

Constitutional Provisions and Centre-States Financial Relations with Indian Context in Present Scenario – A Critical Study

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Abstract

A federal economy is normally described by the development of uneven characters between utilitarian duties and financial assets of various levels of government. Vertical imbalances sources regarding assets and expenses rose between various levels of government requiring the exchange of assets from the Centre to the States. Along these lines, intergovernmental moves are an inalienable aspect of a staggered financial framework. In India, the Finance Commission establishes a significant channel of Central exchanges to the states. This paper takes a gander at the role of the Finance Commission with respect to the devolution of taxes between the Centre and the States from the distinct pool. Specifically, the paper centres on the Fourteenth Finance Commission FFC that has made sweeping changes in tax devolution that will move the nation towards more prominent helpful just as serious federalism.

Keywords: Finance Commission; Centre-state financial relations; Horizontal devolution; Vertical devolution.

Introduction

Federalism has always been evolved due to the diversities that are found in a country along with desire to bring these diversities into a single political whole. It is because of diversities of region, language, religion, culture, race etc. that the people of different communities and regions have tried to retain and preserve their own identities. At the same time there is a desire for Union for military and economic advantages. Thus there are two things for the formation of a federal political system. First, there is a will to have a Union that the component units would be inspired and bound together by common ties of national affinity and sentiments. Secondly, the units joining the federation are permitted to maintain their own separate identity. A federation is a union of states and it is generally the result of two kinds of forces viz. (i) centripetal and (ii) centrifugal. A federation appears because of centripetal forces when the autonomous forces consent to hold hands and in this manner make another state. For example, in the United States as well as in Australia, federations were formed by the existing colonies joining their hands together to form the Union. Similarly, a unitary government is changed into a federal government because of radiating forces when the units request a huge proportion of independence which can be given uniquely in a federal structure. This is what was done in India when the country split up into smaller units based on political, economic, linguistic and other differences and the units demanded a greater autonomy. Thus a federation is conceived mainly to maintain a balance between fractionalisation which on the one hand, erodes central authority and on the other over-centralisation which destroys autonomy of units.

To maintain a better federal relationship between the component units and the federation, the sovereign power is divided between the centre and the states which exercise their powers in their respective allotted sphere. Hence, in a federal system, the powers of the Government are divided between a Government of the whole territory of the country and the Governments of the constituent units. All the governmental powers belong to the constitution and the constitution

Divides these powers between the central government and the state governments. Hence neither of the government receives power from the other, nor is subordinate to the other.

However, the Union-State relationship in a federation is a sensitive subject. There is always a possibility of conflict of jurisdiction and clash of wills between the centre and the states even at the best of the times. The major problem revolves round the question of distribution of power between the centre and the states and over centralization versus decentralization. Particularly, in this new era, with the advent of liberalism and neo-liberalism, the state has become a welfare and service state leading to nationalization of sentiments. All these led to a defector concentration of powers in the centre and this has greatly disturbed the federal balance.

When we examine the federal balance of a country, it is generally found that, of all the relations between the centre and the states, the financial relation is the most complex and complicated one. Finance becomes the crux of the problem for maintaining balance of power between the centre and the states. The financial relations between the centre and the states sometimes leads to over centralization of power of the centre, sometimes to the demand for more autonomy of states and sometimes leading to the healthy relation between the centre and states leading to cooperation and coordination between the two. The slow development of the states, inequality of the states, vertical and horizontal economic imbalance between the states are usually claimed to be the contributions of the distributions of financial power between the centre and the states.

In India too, having a federal set up, there is today an imperative need to look objectively and dispassionately into the problem of Union-State relations in all its ramifications, to identify the areas of tension and dissension. Of such tensions, the core of dispute is resources or to say Union-State relations in the field of finance which have come under severe strain in India. It is usually believed that in a federation, the Units should have adequate resources to discharge their functions and responsibilities. But in no federation of world, it has been possible to provide for allocation of resources corresponding to allocation of functions. Therefore, the states have to depend upon the financial assistance from the federal government. , Such dependence not only affects the autonomy of the states but also becomes a source of constant friction between the Union Government and State leading to vertical imbalance as well as creates inequality among the state's leading to horizontal imbalance. Hence one of the primary objectives of financial assistance from Central Government to State Government i.e., the devolution and transfer of resources from the national to sub-national levels is to smooth the fiscal imbalance between the Union Government and State Governments and among the State Governments. While major taxes are assigned to the Central Government, most of the responsibilities

