

**COOPERATION AND COMPETITION IN INDIAN FEDERALISM
(1989 - 1999)**

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MASTER OF PHILOSOPHY

BY

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Declaration

This Dissertation entitled "**COOPERATION AND COMPETITION IN INDIAN FEDERALISM (1989-1999)**" submitted for the Degree of Master of Philosophy of Jawaharlal Nehru University, has not been previously submitted for any other degree of this or any other university and is my original work.


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We recommend that this Dissertation be placed before the Examiners for evaluation.


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Dedicated
to my
Parents

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Abbreviations

AGP	Assam Gana Parishad
AIADMK	All India Anna Dravidra Munetra Kazhgham
BJD	Biju Janata Dal
BJP	Bharatiya Janata Party
BSP	Bahujan Samajwadi Party
Cong (I)	Congress (Indira)
CPI	Communist Party of India
CPI(M)	Communist Party of India (Marxist)
DF	Democratic Front
DMK	Dravidra Munetra Kazhgham
HVP	Haryana Vikas Party
INLD	Indian National Lok Dal
JD	Janata Dal
JMM	Jharkhand Mukti Morcha
LDF	Left Democratic Front
NCP	National Congress Party
RJD	Rashtriya Janata Dal
RJP	Rashtriya Janata Party
SAD	Shiromani Akali Dal
SP	Samajwadi Party
SS	Shiv Sena
TDP	Telugu Desam Party
TMC	Tamil Manila Congress
UDP	United Democratic Front

List of Tables

- Table 2.1 : Performance of Congress Since 1980.
- Table 2.2 : Performance of BJP Since 1980
- Table 2.3 : Overall Performance of the Parties in the General Elections
- Table 2.4 : Performance of National parties Since 1991.
- Table 3.1 : Per Capital Net State Domestic Product
- Table 3.2 : Per Capita Consumption of Electricity
- Table 3.3 : State – Level Coverage of Roads
- Table 3.4 : Ratio of Investment in State (1997)
- Table 3.5 : Annual Rates of Growth of Per Capita Gross State Domestic Product
- Table 4.1 : Expenditure Pattern of State Governments
- Table 4.2 : Developmental and Non-developmental Expenditure of Central and State Governments
- Table 4.3 : Deficit of State Governments
- Table 4.4 : Revenue Receipts of All States 1990-1999
- Table 4.5 : States' Fiscal Position: A Summary View

Contents

	Page No.	
Chapter 1	Introduction: The Cooperative Imperative in Federal System	1-26
Chapter 2	States Participation and Coalitional Process	27 -65
Chapter 3	Coordination and Economic Policy	66-91
Chapter 4	States Powers and Responsibilities Under Economic Reforms	92- 124
Chapter 5	Conclusion: New Federalism: Promise and Reality	125 -133
Bibliography		134-144

Chapter 1

Introduction

The Cooperation Imperative in Federal Systems

Conceptual Issues

Cooperative federalism as a concept has gained much currency after the Second World War. Writers in America coined the term “cooperative federalism” in 1930 to describe the new style federalism, which shows administrative, financial and legislative cooperation among the different levels of government. Morton Grodzins, one of the exponents of this concept, describes it as marble – cake. In a marble- cake, colours merge and there is no neat stratification of colours into different layers. Similarly, it is difficult to strictly divide governmental functions amongst the various levels of government.

“Cooperative federalism (also known as marble-cake federalism) emphasizes the value of cooperation among levels of government, because joint efforts may produce better results than anyone level acting alone...The national government has great difficulty in keeping track of countless variation in local needs, and priorities, yet local government, may lack the resources to cope with their problems alone. A partnership is a reasonable solution because no level of government is likely to have a monopoly on good ideas, sharing responsibilities can let the best ideas come to the forefront regardless of the level from which they come.”¹

¹ Nice, David : *Federalism: The Politics of Intergovernmental Relations* , (St. Martin's Press, New York, 1987), p.7

M.P. Jain has described the concept of cooperative federalism as “the promotion of cooperation and the minimisation of friction between the various constituents of the federal Union whether it is Centre versus State or State versus State”.²

