked the launch as a cosmetic relabeling exercise–the new body's acronym-based name means 'Policy Commission' in Hindi, suggesting a less bold departure than the English version does. Several believe that is consistent with the negativism that has become the hallmark of the Congress.
4. Despite being blamed by critics for the slow growth that long plagued India, the Commission survived the market reforms of the early 1990s, riling Mr. Modi with its interventions when he was Chief minister of industry and investor friendly Gujarat.
5. Mr. Modi, elected by a landslide last year on a promise to revive flagging growth and create jobs, had vowed to do away with the Planning Commission that was set up in 1950 by Congressman and Prime Minister Jawaharlal Nehru.
6. But his plans been derided by the Congress party, which wants to defend the Nehru legacy and describes Mr. Modi's vision of "cooperative federalism" as cover for a veiled power grab.
7. India's first Prime Minister Jawaharlal Nehru, a socialist who admired Joseph Stalin's drive to industrialize the Soviet Union, set up and chaired the Commission to map out a development path for India's agrarian economy.
8. In 2012, the Planning Commission was pilloried for spending some Rs. 35 lakh to renovate two office toilets, and then it was lampooned for suggesting that citizens who spent Rs. 27 or more a day were not poor.
9. The commission had remained powerful over the decades because it had emerged as a sort of parallel cabinet with the Prime Minister as its head.
10. The Commission's power in allocating central funds to states and sanctioning capital spending of the central government was deeply resented by states and various government departments.
11. The NITI Aayog will also seek to put an end to slow and tardy implementation of policy, by fostering better Inter-Ministry coordination and better Centre-State coordination. It will help evolve a shared vision of national development priorities, and foster cooperative federalism, recognizing that strong states make a strong Nation.

Need for a New Approach

The progressivity of past transfers of resources has been important causes of the persistent inter-state imbalances.[32] If the inherited disparities are to be reduced, an element of high degree of progressivity has to be introduced. The present structure of inter-governments transfers in India is hardly based on a rational appraisal of the issues involved. It is too deeply rooted in the decisions of the past and can grandly be considered to promote equalization in any sense. This is more true in the case of the Finance commission. The successive Finance Commission has continued to follow Sir Otto Niemeyer's approach which was meant for a colonial country. In fact, their approach has been out of date and out of true with the changes objectives of public policy and needs of the country.[33] consequently, the financial transfers from the Centre to the States make but insignificant contribution to the objective of equalization.

The multiplicity of agencies making uncoordinated recommendations for various categories of transfers adds to the difficulties. In the area of grants-in-aid confusion has arisen because the planning Commission has encroached upon the field of the Planning Commission and stated making current transfer in respect of expenditure on revenue account.[34] However, this is not the basic cause of the issue, the main issue is to evolve a rational approach, the different agencies may be made to subscribe.

It the nation is relying interested in the removal of inter-state inequalities, a strategy of regional development involving:

1. The identification of backward regions.
2. The assessment of their growth potential.
3. The formulation of plans to exploit fully the growth potential over a specified time period.
4. Assessment of the fiscal capacity of each States.

Have to be evolved. The financial component of the plans thus formulated will indicate the warranted levees of expenditure. On the other hand the estimates of fiscal capacity will yield the level of warranted 'own' revenue to be raised by each state to help amount of equalization, grant for each State may then be calculated simply as the difference between the warranted expenditure and warranted revenue.

However, form a operational point of view, the approach requires precedence to be given to the planning commission over the Finance Commission as equalization grant need to be specifically related to the plan expenditure of the States. Under the present financial arrangement the Finance Commission cannot achieve fiscal equalization, at best the planning Commission perhaps can/

To achieve fiscal equalization in the desired directing, that is needed must, is the introduction of more and more progressiveness in the transfer of resources from the Centre to the States. The main factors influencing the resources transfer either through the Finance Commission or the Planning commission have been:

1. Population
2. Tax Collection
3. Some Index of Backwardness, and
4. Outlays required for large irrigation and power portents or for up gradation of particular services.

Since population criterion is a natural criterion and does not serve the equity objective, the undue importance assigned to it in various formulae should be minimized. Also allocation in proportion to tax effort and expenditure on gig projects generally tend to be progressive as tax collections and the expenditure on big projects are systematically higher in States with per capita higher income, thus, it is in the interest of fiscal equalization that these criteria should be dispensed with from all formulae dealing with inter-government financial transfers. What is

needed must is that allocation e made only in terms of State backwardness and the index to judge the backwardness should be the poverty ratio as one of the avowed objectives of the five year Plan, is the eradication of poverty and assailment of full employment. The motion is too volatile to accept for ling the prospect for fewer States and stagnation for the majority. With alteration and adaption, the exiting framework of both the Finance Commission and the Planning Commission can accomplish the purpose.

