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Niranjan Sahoo

OBSERVER RESEARCH FOUNDATION

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About the Author

Dr. Niranjana Sahoo is a Senior Fellow with vast experience on issues concerning public policy and governance. At ORF, he has been handling studies and programmes on democracy, campaign finance, human rights, federalism, decentralisation and cross-cutting issues of equity, access and inclusion. A recipient of Ford Asia Fellow, Dr Sahoo is currently a South Asia expert for *The Rising Democracies Network*, under the Carnegie Endowment for International Peace, Washington, D.C. He holds a PhD in Political Science from University of Hyderabad, Andhra Pradesh.

Centre-State Relations in India: Time for a New Framework¹

Introduction

The success or failure of any government in Delhi depends largely on its ability to manage the federal arithmetic. In the country's existing federal structure, many core economic activities and service delivery functions are carried out by the states while the Centre provides broad economic and political directions. Prime Minister Narendra Modi understands these complexities well, having served as the Chief Minister of Gujarat for 12 years. After a landslide victory in the May 2014 elections, he has on occasions stated that his government is serious about restructuring Centre-state relations and strengthening the principles of “cooperative federalism.”² The strongest statement of intent in this regard was made when the new government announced the dissolution of the Planning Commission, an institution often perceived as a symbol of Centre's domination. Another major development was the government's acceptance of the recommendations of the Fourteenth Finance Commission (FFC), raising devolution of central taxes to states to a mammoth 42 per cent.³ While this may seem to be a good beginning, there is still a long way to go to overcome the several challenges facing Centre-state relations.

It needs to be recalled that Centre-state relations faced major hurdles during the ten years of United Progressive Alliance (UPA) rule. Notwithstanding the Common Minimum Programme that sought better coordination with states and regional partners, the UPA coalition

was largely unsuccessful in garnering the support of states and failed to walk the talk on its much promised “cooperative federalism.” The Centre and states were repeatedly at loggerheads on a number of issues, including national security, economic policies, creation of new states and even foreign policy matters. This was starkly reflected in the failure to reach an agreement on crucial economic issues such as the Goods and Services Tax (GST) and foreign direct investment in retail.

More glaring was the failure to reach a consensus on ensuring internal security: the Centre's proposal for setting up a National Counter Terrorism Centre (NCTC) was outrightly rejected by state leaders. In this context, this paper attempts to capture some of the key challenges facing Centre-state relations. It assesses the major shifts that have occurred in India's federal system in the last three decades, particularly those that have necessitated a major restructuring of certain federal principles. Finally, the paper provides a comprehensive list of recommendations to improve Centre-state relations in India.

Changing Centre-State Relations: The Key Triggers

Three cross-cutting developments, namely the rise of regional political parties, globalisation and liberalisation of the economy and judicialisation of the federal process have deeply influenced the manner in which the concept of federalism is perceived today from what was originally envisaged by the framers of the Indian Constitution. These triggers have brought federalism under a new spotlight, even as tensions between the Centre and states over crucial issues continue to rise. The following sections assess the factors that have had a serious bearing on Centre-state relations and the overall federal power-sharing framework in the country.

Rise of Regional Parties

The rapid decline of the Indian National Congress (INC) in the 1960s led to an upsurge of regional politics and brought key principles of federalism under intense scrutiny. The dramatic collapse of one-party dominance or “the Congress System”⁴ and the simultaneous rise of coalition governments and regional parties triggered a dramatic shift in federal relations, resulting in states gaining a greater voice and more political autonomy. The mushrooming of regional parties⁵ and emergence of new political players led to a decisive shift in the country's electoral equations.⁶ In each general election since the 1980s, the vote share of regional parties has gone up – from less than 20 percent in 1984, it now hovers anywhere between 48-53 percent. In the 2009 general elections, regional parties captured a staggering 53 percent of the total vote share.⁷ Despite the massive mandate given to the Bharatiya Janata Party in the May 2014 Lok Sabha elections, national parties received just about 52 per cent of the vote share.⁸

The rising influence of regional parties is apparent from the critical role they have played in government formation at the Centre since 1989. Every government at the Centre since then (including the incumbent NDA government), has had to take the support of regional parties to remain in power. Since 1999, more than 20 parties have been sharing power at the Centre. Hence, where political power is concerned, the centre of gravity has shifted considerably towards the states and regional parties. Despite the BJP's majority in the Lok Sabha, it depends heavily on regional parties as they currently dominate the Upper House of Parliament. The net outcome of these changing political equations is that the existing principles which govern Centre-state relations are increasingly being contested by the regional players. Matter related to

foreign policy and national security—once considered exclusive Central Government domains—are now increasingly being contested by regional parties.

Liberalisation and Globalisation of the Economy

The most decisive shift in Centre-state relations began with the onset of liberalisation and formulation of the New Economic Policy (NEP) by the Centre in 1991.⁹ The shift from a public sector-dominated economy based on import-substitution industrialisation to a private sector-dominated market economy dramatically changed the dynamics of Centre-state relations.¹⁰ Private sector investments began flowing directly into states and market mechanisms determined development factors like infrastructure and services at the state level. However, market economy reforms have resulted in paradoxical outcomes with a direct bearing on Centre-state relations.¹¹ While market reforms have given states more autonomy and helped them to reap economic benefits, the hold of the Centre over the states has weakened leading to fissures in the country's federal structure. Economic liberalisation has brought unprecedented prosperity to some states that once depended on Central grants and concessions; these states, including Gujarat, Tamil Nadu and Maharashtra, are now asserting themselves in the economic sphere, charting out their independent course on development issues and rarely consulting the Centre on economic matters.¹²

Judicialisation of Centre-State Relations

The decentralisation of federalism (largely favouring states¹³) has been further aided by the role played by an “activist”¹⁴ judiciary since the early 1990s. While in the *Keshavanand Bharati vs. Union of India* case¹⁵ the

Supreme Court declared federalism as the “basic structure” of Indian Constitution, in the famous *S.R. Bommai vs. Union of India*¹⁶ verdict it put an end to the misuse of Article 356¹⁷ that gives the Centre far-reaching powers on dismissal of state governments. The latter judgement dramatically tilted the federal scales in favour of the states. Many other judgements have also gone in favour of states¹⁸ but it was the *Bommai* ruling that was the game-changer in Centre-state relations. In one stroke, the apex court made it nearly impossible for the Union Government to impose President's rule in a state. The judgement, which came in the backdrop of rising regional political players and weak coalition governments at the Centre, fundamentally altered Centre-state relations with long term consequences.