Federalism has entered a new phase. This new phase may conveniently be called ‘cooperative federalism’ which is a system by which State and national Governments supplement each other in their day to day working and jointly perform a variety of functions.”³

“Cooperative federalism, the reigning concept of American federalism from about 1954 to 1978, was a political response to the policy challenges of market failure, post-war affluence, racism, urban poverty, environmentalism and individual rights.”⁴ “An empirical study made by Watts in the six new federal Constitution of India, Pakistan, Malaysia, Rhodesia and Nyasaland, Nigeria and West Indies shows that cooperative federalism became the inevitable trend in their systems. This trend has come about because of the extension of nation-wide commercial enterprise, development of an interdependent economy, ever

² Jain, M.P. : ‘Federalism in India’ in *JILI* vol. 6 (1964), p. 365

³ Pal, Chandra: *Centre-State Relations and Cooperative Federalism*, (Deep and Deep, New Delhi, 1985), p. 20.

⁴ Kincaid, John: ‘From Cooperative to Coercive Federalism’ in *Annals, AAPSS*, 509, (May, 1990), p. 139.

enlarging concept of the positive functions of Government in modern society.”⁵

A number of factors have been responsible for the frequent usage of the term cooperative federalism. With the adoption of a Welfare State, the Government's power both at the Central and the State or provincial level is ever multiplying. It is not possible for one level of Government to perform such functions on its own, therefore it needs to be shared by the different levels of Government. A strict division of functions is also not possible because the functions intermingle and overlap. What is needed is thus a proper understanding between the Union and the State Government in sharing these functions. This would prevent overlapping of the functions, save on time and above all ensure efficiency. The Central and State Governments have come to realise that they are inter-dependent and not independent of each other. For a policy framed by the Central Government can be implemented at the State level only if the State Government is willing to carry it out. Again, the State Government has to depend, to a great extent on the Centre for framing out laws and policies, without which it is unable to carry out any projects or programmes.

⁵ Verma, S.L.: *Federal Authority in the Indian Political System*, (RBSA Pub., Jaipur, 1987), p. 48.

Nalini Pant, has summarized the characteristics of federalism as follows:

- (1) It is a positive concept.
- (2) There is an emphasis on shared actions among the federating units.
- (3) There is an emphasis on "process" rather than "structure".
- (4) It is need base, and
- (5) It manifests the will of the people and is therefore consonant with participatory democracy. ⁶

The concept of cooperative federalism differs from the definition of federalism as given by Wheare. Wheare's description of federalism can be described as classical federalism, where the two sets of Government are independent and rivals. According to Wheare, the two levels of Government are independent, each performing their own given set of functions. Cooperative federalism on the other hand talks about different levels of Government cooperating with each other and working as equal partners. To view the working of federalism in the strict classical sense is not possible in the modern age. Industrialisation and growth of welfare State has led to a further increase in the number of functions to be performed by the Government, and this is not possible for one set of Government to perform such functions on its own. The post Second World War period saw the growth of industrialisation and Welfare State, and as such the strict definition of federalism viz. classical federalism

⁶ Pant, Nalini : 'Reflection on Cooperative Federalism and its Relevance in India' in Khan, Rashceuddin: *Rethinking Indian Federalism*, (Institute of Advanced Study, Shimla, 1997), pp. 134-135.

began to lose its significance and thus emerged the concept of cooperative federalism.

Cooperative federalism is therefore a kind of process, which has evolved with time. It is not something static, but which changes accordingly to suit the needs of time. It emphasises more on the spirit of cooperation and sharing among the different levels of Government rather than a feeling of rivalry and antagonism between the different levels of Government.

Morton Grodzins definition of cooperative federalism as "marble-cake" is the best definition of the term. The functions of a Government resemble a marble-cake, where the colours merge without any neat horizontal or vertical stratification of layers. The Central and State Government no doubt have different functions to perform, but there is no neat stratification as to where exactly the functions belong. Take for example, the function of law and order which has been assigned to the State, but in times of crisis the State Government has to depend on the Central Government for the deployment of armed forces to maintain law and order and as such the Central Government too becomes involved in the maintenance of law and order in a State. Since the functions intermingle, it becomes difficult to assign one particular function exclusively to one set of Government. Under such circumstances,

therefore, the different levels of Government should work together in a cooperative manner.