of growing expenditure are entrusted to the State Governments, which in turn lead to vertical fiscal imbalance. On the other hand, the capacity of the state to rise owns resources are not uniform because of variations in their tax base and socio-political conditions. In addition to this the cost and demand level of certain assigned expenditure responsibilities differ across States. Under these circumstances, horizontal imbalance among the State Governments is a normal feature in Indian federation. Both these imbalances are redressed through inter-governmental financial resource transfer or borrowing by deficit jurisdictions or a combination of the two. For that, India has made bold effort from time to time to deal with such complex issues involved in the allocation of resources. Elaborate provisions like establishing of Finance Commission, Planning Commission, National Development Council and others have been made in the country to deal with federal financial relations. Besides, a brief survey of the evolution of federal financial relations until the Constitution came into force gives an idea about the changing needs and demands of federating units from time to time.

Aim of the Study

When the Constitution was framed and a federal set-up began to function in India, there was no equality of States. States were dissimilar in their territory, population, social structure and above all economic development. Financial inequality among the States was most perceptible because of the existing horizontal economic imbalances among the states. So, since the inception of the Constitution, the Government of India is trying to bring the economic equality among the regions and the states by establishing the Finance Commissions, Planning Commissions, National Development Council etc. as per the provisions of the Constitution. But after more than fifty years of the operation of the Constitution, the financial inequality among the states still persists. So the question emerges where the fault lies for which some states are not developing up to the standard, they lag behind other states and the undeveloped and developing states are becoming prey to disturbances of peace and order leading to regional discontents, disunity and secessionism. National Unity, integration and development become disturbed. All these constitute the major problems of the present study. In order to identify the specific financial issues emerging in India, in this study, we have made an attempt to study the financial provisions of the Constitution of India and their working till the end of the twentieth century. So that, we could know where the fault lies in the constitutional provisions and their working and suggest the remedies for the maintenance of a healthy federal financial balance as well as speedy development of the country.

Review of Literature

A number of books and articles in journals have already been published dealing with theoretical problems and functional issues of federalism. On evolution of federal institutions in India several studies have been made by scholars

like A.B. Keith, A Constitutional History of India (1936), A.C. Banerjee, The Constituent Assembly of India (1947), C.H. Alexandrowicz, Constitutional Development in India (1951), B.N. Rau, India's Constitution in making,(1960), K.R. Bombwal, The Foundation of Indian Federalism (1967), P.K.Sharma, Federalism and Political Development (1979), H.R. Khana, The Making of India's Constitution, (1981) and Dr. Chandra Pal, State Autonomy in India, and Federalism: Emerging Trends (1984). The book titled, The Framing of India's Constitution: A study, (1968) is edited by a group of authors under the Chairmanship of B. Shiva Rao. It deals with the historical background of the evolution of federalism in India starting from Regulating Act of 1773 to Government of India Act, 1935.

A number of literatures have come out dealing with several issues, processes and functioning of federalism in India. Amal Ray in his book titled Inter Governmental Relations in India (1966) describes the powers and jurisdictions of both the Central and State Governments and the pattern of relationship between them arising from their autonomous powers and jurisdiction under the constitution. The same author elaborates the political process shaping the Indian Federalism in his book titled Tension Areas in India's Federal System (1970). Similarly a number of scholars like K. Santhanam Union-State Relations in India (1964), C.H. Alexandrowicz Constitutional Development in India (1957), A.G. Noorani, Centre-State Relation in India (1972) and many others have done the study of federal institutions in India and their study is purely institutional. Prof. Sharada Rath in her book Federalism Today, Approaches, Issues and Trends, (1984) makes a detailed discussion on various theories and approaches to federalism and in that context she made an extensive study of various issues and trends in federalism in India.