Major Areas of Centre-State Discord

These developments added new dimensions to Centre-state relations, brought newer stresses and tensions in federalism and opened up a fresh debate on issues, ranging from fiscal federalism and regulation to national security and foreign policy. The following sections analyse some of these pressures that have strained Centre-state relations in the past few decades.

Fiscal Relation: Mother of all Federal Battles

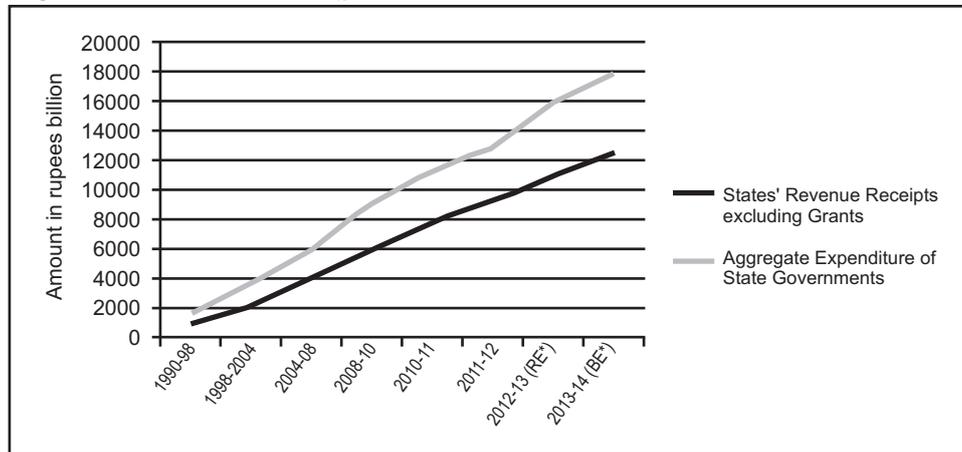
The major point of contention between the Centre and states is over fiscal jurisdiction. For a long time, states have been contesting the Centre's unilateral and supreme control over issues of taxation and resource sharing, but to no avail. However, with successive coalition governments at the Centre and rise of regional parties, states are in a much stronger bargaining position.

By constitutional design, the Union is vested with key powers on financial matters for reasons of monetary stabilisation and distribution.¹⁹ For instance, the Centre alone is constitutionally empowered to regulate the money supply, contract foreign loans, charge income tax on non-agricultural income and on services, or collect import and export duties.²⁰

On the other hand, states have been vested with limited tax powers mostly in non-lucrative areas,²¹ despite having maximum expenditure responsibilities. On average, states raise about 38-40 percent of total current revenues (see Figure 1), while they incur on an average 58-60 percent expenditure in a range of areas, including education, health and law and order. Thus, vertical fiscal imbalance (limited tax bases with maximum expenditure responsibility) is inbuilt in the original constitutional design.

Therefore, most revenues of the states come through the transfers made by the Finance Commission (FC), transfers from the erstwhile Planning Commission (PC) and transfers from central ministries (see Table 1). Of course, these transfers are in the form of loans and grants to the states.²² On average, states get around 38 percent through intergovernmental transfers which is not adequate to cover their entire development expenditure.²³ However, such central transfers are likely to witness a major transformation in the wake of FFC recommendations.

Figure 1: Revenue and Expenditure of States



Source: State Finances, The Reserve Bank of India

Table 1: Percentage Composition of Revenue Transfers from the Centre to states

Period	Finance Commission Transfers			Other Transfer			Total Transfers (4+7)	Transfers as a percentage of GDP
	Share in Central Taxes	Grants	Total Finance Commission	Plan Grants	Non-plan Grants	Total other Transfers (5+6)		
1	2	3	4	5	6	7	8	9
Eighth (1984-89)	53.48	6.65	60.13	35.80	4.07	39.87	100.00	4.83
Ninth (1989-95)	52.98	8.48	61.46	35.91	2.63	38.54	100.00	4.89
Tenth (1995-2000)	62.06	6.55	68.61	29.52	1.87	31.39	100.00	4.09
Eleventh (2000-2005)	58.38	11.00	69.38	28.65	1.97	30.62	100.00	4.16
Twelfth (2005-10)	56.48	11.55	68.03	28.55	3.43	31.97	100.00	5.21
2005-06	57.00	14.95	71.94	25.36	2.70	28.06	100.00	4.69
2006-07	57.93	13.47	71.40	25.54	3.05	28.60	100.00	5.11
2007-08	58.82	10.21	69.02	27.69	3.29	30.98	100.00	5.46
2008-09 (RE)	56.04	9.69	65.74	30.92	3.34	34.26	100.00	5.37
2009-10 (BE)	53.62	11.22	64.84	30.88	4.28	35.16	100.00	5.23

Source: Basic data from Indian Public Finance Statistics, Union Finance Accounts and Central Budget documents (Punchhi Commission Report 2010, Government of India)

Problems with Inter-governmental Transfers

While the distribution of fiscal powers between the two principal constituent units is nothing unusual and largely in sync with major federal models,²⁴ it is intergovernmental transfers that complicate the matters. Among the key instruments navigating the federal transfers, the FC handles over 2/3rd of total federal transfers. The FC's approach to transfers is based on (i) estimating the overall budget available as per the total resource requirement of the Union and the states; (ii) assessing the current revenues and non-plan expenditures of states; (iii) estimating the proportion of Central tax proceeds to be assigned to the states and allocation of these among them; and (iv) providing Grants-in-Aid to close any gaps between non-plan current expenditures and revenue.²⁵

While the FC's approach to transfers remains formulaic in nature, the criteria governing the quantum of transfers keeps changing with every new commission. For instance, while all commissions take into account mainly population, income, geography, tax efforts, and fiscal discipline in determining percentage of transfers to respective states, new methods and instruments²⁶ to bring greater parity among states have mostly remained a “gap filling” exercise.²⁷ Further, the transfers made by the commissions (on the basis of factors like fiscal capacity distance and index of fiscal discipline) are not designed specifically to offset fiscal disadvantages of the states arising from lower revenue raising capacity and higher unit cost of public service.²⁸ The states however must accept they have failed to build capacity and come up with serious initiatives to increase revenue from these assigned sources.²⁹

The Finance Commission is still doing a decent job as far as the redistribution of resources goes. But given that the FC's transfers are restricted to tax devolution and grants to cover non-plan current

expenditure, it is unable to bridge inter-state inequality, which gathered (see Appendix 1) greater pace in the decades following economic liberalisation.³⁰ Further, with non-formulaic allocations receiving greater credence in the recent years,³¹ the FC's constitutional primacy as a statutory agency to disburse transfers has taken a sharp decline.³² In addition, much of the good work of the Finance Commission with regard to equalisation and fiscal balance among the states has been negated by other channels of transfer particularly the erstwhile Planning Commission.