Cooperative Federalism in the Indian Context

Granville Austin, prefers to call Indian federalism “cooperative federalism”, “which produces a strong Central or general Government yet it does not necessarily result in weak provincial Government, that are largely administrative agencies for Central policies.”⁷ According to Lawrence Saez, “The Indian model encapsulated some of the tenets of what has come to be known as cooperative federalism.”⁸

At the time of the framing of the Indian Constitution, many factors had to be kept in mind. Firstly, India had just witnessed a partition on the basis of religion, so the Constitution framers were apprehensive of giving more powers to the States, as India being a land of diverse language, religion and culture, it would only lead to further secession. Again, during that period of time, India’s economic development had been on the brink, so the Constitution framers felt it more appropriate to introduce a system of centralised planning whereby regional development would be ensured, thus leading to the economic development of the country as a whole. In order to prevent regional disparities in the

⁷ Austin, Granville: *Indian Constitution: Cornerstone of a Nation*, (OUP, New Delhi, 1966), p. 187.

⁸ Saez, Lawrence, *Federalism Without a Centre The Impact of Political and Economic Reform on India’s Federal System*, (Sage, New Delhi, 2002), p.29.

economy it was also necessary to adopt the system of centralised planning. What strengthened the needs for a centralised State during the period had been the presence of the Congress Party in the Centre and, in nearly all the States till the early 1960's. The Congress had always been in favour of a strong Central Government, and being in power at that period of time it no doubt went for a strong Central Government.

The functions have no doubt been divided into three Lists, but the important functions have been entrusted to the Central Government. Again, though both the State and Central Government can make laws regarding subjects in the Concurrent List, the laws made by the Central Government override State laws in case they clash. Again residuary power rests with the Central Government and not the States. Thus, India presents a picture of being more of a unitary State than a federal one.

However, despite the strong unitary features of the Constitution and the centralising impact of planning the Indian political system evolved a distinct federal style. Despite the Constitutional powers of the Central Government, the States of India are not without significance. The States in fact control important subjects like education, agriculture and health. India being a vast country, it would therefore be difficult for the Central Government to handle such functions on its own. Moreover, until and unless the State Governments cooperate such policies framed by the

Centre will not be implemented. "The States need Union funds, but the Union without the cooperation of the States could not long exist. The State Governments may often be instruments of Union (national) policy, but without their help the Union could not give effect to its programme. The two, therefore, are mutually dependent."⁹

Indian federalism has been going through different phases. There was a period of time when centralisation was the order of the day. This was possible till the early 1960's since the Congress was in power both at the Centre and the States. Article 356 was used frequently to remove State Governments on the whims and fancies of the Central Government. The Governors acted as agents of the Centre. This did a great deal in damaging the relation between the Centre and the States. The period under the regime of Mrs. Gandhi witnessed a strain relation between the Centre and the States since she was in favour of a strong Centre with limited powers to the States. It was then, that a Commission under Justice Sarkaria was formed, to look into matters of Centre-State relations.

The Sarkaria Commission, which had come out with its Report in 1987 declared that, "a Constitution is not a static frame but an organic

⁹ Op.cit (Austin, Granville 1966) p. 234.

living institution.”¹⁰ The Committee members of the Sarkaria Commission had acknowledged the fact that the Constitution is not a static body, but has to change according to time, so as to meet the changing needs and problems of the people. They also acknowledged that the two sets of Government, viz. the Central and State Government cannot work in isolation, and divide their work into watertight compartments. “Several features and provisions of the Constitution appear to have been deliberately designed to institutionalise the concept of cooperation.”¹¹

The need for cooperation becomes obvious in respect of a Concurrent List. Again, “several entries of the Union List are expressly intertwined with certain items in the State List, ... These criss-cross patterns of entries in the Lists indicate not only the flexibility in the division of powers but also postulate cooperation between the Union and States in their working.”¹²

The concept of cooperative federalism has been gaining more importance in India in the 1990s. There are a number of factors responsible for it viz. emergence of coalition politics at the Centre, emergence of regional parties and their growing strength in Central

¹⁰ *Sarkaria Commission Report*, 1988, p.5.