The present, the dialogue between the backward States and the Centre reflects complete surrender or more confrontation, depending on the political equation between the Centre and the States. Sometimes it is more rhetoric than joint Quest, more and removal of inter-state imbalances is in danger of becoming lost for the meager satisfaction of political posturing.

India today is at cross roads. A cross road implies an opportunity to carry forward in the direction one has come, or to chance direction, I believe the nation will choose the other way. It the words of our Prime Minister 'Let us help them to lend their energies with unity and discipline in the grant Endeavour to reach rewards a brighter furure.[35]

Problems of Federal Finance in India

Gap between Needs and Resources of State Governments

The constitution provides for division of financial powers between the Centre and the States. However the revenue-raising capacity of the States is restricted because of the nature of taxes assigned to them. Since land is limited, the scope for increasing land revenue as also limited. Similarly, taxes on agricultural income, excise duties on intoxicants, taxes on motor vehicles, entertainments. Etc., are also comparatively less elastic than the taxes assigned to the Centre. Sales Tax is the only tax levied by the States which has substantial elasticity. Because of the economic progress registered by the country in the last three decades, the base of income tax, Union excise ditties, customs duties and other important Central taxes has expanded considerably. (This has given immense powers to the Central government to increase its resources with the passage of time. This structure of financial relations between the centre and the State governments- less elastic sources of revenue for the states and more elastic sources of revenue for the Centre- places the States at a distinct disadvantage. While demands on the states' resources are increasing rapidly because of the pressure of development services, especially in the field of social welfare.) There income has failed to increase correspondingly. Accordingly, **vertical imbalances have accentuated over the years and the dependence of the State governments on the Centre has considerably increased,** [36]

The Question of State Autonomy

This "strong Centre and the weak States" arrangement was introduced intentionally by the framers of the Constitution in a bid to stall the divisive forces operation in the economy. The partition and its after effects created a strong public opinion in favor of such an arrangement. The one- party rule at the Centre and the States further cemented this relationship and the role of the States became more a more secondary. As pointed out in the 'Document on centre-State Relations adopted by the West Bengal government in December 1979 the structure of the Indian Constitution is more unitary than federal. By vesting all residuary powers in the Center and by keeping 47 items in the concurrent list it strengthened the base of Central control and visited the Central government with practically unlimited powers to interfere in the governance of States. Though law and order is a State subject, the Centre has not hesitated in interfering in this field through the establishment of the Central Reserve Police the Border Security Force, the Industrial Security Force. Etc.

All these processes in the political field have considerably eroded independence of the States and their political and economic powers. Therefore, quite recently, demands for increase in State autonomy have been raised by various quarters, While no one denies the importance of a strong Centre for preserving the integrity of the nation. It is necessary to give a serious though to these demands. Grant of a certain amount of autonomy, at least n the sphere originally contemplated by the Constitution. is necessary to fulfill the democratic ambitions of the people. **A 'strong Centre' without 'strong states' is not conceivable.**

Reduced importance of the Finance Commissions

We have noted earlier that transfers through the Finance Commission (which is a statutory body) contribute only about one third of total transfers from the Centre to the States.This eans that about two-thirds of the transfers are channeled through the Planning Commission or the Central Government directly. For a considerable period of planning, the Planning Commission was not guided buy any objective criteria to determine the share of different States in its assistance and this introduced and aura of arbitrariness in the whole transfer mechanism. Since the Centre contributed a large amount of resources in the form of discretionary grants to the State, it acquired considerable powers to affect the decision- marking processes at the State level. This led to a further erosion of autonomy of the States.

Failure to Tackle the Problem of Regional Imbalances to Any Satisfactory Extent

The process of resource transfers through the planning Commission and the Finance Commission has failed in correcting the "horizontal imbalance" among the federation units and disparities in their per capita incomes are growing.[37] We have already noted that plan assistance is provided 70 percent in the form of loans and 30 percent in the form of grants. Since the ratio is a fixed one and does not discriminate between advanced and backward States, it amounts to discrimination against backward States. Since advanced States have a relatively better economic position they should be grant a greater percentage of resources in the form of loans while backward States should receive a larger percentage in the form of grants. Non-compliance to this common sense logic has resulted in a paradoxical situation where the comparatively richer States received a higher per capita grant than poorer States. For example, during 1969-70, rich States like Punjab and Haryana received a higher per capita grant than the

poor states like Uttar Pradesh, Madhya Pradesh, Bihar and Andhra Pradesh, Bihar with lowest per capita income also received the lowest per capita grant.