The Planning Commission, disbanded recently by the National Development Alliance (NDA) government, was the largest contributor to the chaos and confused nature of Centre-state relations. The PC's transfers were in the forms of grants and loans to states. Like the FC, the PC too disbursed funds mostly on the basis of a formula³³, albeit with plenty of room for discretion. While it had employed the Gadgil formula since 1969 (later renamed as Gadgil-Mukherjee formula³⁴), its formulae were often arbitrary and susceptible to manipulation. For instance, the rationale for 30 per cent funds to the special category states had no explicit basis.³⁵ Given considerable resources were involved, state after state had been demanding the special category status to avail generous grants and tax concessions from the Centre.

The major disruption to fiscal federalism has come from the steady rise of discretionary transfers. It must be noted that all central sector schemes (run by different central ministries) and a plethora of Centrally Sponsored Schemes (CSS) run by the Central government used to be administered through the PC. It was here that the PC enjoyed huge amount of discretion while allocating such scarce resources.³⁶ Much of central assistance has been in the form of non-plan expenditure mainly

determined by the PC to run CSSs. These grants (see Table 1) are transferred in a discretionary manner and mostly governed by political considerations of the Centre.³⁷ In fact, a number of Chief Ministers of opposing parties had accused the Planning Commission of 'bias' and acting as 'super bully' in telling states what to spend and how to spend their finances.³⁸ Such tendencies, especially the discretionary route had led to considerable erosion of fiscal federalism and growing disenchantment among the regional leaders.³⁹

The problem with this sort of non-plan expenditure through CSS route is that it has undermined the fiscal space of state in a number of ways. For instance, with expected state contribution in various schemes, many states are left with little resources to spend on programmes of their own. In some cases, backward states such as Jharkhand and Chhattisgarh have expressed inability to arrange their share of funds, thereby losing considerable portion of development grants. This has led to states being forced to borrow from the market. Here too richer states are in a position to tap cheaper private sources of funds including capital markets. Thus, even on borrowing from markets, there is significant inequity.⁴⁰ While the NDA government is keen on rationalising and gradually transferring many of CSSs to states (eight of them passed to states during the current financial year), pruning flagship programmes is a tall order as there are competing interests that would like the present system to continue.

These apart, there are other procedural issues that are adding to an already vitiated fiscal relation. One of them is fiscal decentralisation commitment through 73rd and 74th Constitutional amendments. While a Constitution-mandated third tier bodes well for the polity and democracy, this in effect means the delegation of functions and finances from the states to the local bodies, meaning substantial expenditure

powers going to these bodies. Even some tax powers such as property tax and motor vehicle tax have gone to local bodies.⁴¹ However, this has not been backed by decentralisation of economic powers from the Centre to the states. With number of central schemes routing funds directly to local bodies, states feel their fiscal space has been further encroached by the Centre.⁴²

There are other central fiscal interventions over which states feel the inequity and the dice being loaded in favour of the Union. For instance, most state governments blame the Centre for creating huge financial burden on their already dwindling exchequers by setting up frequent pay revisions.⁴³ Similarly, states have been complaining about the Centre soaring up its revenues via the imposition of cesses, service tax and other lucrative sources of resources that are not placed in the divisible pool.⁴⁴ Again, states are not repatriated from the sale of spectrum and other precious natural resources by the Centre. In fact, some of these grievances are at the core to states raising entry barriers (be it entry tax on goods entering or tax on crude oil) and the cumulative opposition by the states to progressive and financially rewarding proposals like the Goods and Services Taxes (GST). In sum, while political clout of the Centre has witnessed a considerable decline due to greater federalisation of polity, there is no corresponding change in financial powers of the Centre. On the contrary, the Centre's financial powers vis-à-vis the states has considerably grown in the post-liberalisation period.

Regulatory Powers vis-à-vis Centre-States Relations

States play a peripheral role in the regulatory aspects of the economy and the market even after more than two decades of economic liberalisation. The Centre continues to enjoy unassailable regulatory powers over

nearly every level of the economy. For instance, take the case of natural resources. While natural resources (mainly oil, natural gas, and hydro power) have emerged as one of the key revenue drivers for state economies, a rational framework for their redistribution (providing adequate compensation to states) is yet to evolve. One can find similar narrative in the case of major minerals, a key area of sprucing up revenues for a number of states in India. For a long time, mineral bearing states have been raising a banner of revolt against very low royalty given to them under the current revenue repatriation arrangement. Under current arrangement, not only does the Centre corner 50 per cent of revenues generated from minerals, in some cases (especially iron ore), states receive a meagre 20 percent share (royalty and sales tax). In fact, a number of states have knocked on the doors of the higher judiciary to raise their share in the revenue pool concerning natural resources. Although several court judgements⁴⁵ have come to the rescue of states, this remains a non-starter. This is vindicated from the fact that the pending Mines and Minerals (Development and Regulation) Bill, 2011 promises no such rights to states. Thus fiscal federalism is yet to be translated into 'resource federalism'⁴⁶ and under the changed scenario, especially at a time when market reforms are gaining traction and states (read regional parties) are increasingly competing for every revenue pie to soar up welfare activities, the pressure is on Centre to shed a significant portion of regulatory powers.

New Zones of Conflicts

The changed macro political economy, in the backdrop of the phenomenal rise of regional parties in recent decades, has had an impact on certain domains that were once considered the Centre's prerogative. For instance, the Centre's monopoly to decide on foreign policy and

national security issues has on occasions been questioned by the states, especially those governed by regional parties.