¹¹ *Ibid.* p.11.

¹² *Ibid.* p.11.

politics and the adoption of an economic reform programme in the 1990's are but few of them.

The growing importance of cooperative federalism in the 1990s is reflected in the Ninth Five Year Plan. The Plan has dealt extensively with the concept of cooperative federalism. Accordingly, "cooperative federalism makes it possible to raise all the available resources of the Government at different levels in a coordinated way and channel them for the use of the common good of the people. Cooperative federalism encourages the Government at different levels to take advantage of a large national market, diverse and rich natural resources and the potential of human capabilities in all parts of the country and from all sections of the society for building a prosperous nation."¹³ Cooperative federalism is also "intended to ensure a minimum bundle of basic services and a nationally acceptable level of living of all the people of the country."¹⁴

The ideas that have been reflected in the Ninth Five Year Plan only goes to show the increasing importance the concept of cooperative federalism is gaining in recent years. The National Commission to Review the working of the Constitution (NCRWC) has also stressed on the spirit

¹³ *Ninth Five Year Plan 1997- 2002* (6.1).

¹⁴ *Ibid.*(6.1).

of cooperative federalism, so that the balance between the Union and the State is preserved. "Under our Constitutional system, no single entity can claim superiority. Sovereignty doesn't lie in any one institution or in any one wing of the Government. The power of governance is distributed in several organs of the institution-a sine qua non for good governance."¹⁵

Federalism in India is thus undergoing different phases. From being a highly centralised one in the 1950's and early 1960s, to a bargaining and competitive federalism in the mid 1960's to early 1970's, to one of cooperative and competitive in the 1990's. The fact that regional parties have come to play an important role in central politics as coalitional partners has further strengthened the role of cooperation between the centre and the states in India.

Centre-State Relations Under Congress Rule

To understand the different phases Indian federalism has been undergoing, it would be appropriate to study federalism under the Congress regime. The Congress Party has been largely responsible for the shaping of the Centre-State relations as it was in power when the Constitution was being framed. The Congress being a national party had always stood for the issues concerning the nation as a whole. As long as

¹⁵ Website of NCRWC (www.ncrwc.nic.in), *Consultation Papers*, accessed on 10th January, 2002.

it had been the same party that was ruling both the Centre and the States, not much of a problem was being faced in the relations between the Centre and the States.

The Congress Working Committee (CWC), which has been an important body of the Congress Party, has been playing an important role in coordinating Centre-State relations. Being in power both at the Centre and the States till the early 1960's, it was able to settle any dispute that arose between the Centre and the States at the party level. Stanley Kochaneck had observed. "After independence, the Congress considered it convenient for the working committee or chief decision making body of the party to attempt to establish national policy which could be used as model by the States..."¹⁶

Since the meetings of the CWC is being attended by all Chief Ministers, it began to be considered as "an important arena for informal discussions of all India policy, decisions which served more or less as official guidelines to the States."¹⁷

The approach of Nehru towards Centre-State relations in the 1950s was of cooperation and accommodation. This was possible to a great extent because the same party had been ruling in the Centre and

¹⁶ Kochaneck, Stanley: *The Congress Party of India: The dynamics of one party democracy*, (Princeton University Press, Princeton, 1968), p.188.

¹⁷ *Ibid*, p. 188.

most of the States. By the 1967 General Elections, the Indian political system had been transformed "from a dominant one-party system to multi-partyism."¹⁸ Congress Party began to lose power in many States and in its place emerged a number of regional parties.

The death of Nehru brought his daughter to power. Most States by then had come under the wave of different parties, and differences between the Centre and the States began to rise. Mrs. Gandhi to a large extent had also been responsible for the growing tension between the Centre and the States as she was in favour of a strong Centre. Even at the party level she wanted to centralise all power in her hands. She was of the view that centralisation of power would enable her to have a hold over regional politics. Centre-State relations during 1967-77 had been thus practically reduced to a State of non-existence. Indian political process became the victim of centralisation under the rule of Mrs. Gandhi. Centre-State relations had been at its lowest ebb during the rule of Mrs. Gandhi. As a result of such centralisation, the States began to resent the attitude of the Centre and this often led to confrontation between the Centre and the States. State led opposition parties began to demand for more autonomy. Mrs. Gandhi however did not pay any heed

¹⁸ Ibid, p.427.

and would often use the draconian Article 356 to dismiss any State Government.