As far as transfers through Finance commission are concerned, **all Finance Commission sought to give due importance to backward States. However, there was no clear-cut bias in favor of backward States. The ultimate result was that advanced States cornered a major share of the actual devolution of resources from the Centre to the States in the awards of many Finance Commissions.** For example, the four advanced industrial states of Maharashtra, Gujarat, Tamil Nadu and West Bengal obtained more than one-fourth of total income tax transfers in the awards of many Finance Commissions. However, the distribution of proceeds from Union excise duties was more judicious.

All Finance commission give under importune to budgetary needs while deciding the allocation of grants-in-aid. They did not realize that advanced States could also incur large budgetary deficits (even deliberately at times) and qualify for larger grants -in-aid. This led to a paradoxical situation in some instances as richer States got more grants-in-aid as compared to poorer States.

The third constituent of resource transfer, viz., **discretionary grants is not guided by any distinct philosophy of helping the poorer States to a greater extent.** It is guided more by political considerations than by anything else. In any case, discretionary grants also so not seem to have helped the backward States more vis-as-vis the advanced States

Suggestions for Improvement

In suggesting any reforms in the federal finance structure, the above problems should be constantly kept in mind. It is also imperative to remember that the Centre-State financial relations form a part of Centre- State relations in general whose character is, to a large extent, political, **it is unfortunate that is this country, the question of state autonomy is raised mostly to gain political advantages and is not guided by sound economic logic as it should be.** Most of the political parties clamoring for State autonomy have narrow sectarian outlook. This is the basic reason why in this country 'regional' is viewed as something 'anti-national'. Selfish and corrupt politicians have stalled the process of true federalism. Therefore, a smooth and truly beneficial federal financing system in this country can evolve only when a true federal spirit develops, Since this is not foreseeable in the immediate future, a compromise has to be struck between a 'strong Centre' policy and 'State autonomy' demand. Politically the centre should remain strong but it should reduce its interference in the financial sphere of the States. To accomplish this, some of the steps that can be initiated in the first instance are:

1. The scope of the Finance commission should be enlarged considerably since it is a statutory body**.** This world reduces the interference of the Centre in the financial management of the States and the 'arbitrariness of discretionary grants' that accompanies such interference. In addition, it would reduce the atmosphere of suspicion and distrust in the States over the role of the Centre in federal finance system.
2. Some States have demanded the setting up of a permanent Finance Commission instead of one constituted on five years. This is sought to be justified on the following considerations:
   a. A permanent Finance commission would reduce the scope for the Central government to make discretionary transfers in an ad hoc manner to the States; and
   b. When a Finance Commission is appointed, it has to start on a clean slate, collect the material required for its work from the State governments and the Central government and then initiate such studies and analysis as it requires. A permanent finance commission (as the Australian Grants Commission in Australia) would be able to keep under review various aspects of the finances of the Centre and the State governments, special features of particular States, and the factors which affect their finances.

This suggestion did not find favor with the Seventh Finance Commission since it felt that if a permanent commission is set up, there might well be a tendency for member to be regarded as full- time employees of the Central government. This would be unhealthy from the point of view of the Commission's function vis-a-vis the State governments. Besides, under the present arrangement, new persons with a fresh approach and unbiased opinions can be inducted into the Finance Commission. On these grounds, the seventh Finance Commission did not support the idea of a permanent Commission. However, it called for the establishment of an expert non-political agency by the Central government to perform such functions as the Secretariat of the commission is expected to perform. In addition, it can be entrusted to play 'a watching and advisory whole' with regard to Centre-State financial relations generally.[38] The eighth Finance Commission and the Tenth Finance Commission advocated the setting up of a permanent Finance commission division in the Ministry of Finance, appropriately staffed, and with adequate technical expertise under a senior or ricer. Functions proposed for this Division are as follows:

1. To watch the implementation of the recommendations of the Finance Commission:
2. To watch closely and analyses the trends in the receipts and non-plan expenditure of the State government and identify the reasons for variation between actual and estimates made by the Finance Commission;
3. To monitor and evaluate the utilization of up gradation grants;
4. To preserve the records of the previous commissions, and take such necessary action to obtain future information as might be of use to the future commissions; and
5. To conduct studies and publish papers and data having a bearing on State finances.[39]

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Adequate Steps should be Undertaken to Narrow Down Inter-State Disparities by Adopting A Set of Criteria Distinctly Beaded in Favor of Backward States

This can be ensured by giving more weight age to backwardness reflected thought various economic and social indicators like per capita income, level of literacy, road length, administrative services, and hospital beds, Etc**.**

Main Take aways
Preserved fiscal space for Union : 38% of shareable pool + cusses & surcharges + non-tax revenues
Raised fiscal space for spending on Union List items
Met States complaints about tied, conditional, discretionary grant through compositional shift
Attempted enabling equal level of public services for equal tax price across country
Rationalized overlapping grants from multiple channels
Left fiscal space (15% of divisible pool) for CSS type grants for national priorities, externalities across States
New federal institution proposed to oversee such flows