Foreign Policy

In recent years, foreign policy and treaty-making powers of the Centre have been subjected to greater scrutiny by the states. While states in the past did have a say on these matters, the past few decades have seen a number of states asserting their stand and even vetoing vital strategic and foreign policy decisions of the Centre. Regional parties in Tamil Nadu and West Bengal, playing the coalition and electoral cards, have arm-twisted the Centre into retracting its position on important national issues. In this regard, two glaring examples have been the cancellation of the Teesta River Treaty agreement with Bangladesh due to West Bengal Chief Minister Mamata Banerjee's last minute volte face and the political blackmail resorted to in 2012 by the then Tamil Nadu Government led by the DMK on the UNHRC vote on Sri Lanka.⁴⁷ More such instances in the future could have serious consequences for India's foreign relations and long term strategic security.

National Security

Unfortunately, proposals and policies related to national security have vitiated Centre-state relations in recent years. Following the November 2008 Mumbai terror attack, there was an intense debate on assigning certain key responsibilities involving internal security to the Central government. It must be mentioned that public order comes under the purview of states. Therefore, the Centre's role has been limited, even when crimes are federal in nature (involving two or more states). Unlike in the US, there is no such listing a 'federal crime' under the Indian Constitution. Besides, no central agency, including the Central Bureau of

Investigation (CBI), has powers equivalent to that of the US Federal Bureau of Investigation (FBI) that combine intelligence and suo motu investigation. With the rise of terrorist attacks as well as the Maoist insurgency, which has spread to several states and poses a grave threat to national security, there have been growing demands from various sections to review the existing federal arrangements on national security.

However, states have unanimously opposed any moves by the Centre that would alter the existing framework. For instance, recently when the Union Government floated the idea of setting up a National Counter-Terrorism Centre (NCTC) to counter terror threats and high-level crimes, most states including some belonging to the ruling party opposed the move saying it would undermine the autonomy of states that is guaranteed under the Constitution. Similarly, even less threatening proposals like amending the Railway Protection Force Act, 1957 and the Border Security Force Amendment Bill 2011 have been opposed by states.⁴⁸ This stalemate on national security issues has serious ramifications. More seriously, it points to a steady erosion of faith and trust between two constituent units and a larger crisis facing India's federal structure.

Missing Federal Bridging Institutions

Adding to the problems already faced by weak and fragile Centre-state relations are dysfunctional federal building institutions. Despite Centre-state relations getting acrimonious, successive governments at the Centre have paid little or no attention to creating and nurturing federal bridging institutions. The federal relations were relatively smoother and manageable in the initial decades of constitutional governance, especially when country's polity was dominated by the Indian National Congress (INC). The INC virtually acted as an 'informal forum' of

bargaining for much of the states and contentious issues were resolved in a cooperative framework.⁴⁹ Such arrangements no longer exist. Conflict-bridging institutions such as Inter-State Council (ISC)⁵⁰ created in the 1980s, with the expressive purpose of easing acrimonies and promoting cooperative federalism, have enjoyed little support from political masters at the Centre. In short, failure to create robust institutional architecture and conflict mediation process within the federal structure has aided in accentuating the deadlock between the Centre and states on many issues that would otherwise have been resolved amicably.

To sum up, the growing imbalances and deeply unequal Centre-state relations grounded on many paradoxes have created roadblocks for cooperative federalism. In this regard, a serious review of Centre-state relations is overdue and the country, which has reached an inflection point on many frontiers, can barely ignore the key structural impediments stalling the nation's growth and governance.

A Roadmap for Revitalising Centre-state Relations

Solutions to many long standing issues concerning Centre-state relations have become a sort of 'cottage industry' as committees, commissions, research bodies and analysts have poured out reams of paper and articles on these matters. From the Rajmannar Commission (1969), the Sarkaria Commission (1987) to the M.M. Puncchi Commission (2007) and the Second Administrative Reforms Commission (ARC) Report in 2008, a lot of effort has been made by successive regimes at the Centre and states on finding amicable ways to improve the Centre-state relations but with little success.⁵¹ This does not mean there has been no forward movement at all. On resource sharing, for instance, the Centre has

responded by refining the formula for transfers (Finance Commission) and by conceding certain demands over tax sharing. It has also agreed to remove freight equalisation policy in the previous decade.

Yet, these measures have not fundamentally altered the deep inequality in financial relations. While the 10 per cent hike in devolution to states by the FFC is likely to bridge the fiscal gap between the Centre and states, it is still too early to comment on the real implications of the new policy announcement. In other words, the Centre-state relations require a massive overhauling to address structural inequities.

With a chief minister becoming the Prime Minister of the country, there is a real possibility of revisiting some of the contentious federal provisions impacting Centre-state relations in negative ways. While no one is suggesting writing a new Constitution, some sort of a grand bargain between the Centre and the states is inevitable.⁵² In other words, a re-ordering of federal system and related constitutional provisions is long overdue. The following possibilities can be explored:

Push for Greater Economic Federalism

- There is an urgent need to improve the revenue sources⁵³ and one way to do this would be by revisiting tax jurisdiction between Centre and state. Since states are losing out many revenue sources, the sanctity of state taxes needs to be maintained and the Centre should come clear on centralising and unifying tax proposals such as DTC and GST. By accepting the FFC's recommendations of raising the devolution to an unprecedented 42 per cent, the Union Government is showing some serious intent to address the long standing fiscal issues. However, the jury is still out on this move and its outcome.⁵⁴

- On equity issues, there is a need to enhance the allocating powers of the Finance Commission. For greater legitimacy, the commission should have representation from the states.
- An overhaul of Centrally Sponsored Schemes (CSS) is necessary as this is becoming a strain on state finances.⁵⁵ The recently constituted NITI Aayog should take up this on a priority basis.
- The state governments that have better knowledge of local conditions and requirements must be given autonomy in decisions (land, labour, infrastructure such as metro rail, airports, etc⁵⁶) that have significant bearing on local economy. For example the Gujarat government privatised several minor ports by entering into joint ventures and this became an excellent model for the central port policy.⁵⁷
- Ensure more formal and substantive participation of the state and local governments in the regulatory system including forests, mines, environment etc.
- Rework on “resource federalism” by developing acceptable framework for resource revenue-sharing such as the auction of spectrum.⁵⁸
- The states taking the burden of environment (maintaining green coverage) need to be compensated for the sacrifice that they make for common good.

Amend the Concurrent Provisions

A review of the Seventh Schedule comprising the Union, State and Concurrent lists needs to be seriously looked into. This was eloquently recommended by the 5th Pay Commission.⁵⁹ For instance, while some areas such as taxation or jurisdiction involving centrally-sponsored

schemes can go to the state list, items such as law and order and those with national and international security ramifications can be put in concurrent list, thereby giving the Central government a decisive say.