The fact that Chief Ministers had been removed at the whims and fancies of the Central Government further aggravated the sub-regional feelings. Most important example is Andhra Pradesh, where removal of four Chief Minister between 1980-83 finally led to the formation of the Telugu Desam Party.

Death of Mrs. Gandhi brought her son Rajiv Gandhi into the fray. He was in favour of improving the relations between the Centre and the States. Signing of the Assam Accord with the All Assam Students Union, Mizo Accord with the Mizo National Front, Rajiv-Longowal Accord with the Akalis in Punjab only goes to show the interest Rajiv Gandhi had been having in solving regional problems. The much talked about 73rd Amendment dealing with Panchayats and Municipalities had also been given much push by him, though however it did not take shape during his time.

By 1989, the Congress was no longer in a position to form the Government on its own in the Centre. It had to take the support of other parties while forming the Government. This brought about a remarkable change in the entire outlook of the Congress party regarding Centre-State

relations. Mr. P.V. Narasimha Rao, leader of the party had declared that Centre-State relations would be based on cooperative spirit with the State advising the Union Government on the steps to be taken in various spheres. While addressing the concluding session of the Governor's Conference, he advised "the need for development of all regions uniformly and actually responded positively to specific suggestion which were made by the Governors of the North East in connection with the strengthening of the infrastructure of the PDS."¹⁹

The Panchayati Raj Act or 73rd Amendment, which was being proposed during Rajiv Gandhi's period, finally got passed during the Prime Ministership of P.V. Narasimha Rao. This Act basically dealt with the arming of powers to the local Government.

One important factor for this change in the attitude of the Congress Party, had been the fact that the Congress Party could now no longer command the same kind of majority it had done earlier.

Cooperation Between the Centre and the States

Cooperation between the Union and the States is ensured through a number of institutions.

Cooperation in the Legislative Sphere

¹⁹ *Hindustan Times*, December 29th, 1991.

The division of powers in the legislative sphere between the Centre and the State shows that there is a tilt in favour of the Centre. The legislative power of the Parliament is divided into three List – Union List with 97 subjects; State List with 66 subjects and the Concurrent List with 47 subjects. Each set of Government can frame laws under their own list except for the Concurrent List, where both the Union and State Government can make laws. It is with regards to matters in the Concurrent List that cooperation between the Union and the State becomes obvious.

There is overlapping of responsibilities through the placing of same subjects in more than one List. For instance, different aspects of trade and commerce finds mention in all the three list viz. entries 41 and 42 in List I, entry 26 in List II and entry 33 in List III. This overlapping of functions has resulted in cooperation between the Centre and the States.

Cooperation in the Administrative Sphere

With the emergence of an industrialised and a Welfare State, there has come about a change in the concept of federalism. Problems do not remain confined to one State alone, but transcends State boundaries and what is needed is therefore greater cooperation between the Centre and the States. The main reason for Union agencies to operate is to ensure that the States are able to carry on their functions. Such agencies

include the Governor, All India Services, High Courts etc. Since appointments to such offices are being made by the Central Government, they therefore serve as links between the Central Government and State Governments.

However at times rather than creating cooperation, it is leading to further conflict between the Centre and the States. The role of the Governor as an agent of the Centre has often been questioned. This becomes more obvious when he sends reports to the President regarding the imposition of Presidents Rule. Thus, the misuse of Article 356 has been a major source of constrain between the Centre and the States.

Cooperation in the Financial Sphere

Cooperation between the Centre and the States in the financial sphere is one of the most important aspects of federalism. This is because the States depend to a great extent on the Centre for the transfer of financial resources. Again, in the field of taxation, Centre-State cooperation becomes necessary. This is because of the fact that in cases like under Article 268(1), there are some taxes imposed by the Union but collected and taken by the States. While still under Article 269(1) taxes like succession and estates, railway taxes are imposed by the Union, but the States shares the entire proceeds. Under Article 270

(1) and 272, there are some taxes such as non-agricultural income that are collected and levied by the Union but the proceeds are shared between the Centre and the States. The question of cooperation between the Centre and the States becomes necessary because the States depend on the Centre for financing their development programme. The presence of institutions like the Finance Commission, Planning Commission, National Development Council provided means for furthering cooperation between the Centre and the States.