Raj Kishore Sinha in his book named Evolution of Fiscal Federalism in India, 1981, analyses the nature of federalism in India and evolution of fiscal federalism. In this book he has made an attempt to bring to the notice the different steps taken towards greater 'centralisation in India particularly in the field of finance.

A.K. Singh in his book Finance Commissions in India: An Analytical Study (1991) has studied extensively the role of Finance Commission starting from the First Finance Commission to Eighth Finance Commission and made an elaborate review of the working of these Commissions in bringing balance in Centre-State relations. He has analysed the rationale of Centre-State relations in India.

A.K. Gour in his book Centre-State Financial Relations and Finance Commission has studied about the historical development of Centre-State Financial relations in India. He examines the existing constitutional arrangements for the inter-governmental financial transfer and the role of

different Finance Commissions affecting these transfers.

M.M. Sury has studied about Centre-State relations in his book titled Fiscal Federalism in India (1998). This book provides a detailed description and analyses of the evolution and the present nature of Centre-State -financial relations in India. It examines the existing arrangements for inter-governmental financial transfer, the role of the Finance Commission and Planning Commission in effecting these transfers, particularly the principles followed by these agencies for reducing vertical and horizontal imbalances in the availability of resources. Current problems and controversies besetting Centre-State financial relations are highlighted by the author from various view points.

The book Fiscal Federalism: Theory and Practice (1996) is written by M. Govind Rao and Tapas K. Sen. This book mainly examines the historical political and economic factors behind the federal arrangements in India. Particularly, it studies about the fiscal arrangements and authors apply both economic principles and political knowledge to suggest feasible reforms to enhance the system's efficiency. Further, the authors have put stress on the nature and consequences of vertical and horizontal fiscal overlapping or imbalances in India and conclude with an outline of priority policy and institutional reforms in inter governmental relations.

M. Govind Rao has studied about the Centre-State resources transfer in the book Federalism in India: Political Economy and Inter-Governmental Reforms (2002). The author has studied about the challenges of reforming policies and institutions of Indian Federalism. The author has made a historical review of Indian Federalism dealing with the process of bargaining and compromise, control and commitment of dimensions of federal governance. He studies about the political economy of Centre-State transfer of resources in India. He has also made a study of pattern of Indian Federalism in context to global environment.

M.J.K. Thavaraj in his book (2003) Financial Administration of India has studied that financial system and its operation is an important aspect of public administration. It is one of the potent instruments for concretizing the objectives of administration and aspiration of the people. He has examined how the 89th Amendment to the constitution, acceptance and implementation of the recommendation of the Eleventh Finance Commission, constitution of the Twelfth Finance Commission, recommendation of the Kelkar taskforce on direct taxes and indirect taxes have provided important guideline for bringing about significant changes in the financial administration in India.

Indira Rajaraman in the book titled, A Fiscal Domain of Panchayat, 2003, explains about the finances of Panchayats in India. This book is the first of its kind on the treatment of the third tier of the

government i.e. Panchayats and their finances as contrasted with urban local body finances.

Financial Relations

Any honest and unprejudiced observer can have almost certainly that having respect to the developing duty of the states the dissemination of taxes and revenues is exceptionally unjustifiable to the states excessively good for the centre. Taxes on salary are demanded and gathered by the government of India and appropriated between the union and states, however the articulation taxes on pay do exclude corporation taxes. Corporation tax implies a tax on a salary which is payable by the companies and for which no credit is given to the investors who get profits from the companies. Because of changes made by the Finance Act 1959, all salary tax paid by the restricted companies should now be treated as corporation tax and subsequently, the states are not qualified for any portion of it. Union duties of extract might be shared between the union and states, however "in the event that the main parliament by law so gives". The administrator of the fourth finance commission alluded to the chance of making a protected amendment putting extract duties on a similar balance as the salary tax that is making extract duties additionally detachable between the union and states. In any event, when a tax or duties is mandatorily detachable between the centre and states, the union has the option to impose a surcharge, on salary tax only with the end goal of the union. States must be given a lawful right to a bigger offer in the tax revenues gathered by the centre as opposed to having depended upon the optional magnanimity of the union under article 282. The scheme of allocation of centre –state taxing power though designed with many considerations in view – convenience, simplicity, economy, and uniformity, yet fails to create an equilibrium between responsibilities and resources at the state level .Most of the lucrative sources of taxation lie with the centre .Moreover ,the centre has whole country to tap and can tax the taxing capacity existing anywhere in India .On the other hand ,while the fiscal needs of states are huge ,because of their responsibility to provide for development ,welfare and social service activity like education housing, health, agriculture etc., for which there is insatiable demand in the country, their revenue raising capacity is cabined due to many reasons ,some of which are ;