Strengthen Decentralisation Process

The passing of the 73rd & 74th amendments were landmarks as they mandated a third tier in the federal set up. This implementation, however, remained slow and ineffective partly because of resistance from the states (political and bureaucratic leadership) and the Centre's lack of political will.⁶⁰ While the states have to take the call, the Centre can incentivise the process by aligning and linking many of its flagship schemes with local bodies.

Strengthen 'Federal Bridging' Institutions

India is woefully short of institutions and mechanisms for negotiation, bargaining and dispute resolution. It is time to strengthen and revitalise critical institutions like the Inter-State Council. It can be taken out of the jurisdiction of the Home Ministry and placed under the Prime Minister's Office or the Cabinet Secretariat. This would provide it more credibility and importance. Major federal grand bargains can be cleared by such institutions.

Similarly, bridging instruments such as the Finance Commission, Inter-State Council, the Inter-State Tribunals and the National Development Council can play a critical role in cementing harmonious relations between the Centre and states. Thus there is a need to either strengthen old institutions or scrap them and create new institutions such as a Regional Council of States as mooted by the NDA.

Institutionalise the Culture of Dialogue

Beyond instrumentalities, for Centre-state relations to improve what is required is a culture of dialogue and regular conversation. It is time to rescue Centre-state relations from the annual rituals hosted by the National Development Council. While the new institutional anchor, NITI Aayog, is a step forward, it is grossly inadequate for a country of India's size and complexity. India needs more enabling institutions to bridge the mistrust and communication gap that exists between the Centre and states.

Appendix 1: Per Capita GSDP at Current Prices (2004-05 Series) (Rs.)

State / UT	1983	1987-88	1993-94	1999-2000	2004-05	2009-10
Andhra Pradesh	2,342 (M)	3,810 (M)	9,124 (M)	18,559 (H)	28,896 (H)	59,739 (H)
Arunachal Pradesh	2,915 (H)	5,138 (H)	10,958 (H)	18,194 (H)	28,576 (H)	55,799 (H)
Assam	2,529 (M)	4,212 (M)	7,930 (L)	13,349 (L)	19,166 (L)	31,918 (L)
Bihar	1,387 (L)	2,354 (L)	4,170 (L)	6,778 (L)	8,621 (L)	17,065 (L)
Chhattisgarh	2,332 (L)	3,788 (L)	9,400 (M)	14,209 (L)	21,636 (L)	42,868 (M)
Goa	5,961 (H)	9,544 (H)	22,693 (H)	57,543 (H)	90,660 (H)	204,602 (H)
Gujarat	3,555 (H)	5,547 (H)	13,085 (H)	24,192 (H)	39,165 (H)	75,362 (H)
Haryana	3,852 (H)	6,321 (H)	13,874 (H)	26,409 (H)	43,177 (H)	90,719 (H)
Himachal Pradesh	3,243 (H)	5,258 (H)	11,447 (H)	25,250 (H)	38,548 (H)	73,178 (H)
Jammu & Kashmir	3,532 (H)	5,433 (H)	9,200 (M)	17,110 (M)	25,264 (M)	41,149 (L)
Jharkhand	1,387 (L)	2,354 (L)	9,439 (M)	14,963 (L)	19,757 (L)	33,156 (L)
Karnataka	2,612 (M)	4,399 (M)	10,019 (H)	20,874 (H)	30,270 (H)	59,349 (H)
Kerala	2,978 (H)	4,908 (H)	11,046 (H)	23,745 (H)	37,254 (H)	70,378 (H)
Madhya Pradesh	2,332 (L)	3,788 (L)	7,932 (L)	14,045 (L)	18,066 (L)	32,736 (L)
Maharashtra	3,642 (H)	5,968 (H)	14,879 (H)	27,432 (H)	41,703 (H)	80,695 (H)
Manipur	2,774 (H)	4,840 (H)	9,048 (M)	16,469 (M)	21,960 (M)	31,733 (L)
Meghalaya	2,546 (M)	4,451 (M)	9,349 (M)	17,548 (M)	26,293 (M)	45,882 (M)
Mizoram	2,444 (M)	5,945 (H)	11,510 (H)	20,321 (H)	28,919 (H)	51,537 (M)
Nagaland	3,630 (H)	6,582 (H)	14,629 (H)	21,510 (H)	30,488 (H)	53,339 (H)
Odisha	2,258 (L)	3,554 (L)	6,892 (L)	12,597 (L)	19,907 (L)	41,467 (M)
Punjab	4,231 (H)	7,136 (H)	15,931 (H)	29,185 (H)	38,973 (H)	73,716 (H)
Rajasthan	2,419 (M)	3,846 (M)	8,702 (M)	16,348 (M)	21,770 (M)	42,074 (M)
Sikkim	2,775 (H)	5,035 (H)	11,263 (H)	19,609 (H)	31,425 (H)	93,906 (H)
Tamil Nadu	2,628 (H)	4,762 (H)	11,361 (H)	23,516 (H)	33,983 (H)	69,609 (H)
Tripura	2,586 (M)	4,076 (M)	6,836 (L)	16,313 (M)	26,796 (M)	43,668 (M)
Uttar Pradesh	2,009 (L)	3,245 (L)	6,580 (L)	11,462 (L)	15,022 (L)	27,123 (L)
Uttarakhand	2,009 (L)	3,245 (L)	10,417 (H)	16,441 (M)	28,292 (M)	71,749 (H)
West Bengal	2,700 (H)	4,428 (M)	8,061 (L)	17,049 (M)	25,054 (M)	44,957 (M)
<i>Minimum</i>	1,387	2,354	4,170	6,778	8,621	17,065
<i>Quartile 1</i>	2,339	3,804	8,542	15,975	21,736	41,387
<i>Quartile 2 (median)</i>	2,620	4,607	9,729	17,871	28,434	52,438
<i>Quartile 3</i>	3,315	5,461	11,463	23,573	34,801	72,107
<i>Maximum</i>	5,961	9,544	22,693	57,543	90,660	204,602
<i>Inter-Quartile range (IQR)(Q3-Q1)</i>	976	1,657	2,921	7,598	13,064	30,719

Note: (H) implies High Income State (PCGSDP is higher than the second quartile); (M) implies Middle Income State (PCGSDP lies between the first and second quartiles); and (L) implies Low Income State (PCGSDP lies below or equal to the first quartile).