Constitutional Instruments for Cooperation

One such provision is the Supreme Court, whereby under Article 131 they have exclusive and original jurisdiction in inter-State disputes and as such it helps in minimizing friction between the various State Government. The Supreme Court has original jurisdiction in disputes relating to:

- (i) Centre and State
- (ii) Centre and State on one side, and States on the other
- (iii) Two or more States.

The Supreme Court being the protector of the Constitution sees to it that the framework of the Constitution is protected. The Supreme Court

helps in the settlement of disputes not only between the Centre and States but, amongst the states themselves.

The issue regarding the sharing of rivers water between States is also one important area of tension between the States themselves. In such cases, it is often the Centre, which helps in settling the dispute. Inter-State Water Dispute Act, 1956 had also been enacted to settle inter-State water disputes.

Another area where cooperation becomes a necessity is with regards to health. "The development of health in the national plan has been a joint venture in which the major role has been that of the State Government,"²⁰

Cooperation through Statutory Bodies

These include bodies like the Zonal Councils, Planning Commission and National Development Council, National Integration Council. These bodies have been set up with a view to act as means to bring into existence a harmonious relation between the Centre and the States. The States Reorganization Act 1956 has established Zonal Councils, to advise on matters of common interest to each of the five

²⁰Op. cit (Pal,Chandra, 1985), p. 188.

Zones. The object of these Councils as Pt. Nehru envisaged it is to “develop the habit of cooperative working.”²¹

The Planning Commission set up in 1950 is, the core planning organisation of the country. The States prepare their own plans keeping in mind the broad outline of the Planning Commission. “At every phase of the planning, ‘working partnership’ between the Centre and the States is the characteristic feature.”²² According to the Ninth Five Year Plan, “efforts have been initiated to involve the State Government more closely in the formulation of five year plan.”²³ The system of planning in India is thus a device of Centre-State cooperation in which the norms of development are set by the Centre in discussion with the State, the funds, for which are provided by the Centre.

The National Development Council (NDC) had been set up in 1962 with the purpose of promoting economic policies, mobilising resources and to ensure a balance development of the country. This is more so required in a country like ours, where regional disparities exist. “The position of the National Development Council has come to approximate to that of a super Cabinet of the entire Indian Federation, a Cabinet functioning for the Government of India and the Government of all the

²¹ Basu, D.D.: *Introduction to the Constitution of India*, (Prentice Hall, New Delhi, 1999), p. 335.

²² Ray, Amal: *Inter Governmental Relations in India*, (Asia Publishing House, 1966), p. 138.

²³ Op. cit (Ninth Five Year Plan), 6.18.

States"²⁴. The State Government submit their five-year plans to the Planning Commission, which prepares the National Plan, and after its approval by the Central Government, the NDC goes through it. The Planning Commission takes the NDC's recommendations into consideration before the final shape is given.



Cooperation through Conferences

Cooperation between the Centre and the States and inter-State may take the form of ad-hoc committees or Conferences.

Conferences have been evolving as techniques for facilitating smooth Centre-State relations. Periodical Conferences have become a regular feature of Indian federalism. Amongst the most common held Conferences are the Governors Conference, Chief Ministers Conference, Chief Secretaries Conference, Conference of Inspector General Of Police.

The Governors Conference is held annually to discuss the economic and political situation. Besides the President who acts as the Chairman, the Vice-President, Prime Minister and Central Ministers are also included.

Chief Ministers Conference is the summit meeting of the Chief Executives of the Centre and the States. The frequency of the meetings

²⁴ Santhanam, K.: *Union - State Relation in India*, (Bombay, 1960), p.47.



depends on the gravity of the issues. The Prime Minister presides over the Conference and it is attended by other Central Ministers too. The Conference discusses matters concerning the States and it is on such occasions that the Chief Ministers press for the demands of their States. Such Conferences also helps in minimising the tension between the Centre and the States.