1. The financial condition dominant inside their limits;
2. The fact that they need to impart their taxing forces to the neighborhood governments; and, by their taxing force being fairly inelastic.

The Constitution provides for a financially strong centre so much so the States are almost totally dependent on the Union. The outstanding feature of Indian finances is that most of the resources accrue to the Union and out of these some are transferred to States.

Scheme of Distribution of Revenue

Article 268 gives the plan of the circulation of revenue between the Union and the States. The States have select ward over taxes specified in the State List. The Union is qualified for the returns of the taxes in the Union List. The Concurrent List incorporated no taxes. In any case, while the

returns of taxes inside the State List are altogether held by the States, continues of a portion of the taxes in the Union List be allocated, entirely or incompletely, to the States. The Constitution makes reference to four classes of Union taxes, which are completely or mostly doled out to the States:

1. Duties Levied by the Union yet Collected and Appropriated by the States. As per Art. 268 stamp duties and duties of extract on restorative arrangements referenced in the Union List are levied by the Central Government. These duties are gathered by the states inside which such duties are leviable. The returns of such duties are allocated to the States.
2. Taxes Levied and Collected by the Union yet allotted to the States. As per Art. 269 (1) duties in regard of progression to property other than farming area, (2) estate duty in regard of property other than rural land, (3) terminal taxes on merchandise or travelers conveyed by railroad, ocean or air, (4) taxes on railroad passages and cargo and so on.
3. Taxes levied and gathered by the Union and appropriated between the Union and States. As per Article 270 salary tax excluding corporation tax is levied and gathered by the Union and is circulated between the Union and the States. In the wake of deducting some ascribed to the Union domains and to the Union payments an endorsed level of the taxes are dispersed among States in such way as might be recommended by law.
4. Taxes levied and gathered by the Union and possibly circulated between the Union and States. During other than those on restorative and latrine arrangements are referenced in the Union List are levied and gathered by the Union and whose net continues might be shared between the Union and the States.

The Union Government can obtain cash on the security of the Consolidated Funds of India. State Government needs to obtain the consent of the Centre to raise credits. The centre has forced to grant credits and grants-in-aid to the States. The President appoints a Finance Commission like clockwork to instruct him regarding the dispersion with respect to assets between the Union and the States and other related issues.

Further, the President appoints the Comptroller and Auditor-General of India, who determines the way were the accounts. During a Financial Emergency, the Centre can require the States to decrease the compensations of its workers and direct them to hold all the Money bills for its endorsement.

101st Constitutional Amendment Act: Goods and Services Tax

There are a few articles in the constitution of India which define the financial relations among Union and States. Since GST bills involve an enormous interest of the state governments, such an authentic tax change can't occur without making reasonable changes into the constitution. For this reason, the 101st amendment of the constitution was passed. This act got the consent of the

President of India on eighth September 2016 and came into power on July first 2017. The significant changes made in the constitution (new articles/amended articles) through this law are as per the following:

Article 246 (A)

This is a new article inserted in the constitution. It says that:

1. Notwithstanding anything contained in articles 246 and 254, Parliament, and, subject to clause (2), the Legislature of each State, have the ability to make laws concerning goods and services tax forced by the Union or by such State.
2. Parliament has the selective capacity to make laws concerning goods and services tax where the gracefully of goods, or of services, or the two happens throughout inter-State exchange or trade.

Notable Points from Article 246A

Both Union and States in India presently have "simultaneous powers" to make law concerning goods and services.

The intra-state exchange currently goes under the locale of both centre and state; while inter-state exchange and trade are "exclusively" under central government purview.