Source: State Domestic Product (State Series), Central Statistical Office, Ministry of Statistics and Programme Implementation, Government of India, New Delhi (<http://mospi.nic.in>)

Table 3: State-wise Human Development Index (HDI) Scores and Ranks: 1983 to 2011-12 (Rural & Urban Combined)

State	1983	1987-88	1993	1999-2000	2004-05	2009-10
Andhra Pradesh	0.290 (14)	0.185 (16)	0.217 (18)	0.288 (14)	0.298 (16)	0.286 (16)
Arunachal Pradesh	0.116 (24)	0.066 (24)	0.110 (22)	0.168 (21)	0.234 (21)	0.175 (23)
Assam	0.242 (17)	0.123 (20)	0.147 (21)	0.144 (25)	0.234 (22)	0.176 (22)
Bihar	0.071 (27)	0.024 (27)	0.061 (27)	0.074 (28)	0.050 (28)	0.050 (28)
Chhattisgarh*	0.129 (22)	0.077 (22)	0.069 (23)	0.155 (23)	0.142 (27)	0.114 (27)
Goa	0.774 (2)	0.540 (2)	0.700 (2)	0.701 (2)	0.781 (2)	0.796 (2)
Gujarat	0.502 (8)	0.301 (12)	0.362 (10)	0.390 (11)	0.429 (12)	0.461 (8)
Haryana	0.556 (5)	0.415 (7)	0.396 (8)	0.490 (7)	0.544 (7)	0.516 (7)
Himachal Pradesh	0.622 (4)	0.461 (5)	0.430 (7)	0.550 (5)	0.605 (4)	0.655 (3)
Jammu & Kashmir	0.443 (9)	0.289 (13)	0.316 (13)	0.406 (10)	0.493 (9)	0.443 (11)
Jharkhand*	0.071 (27)	0.024 (27)	0.061 (27)	0.077 (27)	0.145 (26)	0.160 (26)
Karnataka	0.416 (10)	0.342 (10)	0.326 (12)	0.379 (12)	0.436 (11)	0.457 (9)
Kerala	0.818 (1)	0.722 (1)	0.805 (1)	0.815 (1)	1.000 (1)	0.963 (1)
Madhya Pradesh	0.129 (22)	0.077 (22)	0.069 (23)	0.152 (24)	0.182 (23)	0.172 (24)
Maharashtra	0.504 (7)	0.408 (8)	0.446 (5)	0.506 (6)	0.583 (6)	0.602 (5)
Manipur	0.305 (13)	0.205 (14)	0.259 (15)	0.271 (16)	0.256 (19)	0.217 (21)
Meghalaya	0.215 (18)	0.124 (19)	0.225 (16)	0.260 (18)	0.340 (14)	0.259 (18)
Mizoram	0.547 (6)	0.449 (6)	0.613 (3)	0.576 (4)	0.529 (8)	0.449 (10)
Nagaland	0.272 (15)	0.476 (4)	0.438 (6)	0.467 (8)	0.403 (13)	0.262 (17)
Odisha	0.187 (20)	0.141 (18)	0.159 (19)	0.175 (20)	0.174 (24)	0.248 (19)
Punjab	0.691 (3)	0.519 (3)	0.562 (4)	0.578 (3)	0.640 (3)	0.584 (6)
Rajasthan	0.181 (21)	0.081 (21)	0.155 (20)	0.265 (17)	0.278 (18)	0.240 (20)
Sikkim	0.211 (19)	0.160 (17)	0.217 (17)	0.236 (19)	0.299 (15)	0.377 (15)
Tamil Nadu	0.359 (11)	0.345 (9)	0.387 (9)	0.462 (9)	0.587 (5)	0.621 (4)
Tripura	0.258 (16)	0.205 (15)	0.280 (14)	0.285 (15)	0.288 (17)	0.421 (12)
Uttar Pradesh	0.102 (25)	0.058 (25)	0.066 (25)	0.142 (26)	0.167 (25)	0.168 (25)
Uttarakhand*	0.102 (25)	0.058 (25)	0.066 (25)	0.162 (22)	0.247 (20)	0.378 (14)
West Bengal	0.324 (12)	0.318 (11)	0.353 (11)	0.371 (13)	0.462 (10)	0.409 (13)

Note: Figure in the parenthesis shows the ranks

*-prior to 2004-05, HDI score and rank is same as the mother state.

Source: Constructed by authors

Endnotes:

1. The policy paper is a culmination of series of discussions and interaction with many eminent experts and practitioners around political economy and centre-state relations. While so many experts have provided rich inputs and commentaries, author is particularly grateful to Mr. Surendra Singh, former Cabinet Secretary and Honorary Advisor, ORF for initiating and overseeing the progress of the paper. Author expresses his gratitude to Mr. Sunjoy Joshi, Director, ORF for his very detailed and insightful comments to improve the paper. Author is equally grateful to Mr. Samir Saran, Vice President, ORF, Prof. Indira Rajaraman, former Professor at NIPFP, Prof. Balveer Arora, Chairman, Centre for Multi-Level Federalism, Dr. Ajay Chhibber, formerly with Planning Commission, Mr. Dharendra Singh, former Home Secretary, Dr. Satish Misra, ORF for their comments and suggestions. Any errors and factual misrepresentations are author's own.
2. Of course, his government is trying to give it a different name. Union Finance Minister recently renamed it “competitive federalism”.
3. In a radical departure from the previous trends, the National Democratic Alliance (NDA) government has accepted the Fourteenth Finance Commission (FFC)'s recommendation of a record 10 per cent increase in the devolution of divisible pool of central taxes to the states. The Union Budget 2015-16 which recently rolled out a detailed roadmap for implementation of the FFC recommendations aims to devolve a massive Rs. 5.3 lakh crore over next five years. More than the hike (which will go up from 47.5% in 2015 to 49.4% in 2020), what is truly revolutionary is the 'untied' nature of such devolution. See Syed Z. Naqvi, Kapil Patidar and Arvind Subramanian, “A Watershed 14th Finance Commission”, *Business Standard*, 24 February 2015.
4. The famous 'Congress System' (lasted until 1989) was coined by well known political scientist Rajni Kothari. For details see Rajni Kothari, *Politics in India*, New Delhi: Orient Longman, 1970.