Co-operative Federalism

To solve the Centre-State conflicts and promote co-operative federalism consistent with the national integration, the Indian Constitution, following the Australian Constitution, provides for a number of mechanisms. Certain extra-constitutional agencies also exist to help promote federal co-operation in India. Important provisions of the Constitution: Consultative Machinery. Under Art. 263, the President is empowered to constitute an ‘Inter-State Council’ for resolving the dispute arising between the Centre and the States and between the States inter se, so as to avoid the need to go through the judicial proceedings for the same. In June 1990, the Inter-State Council was formally constituted by the President. The Council is headed by the Prime Minister and includes six Union Cabinet Ministers, and the Chief Ministers of the States and two Union Territories (Delhi and Pondicherry). In 1996. A Sub-Committee was appointed to go into the Sarkaria Commission Report and suggest which of its recommendations could be adopted. Adjudicative Mechanism. Under Art. 262, the Parliament has passed the Inter-States Water Disputes Act, 1956 ~to adjudicate on any dispute or complaint with respect to the use, distribution or control of the waters of inter-State rivers or river valleys. Full Faith and Credit Clause. Art. 261, lays down that the final judgements or orders delivered or passed by the Civil Courts and not the Criminal Courts of one State shall be equally enforceable in other States, if they wish so. This is known as the ‘Full faith and credit clause’ Delegation of Executive Functions. Under Art. 258, the President is empowered to delegate some of the executive functions of the Union to the State with its (State's) consent. Under Art. 258 A, similarly, the Governor of a State may entrust, with the consent of the Government of India, any of the executive functions which exclusively fall under the State's jurisdiction. Immunity from Mutual Taxation. Art. 285 says that the property of the Union, property owned by a Government company or statutory corporation do not come under this, and is exempted from the State taxation, except if the Parliament by law provides otherwise. Similarly under Article 289, the State property and income is exempted from the Union taxation, except in the case of trade or business carried out by the State Government or on its behalf. This is basically not only to avoid unnecessary conflicts but also to create space for mutual co-operation between the Centre and the States.[40]

Although the Constitution of India has nowhere used the term 'federal', it has provided for a structure of governance which is essentially federal in nature. First of all, Constitution has provided separate governments at the Union and the States with separate legislative, executive and judicial wings of governance. Secondly, Constitution has clearly demarcated the jurisdictions, powers and functions of the Union and the State Governments. Third, Constitution has spelt out in detail the legislative, administrative and financial relations between the Union and the States.

Within this basic framework of federalism, the Constitution has given overriding powers to the Central government. States must exercise their executive power in compliance with the laws made by the Central government and must not impede on the executive power of the Union within the States. Governors are appointed by the Central government to oversee the States. The Centre can even take over the executive of the States on the issues of national security or breakdown of constitutional machinery of the State. Considering the overriding powers given to the Central government, Indian federation has often been described as 'quasi-federation', 'semi-federation', 'pragmatic federation' or a 'federation with strong unitary features'.

Indian federation should be seen in the context of its democratic system of governance at the national, state and local levels and the pluralities of its culture in terms of ethnic, linguistic, religious and other diversities which cut through the States. India is the largest democratic country as also the largest federal and the largest pluralist country of the world. While democracy provides freedom to everybody, federation ensures that governance is distributed spatially and a strong central government enables that the 'unity amidst diversity' is maintained and the country mobilizes all its resources to maintain its harmony and integrity and marches ahead to progress.

A strong Centre in India is therefore necessary for strong States and vice versa. This is the essence of cooperative federalism. So long as the central and governments were ruled by the same political party, the cooperative framework worked very well. Since the seventies when different political parties are in power in the centre and the states and more recently when coalition governments of national and regional parties are in power in the Centre, there are signs of stresses and tensions in intergovernmental relations between the Centre and the States.

Article 263 of the Constitution has provided for the setting up of an Inter-State Council for investigation, discussion and recommendation for better coordination of relation between the Centre and the States. The Zonal Councils set up under the State

Reorganization Act 1956 provide another institutional mechanism for centre- state and inter-state cooperation to resolve the differences and strengthen the framework of cooperation. The National Development Council and the National Integration Council are the two other important forums that provide opportunities for discussion to resolve differences of opinion. Central councils have been set up by various ministries to strengthen cooperation. Besides Chief Ministers, Finance and other Ministers have their annual conferences in addition to the regular meetings and discussions of the officials of the Centre and the States to share mutual concerns on various issues.

One of the challenges of Indian federation would be how best these mechanisms of cooperative federalism can be strengthened further to promote better coordination and cooperation between the Centre and the States.

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