Article 269A

This is a new article which reads as follows:

1. Goods and services tax on provisions throughout inter-State exchange or business will be levied and gathered by the Government of India and such tax will be allocated between the Union and the States in the way as might be given by Parliament by law on the proposals of the Goods and Services Tax Council.
2. The sum allotted to a State under clause (1) will not frame part of the Consolidated Fund of India.
3. Where a sum gathered as the tax levied under clause (1) has been utilized for the installment of the tax levied by a State under article 246A, such sum will not shape part of the Consolidated Fund of India.
4. Where a sum gathered as the tax levied by a State under article 246A has been utilized for the installment of the tax levied under clause (1), such sum will not shape part of the Consolidated Fund of the State.

Notable Points from Article 269A

This article says that if there should be an occurrence of the inter-state exchange, the tax will be levied and gathered by the Government of India and shared between the Union and States according to the suggestion of the GST Council.

The article also clarifies that the returns such gathered won't be credited to the merged asset of India or state yet particular offer will be doled out to that state or centre. The purpose behind the equivalent is that under GST, where the centre gathers the tax, it relegates the state's offer to state, while where the state gathers the tax; it doles out centre's offer to centre. If that proceeding

is saved in Consolidated Fund of India or state, at that point, each time there will be a need to pass an allocation tax. Hence, under GST, the allocation of the tax revenue will occur outside the Consolidated Funds.

Article 279-A

This article accommodates the constitution of a GST gathering by the president within sixty days from this act coming into power.

The GST council will be empowered to take decisions on the following:

1. The taxes, cesses and surcharges levied by the Union, the States and the nearby bodies which might be subsumed in the goods and services tax;
2. The goods and services that might be exposed to, or absolved from, the goods and services tax;
3. Model Goods and Services Tax Laws, principles of duty, allocation of Integrated Goods and Services Tax and the principles that administer the spot of flexibly;
4. The edge breaking point of turnover underneath which goods and services might be absolved from goods and services tax; The rates including floor rates with groups of goods and services tax;
5. Any exceptional rate or rates for a specified period, to raise extra assets during any normal catastrophe or fiasco;
6. Special provision with respect to the States of Arunachal Pradesh, Assam, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand; and
7. Any other issue relating to the goods and services tax, as the Council may choose.

All choices taken at the GST board will be taken dependent on voting. The cycle of voting is plainly expressed in detail in the constitutional amendment bill.

Other Important amendments in existing articles

The residuary intensity of enactment of Parliament under article 248 is presently liable to article 246A.

Article 249 has been changed so that if 2/3rd larger part goal is passed by Rajya Sabha, the Parliament will have forces to make vital laws regarding GST in the public interest.

Article 250 has been amended so parliament will have forces to make laws identified with GST during the crisis time frame.

Article 268 has been amended so that extract duty on medicinal and latrine arrangement will be excluded from the state list and will be subsumed in GST.

Article 268A has been cancelled so now service tax is subsumed in GST.

Article 269 would enable the parliament to make GST related laws for inter-state exchange/trade. Further, the amendment has also given that Parliament will, by law, on the suggestion of the Goods and Services Tax Council, accommodate remuneration to the States for loss of revenue

arising by virtue of usage of the goods and services tax for a time of five years. This brought about the Compensation Cess Bill.

An assessment of centre-state relations

A critical examination of the legislative, administrative and financial relations makes it exceptionally certain that under the Indian federal framework the Centre has been allocated a predominant role. The States are vigorously needy upon the Union Government. The Constitution has some conspicuous unitary highlights. These are; _ (a) a single Constitution both for the Centre and the States, except for Jammu and Kashmir; (b) a significant aspect of the Constitution can be amended by the parliament alone and the restrictive right of the Parliament to propose amendments; (c) arrangement for single all-India citizenship except for Jammu and Kashmir; (d) the power of the Parliament to change the name, an area or limit of States without their consent; (e) the appointment of the legislative head of a State by the President and his functioning as the operator of the Centre; (f) a unified legal executive both for the Centre and the States with the Supreme Courts at the apex; (g) the portrayal of the States in the Rajya Sabha depends on the number of inhabitants in a State. In this way there is an inconsistent portrayal to the State in the Rajya Sabha; (h) the presence of all-India Services whose appointment is made by the Centre; (i) the power of the Centre to force President rule on States and declaration of public and financial crises; (j) the right of the Parliament to administer on subjects in State List under certain conditions; and (k) single election machinery to conduct elections to the Parliament and State Legislatures. Therefore, a few pundits have considered India a centralized federation. Apparently, the Constitution producers imagined a "co-operative federalism" in which the Union finishes the States ought to collaborate with one another for the common good.