5. By 1 March 2014, according to the Election Commission, there were 219 registered regional parties in India, nearly a 10-fold jump than what it was in early 1970s. For more information, visit the portal <http://www.elections.in/political-parties-in-india/>.
6. Subrata Mitra and Malte Pehl, “Federalism”, Niraja G. Jayal and Pratap Mehta (ed.) *Oxford Companion to Politics in India*, New Delhi: Oxford University Press, 2010, p 45 .
7. Milan Vaishnav, The complicated rise of India's regional parties, *The Carnegie Endowment for International Peace*, November 13, 2013. <http://carnegieendowment.org/2013/11/13/complicated-rise-of-india-s-regional-parties>.
8. Louiss Tillin, The stories of wave, *The Indian Express*, May 17, 2014, see link: <http://indianexpress.com/article/opinion/columns/stories-of-a-wave/>.
9. Harihar Bhattacharya, “Globalization and Indian Federalism: Current Trends”, *An in-house seminar presentation at the Institute of Federalism*, Fribourg Switzerland, 16 May 2007.
10. Govind M. Rao, *A Review of Indian Fiscal Federalism*, Research Study submitted to the Commission on Centre-State Relations; Inter-State Council, Ministry of Home, Government of India, 2009.
11. See Arjun Appadurai and Arien Mack, *India's World*, Delhi: Rupa, 2012.
12. See C.P. Bhambri, “The Central Government in the age of globalization”, in Dua, D.D. and Singh M.P (eds). *Indian Federalism in the new millennium*, New Delhi: Manohar Publications, 2005.
13. For a comprehensive analysis of judicial role in safeguarding interests of states, see Rekha Saxena and Mahendra Prasad Singh, “The Role of Federal Judiciary in Union-States relations in India”, in Jan Erk and Wilfried Snewnden edited *New Directions in Federalism Studies*, London: Routeldge, 2009.

14. See S.P. Sathe, *Judicial Activism in India: Transgressing Borders and Enforcing Limits*, Delhi: Oxford University Press, 2003.
15. *Keshavanand Bharati vs. Union of India*, AIR SC 1461 (1973).
16. The Supreme Court Bench consisting of nine Judges gave its judgment in 1994 that set out clear limitations of Article 356. The Bench said any Presidential Order clamping Article 356 had to be ratified by both the Houses of Parliament. In addition, the powers of the judiciary to review the bona fide or mala fide nature of the Presidential order were reiterated. As a rider, the Court illustrated ten situations which did not amount to “failure of constitutional machinery”. In every sense, *Bommai* judgement shifted the political powers from Centre to states. See *S.R. Bommai vs. Union of India (1994)*, 3 SCC 1.
17. Article 356 is one among the nine Articles (beginning from Art. 352 and ending with Art. 360) known as Emergency Provisions enumerated in the Chapter XVIII of Indian Constitution. Under said Article, the President can dismiss a State Government or dissolve a State Assembly or keep it under suspended animation in the event of a failure of the constitutional machinery in that State. Before *Bommai* judgement, this emergency provision was misused more than 100 times by successive central governments. For instance, between 1966 and 1977, Indira Gandhi's government had invoked Article 356 as many as 39 times in different states.
18. See P. P. Rao, “The Constitution, Parliament and the Judiciary,” in Pran Chopra, ed., *The Supreme Court Versus the Constitution: A Challenge to Federalism* (New Delhi: Sage Publications) 2006.
19. While the Centre remains the preeminent authority with respect to the control of finances, while the states have a large responsibility over spending. See R. Ramkumar, Fiscal Roadblock, *Frontline*, Issue.6, March 13-26, 2010. <http://www.frontline.in/static/html/fl2706/stories/20100326270601900.htm>.

20. Mitra and Pehl, 2010, p 52.
21. While the Seventh Schedule earmarks most lucrative sources of revenue such as import or export duties, non-agricultural income tax and corporate taxes to the Centre, most non-lucrative sources of revenues to the states. For example, tax on land, income from agriculture to the states which meet one-third of their total expenditure which continues to spike every year. These are also difficult taxes to collect.
22. See Mitra and Pehl, 2010 p 52, also see Varshney 2013. P 51-52.
23. To make for shortfall in revenues, states resort to borrowing from domestic market, loans from the Centre and so on to meet the expenditure commitments.
24. This is often practiced in other federal countries such as Germany, Australia and Canada.
25. Govind M. Rao, *A Review of Indian Fiscal Federalism*, Research Study submitted to the Commission on Centre-State Relations; Inter-State Council, Ministry of Home, Government of India, 2009.
26. Ibid p6 .
27. Although horizontal distribution of transfer is carried out through formulaic route (10% for area, 25% population, 47.5% for fiscal capacity and 17.5% for index of fiscal discipline), the horizontal formula has not helped much to enhance aggregate share of devolution to low income states. The aggregate share of low income states remains stagnant at around 54% over the period of past three FCs, while the shares of middle-income states have declined from 29.28% in XI FC to 25.8% in the XII FC and share of high income states have gone up from 9.75% to 11.19% during the same period. See Pravakar Sahoo and Amrita Sarkar, Changing Dynamics of centre-state financial relations, *Yojana*, June 2013, p 22.

28. This is largely because while fiscal capacity distance tries to increase the fiscal capacity of the states, the second put a limit on expenditure according to their revenue. See Pravakar Sahoo *et al* 2013 and Rao 2009.
29. With populist politics on rise, many states have abolished taxation on land and income from agriculture, notwithstanding their limited capacity to collect taxes, let alone imposing new taxes. However, factors like geography/spatial location (like hilly or forested region, coastal areas, etc) and stages of development of a particular state do have significant bearing on the capacity and potentials to generate own revenues.
30. With service sector and to a lesser extent manufacturing taking a giant leap in new revenue generation under globalisation and economic liberalisation, states with competitive edges such as infrastructure, human resources, business friendly environment and better records of governance are reaping rich economic dividend. For an earliest analysis of such trend, see B.B. Bhattacharya and S. Saktivel, “Regional Growth and Disparity in India: Composition of pre- and post-Reform Decades”, *Economic and Political Weekly*, March 6, 2004. For a recent update, see Sanchita Bakshi et al. “Regional Disparities in India: A Moving Frontier”, *Economic and Political Weekly*, Vol. L, No. 1, January 3, 2015.
31. See Rao, 2009.
32. For instance, the Finance Commission has been kept out of plan expenditure and grants for capital expenditure. Bibek Debroy, “The Centre and the States, Excessive Centralisation Hampers Economic Freedom”, *Cato Institute*, 2012. <http://www.cato.org/sites/cato.org/files/economic-freedom-india-2013/economic-freedom-states-of-india-chapter-3.pdf>.
33. According to the present formula, 30 per cent of the transfers (90 per cent of this are distributed as grants and rest as loans) are kept aside for the special category states namely J&K, hilly states of Himachal,

Uttarakhand, northeastern states, while rest 70 per cent of the funds are available for major states, of which 70 per cent are loans and 30 per cent as grants. These transfers are decided based on the required plan investments, their sectoral composition, the resources available to the states and their fiscal performance. See Rao 2005, p18.

34. According to Gadgil-Mukherjee formula, allocation between non special category states is determined by weight to population (60%), per capita income (25%), fiscal performance (7.5%) and special problems (7.5%).
35. For example, shares of transfers based on tax effort are not scaled for size of state. Therefore, if a large state and small state have same tax effort they would receive the same absolute transfer. See Indira Rajaraman, *The Political Economy of the Indian Fiscal Federation, India Policy Forum*, Edited by Barry Bosworth, Suman Berry and Arvind Panagariya, (Brookings and NCAER), 2007.
36. Some economists allege that discretionary transfers appear to have grown as a proportion of revenue sharing with states in recent years. These discretionary transfers tend to favour states with higher per capita incomes. This is particularly true for transfers from the federal government allocating to matching formulae. The use of matching favours richer states. See Rongili Biswas, Sugata Marjit and V. Marimoutou, "Fiscal Federalism, State Lobbying and Discretionary Finance in India", *CSH Occasional Paper*, No. 23, 2008, also Rao 2009.
37. For an insightful analysis on the issue, see Govind Rao, "Dynamics of Centre-State Relations: Emerging Trends," in N. K. Singh and Nicholas Stern edited *The New Bihar: Rekindling Governance and Development*, Delhi: Harper Collins, 2012.
38. Rajaraman, 2007.
39. Not only has the Planning Commission squeezed the autonomous space branched out for Finance Commission, it is claimed that Inter-State council, a vital institution to smoothen federal contestation and

disputes could not grow largely owing to the presence and growing importance of Planning Commission. See Indira Rajaraman, Replacing the Planning Commission, *Business Standard*, August 25, 2014.

40. See Debroy, 2012.
41. Haseeb A. Drabu, Modifying Federalism, *Livemint*, March 2, 2014. See link: <http://www.livemint.com/Opinion/x34c5ePS2iAsQpj4nllmLI/Modifying-Federalism.html>.
42. Ibid.
43. Govind Rao and Tapas K. Sen, “Federalism and Fiscal Reform in India”, *NIPFP Working Paper*, No. 2011-84, 2011, p 23.
44. To illustrate, the share of cesses and surcharges in gross tax revenue of the Centre increased sharply from 3.51 per cent in 2001-02 to 13.63 per cent in 2009-10.
45. For instance in 1992, when certain West Bengal government's action of levying cess on coal were challenged, they were held *ultra vires* by the Kolkata High Court. However, the Supreme Court upheld the legislation on the ground that states were competent to levy cess as long as the cess was on coal-bearing land. The Court observed that “So long as a tax or fee on mineral rights remains in pith and substance a tax for augmenting the revenue resources of the State or a fee for rendering services by the State and it does not impinge upon regulation of mines and mineral development or upon control of industry by the central government, it is not unconstitutional”. See Noronha, Ligia, N Srivastav, D. Datt and PV Sridharan, “Resource Federalism in India: The case of Minerals”, *Economic and Political Weekly*, 21 February 2009, Vol. XLIV, No. 8.
46. See an interesting op-ed article “Federalism 2.0 in India”, Haseeb Drabu, *Mint*, September 16, 2012. Link: <http://www.livemint.com/Opinion/vkp1Bt18KO8tFSjYO0aDrK/Federalism-20-in-India.html>.

47. Niranjana Sahoo, "What Sri Lanka reveals about India's democracy support", *Carnegie Endowment for International Peace*, March 19, 2014. link: <http://carnegieendowment.org/2014/03/19/what-sri-lanka-reveals-about-indian-democracy-support/h4s7>.
48. Ajay Mehra, Public security and Federalism in India, *Uday India*, 2012, Link: http://www.udayindia.in/english/content_12may2012/special-feature.html.
49. See Govind Rao, "Dynamics of Centre-state Relations: Emerging Trends," in N. K. Singh and Nicholas Stern edited *The New Bihar: Rekindling Governance and Development*, Harper Collins, 2012.
50. Inter-State Council was set up after the Sarkaria Commission recommendation (1988). It enjoys little credibility and has become a place to fill retirees.
51. Surendra Singh and Satish Misra, Federalism in India: Time for a Relook, *ORF Issue Brief*, No. 40, July 2012.
52. See Ashok Malik, More Federalism, please, *The Times of India*, June 20, 2013.
53. Nirvikar Singh, 2004. India's System of intergovernmental fiscal relations, *Working Paper IX*, Santa Cruz: University of California.
54. For an insightful analysis of the issue, see Editorial "Half-Hearted Embrace", *Economic and Political Weekly*, February 28, 2015.
55. For an insightful analysis on CSS, see Panagariya 2014.
56. For instance, the Kolkata metro rail expansion proposal is pending with the Centre for several years. Similarly a proposal by Uttar Pradesh government to have an international airport is pending central approval for many years. For more see Ashok Malik, More Federalism, please, *The Times of India*, June 20, 2013. Link: <http://timesofindia.indiatimes.com/home/opinion/edit-page/More-federalism-please/articleshow/20668604.cms>.

57. See Aseema Sinha, Solutions to improve centre-state relations, *India Forbes*, February 2, 2012.
58. Haseeb A. Drabu, Modi-fying federalism, *Livemint*, March 2, 2014.
59. Bibek Debroy, “Effective central governance has quite a lot to do with pruning multiple branches of officialdom”, *The Economic Times*, 23 May 2014.
60. See Mani Shankar Aiyar, Missing the woods for the trees, *The Hindustan Times*, 20 May, 2010, <http://www.hindustantimes.com/Missing-the-woods-the-trees/H1-Article1-546289.aspx>.

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Observer Research Foundation
20, Rouse Avenue, New Delhi-110 002
Email: orf@orfonline.org
Phone: +91-11-43520020 Fax: +91-11-43520003
www.orfonline.org