Residuary power and taxation

All residuary powers are with the Union Parliament. The Sarkaria Commission on Centre-State relations, which presented its report in 1987, needed the residuary powers in taxation to be retained with the centre and not moved to the States, despite the fact that it embraced the Supreme Court's interpretation that these powers can't be so expansively interpreted as to weaken the power of the State lawmaking bodies.

The Sarkaria Commission contemplated that the Constitution-creators didn't include any section relating to taxation in the Concurrent List to keep away from Union-State contacts, twofold taxation and frustrating case. The Commission said that the power to tax may be utilized not exclusively to raise assets yet, in addition, to control economic activity and giving the power to states may bias public interest. A few states request that the residuary powers, including those of taxation, be vested in the States. The States contend that they need taxation powers in request to prepare assets to meet their formative needs.

Other than sharing of taxes between the Centre and the states, the Constitution accommodates grants-in-aid to the states from the Central assets.

There are two types of grants-in-aid, viz, statutory grants and discretionary grants:

Statutory Grants

Article 275 empowers the Parliament to make grants to the states which need financial help and not to each state. Also, different entireties might be fixed for different states. These aggregates are charged on the Consolidated Fund of India consistently.

Aside from this general arrangement, the Constitution also accommodates specific grants for promoting the government assistance of the planned clans in a state or for raising the degree of administration of the booked zones in a state including the State of Assam. The legal grants under Article 275 (both general and specific) are given to the states on the recommendation of the Finance Commission.

Discretionary Grants

Article 282 empowers both the Centre and the states to unveil any grants for any reason, regardless of whether it isn't within their separate legislative competence. Under this arrangement, the Centre makes grants to the states on the recommendations of the Planning Commission—an extra-constitutional body.

"These grants are also known as optional grants, the explanation being that the Centre is under no commitment to give these grants and the issue exists in its caution. These grants have a two-crease reason: to help the state financially to satisfy plan targets; and to - give some influence to the Centre to influence and coordinate state action to effectuate the public. Notably, the optional grants structure the bigger aspect of the Central grants to the states (when compared with that of the legal grants). Subsequently, the Planning Commission has accepted more noteworthy significance than the Finance Commission in Centre-state financial relations.

Other Grants

The Constitution also accommodated the third kind of grants-in-aid, yet for a brief period. In this manner, an arrangement was made for grants in lieu of fare duties on jute and jute items to the States of Assam, Bihar, Orissa and West Bengal. These grants were to be given for a time of a long time from the commencement of the Constitution. These sums were charged on the Consolidated Fund of India and were made to the states on the recommendation of the Finance Commission.

Conclusion

The Central Government continues to be solid and continues to maintain its pre-eminence; endeavours are in progress to fortify the States through different federal components. It was envisioned that the arrangement of coalition-administration at the Central level by giving direct portrayal to incredible territorial gatherings and ensuring their involvement in the dynamic

on National issues was a sound advance to easing of pressures between the federal government and the States. Finance Commission constitutes a significant instrument of Central exchanges to the States. The soul behind the FFC recommendations is to increase the programmed moves to the states to give them more financial self-sufficiency and this is guaranteed by increasing the portion of states from 32 to 42 per cent of the distinguishable pool. Nonetheless, there is concern that monetary space or financial consolidation way of the Centre would be antagonistically influenced. FFC has made expansive changes in tax devolution that will push the country toward more noteworthy monetary federalism, conferring more financial self-governance on the states. This will be improved by the FFC-induced basic of having to diminish the size of other central exchanges to the states. All in all, states will currently have more noteworthy self-governance on the revenue and use fronts.

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