Conferences of other ministers heading various departments like housing, finance, irrigation are also held regularly to discuss problems of mutual interest and as such evolve uniform policies.

The Conference of Chief Secretaries is another important Conference. This has been on the rise as a result of the bureaucratic nature of the entire administrative system. Such Conferences are attended by the Chief Secretaries of State and presided over by the Cabinet Secretary in the Central Government. The first such Conference had been held in 1956 to discuss the law and order problem.

The Inspector General of Police of all States meet to discuss matters like crime, law and order. Crime is not restricted to one State alone, as such it becomes necessary for the States to cooperate in trying to keep the criminals at bay. The Centre also maintains its own police force like the CRPF, RAF, which have to cooperate with the State

machinery. In times when law and order breaks down, the States have to seek the help of the Centre in providing armed forces.

A number of Conferences are held periodically both at the political level and bureaucratic level. This helps in reducing the tension between the Centre and the States. Though the Conferences do not have any legal validity, the fact that high authorities attend, however gives weightage to such Conferences.

Cooperation through the Party System

The Congress Party had been dominating Indian politics since the early 1960s. The Congress Party being in power both at the Centre and the States was able to subdue any tension that arose between the Centre and the States. But this began to change with the losing of power by the Congress in many States by the mid 1960's. New parties began to emerge at the Central and State level.

The 1990s era of coalitional politics has brought about a new phase in politics relating to Centre-State relations. Fall of the Congress, brought about new parties into the political arena. An interesting point to note is that no national party had been able to form a Government at the Centre on its own. It is during this period that regional parties emerge and thus have come to play an important role in Central politics. "The

growth and increased prominence of State based or regional parties introduced a fresh dimension in the working of the federal system.”²⁵

Being a part of the national Government, regional and local issues are now being brought to the Central level. “More than Central influence, the real achievement of the regional parties is that perhaps for the first time a Government in New Delhi has acknowledged the need to recast Centre-State relations.”²⁶ Mr.P.V.Narasimha Rao had declared that, “the Centre-State relations in the future would be based on cooperative spirit with the State advising the Union Government on the steps to be taken in various spheres.”²⁷

The national parties too are beginning to change their stand. Rather than sticking to their rigid ideology, they are accommodating themselves according to the needs of the time. The national parties have also come to realise that they cannot ignore the regional parties. As a result of coalition Governments formed at the Centre between national parties and regional parties, a closer link between the Centre and the States has been established.

Federalism in India is continuously evolving. Though the Constitution framers had established a federal State with unitary

²⁵ Arora, Balveer ‘Political Parties and the Party system’ in Kashyap, S.C., Khanna, D.D., Kueck, G.W. : *Reviewing the Constitution*, (Shipra, New Delhi, 2000), pp. 262-263.

²⁶ *The Hindu* (Madras), June 9th, 1996.

²⁷ *Hindustan Times*, December 29th, 1991.

features, space for Centre-State cooperation has been provided. The fact that the Constitution makes space for Centre-State cooperation through the administrative, legislative and financial provision proves that the Constitution framers had been aware of the fact that India needed provisions for maintaining a harmonious relation between the Centre and the State.

Cooperative federalism implies not only harmonious relation between the Centre and the States, but amongst the States themselves. Intergovernmental relations may be both horizontal and vertical. While horizontal relations talk about relation between States, vertical relation talks about relation between the Central Government and the smaller units. Cooperative federalism thus implies cooperation at both levels, vertical and horizontal.

“While the study of federalism has traditionally emphasised vertical relationships, particularly between national and state level, scholars in recent years have come to recognise the importance of horizontal relationships, such as relationships among states.”²⁸

In the following chapters therefore the nature of the Indian federal system in the 1990's would be analysed in the context of three new developments viz.:

²⁸ Op. Cit (Nice, David, 1987), p. 115

1. emergence of coalitional politics,
2. emergence of regional parties at the Central level,
3. adoption of New Economic Policy and its impact on federalism.

It would be interesting to find out whether there has come about any change in the nature of Indian federalism. Has there been any development towards a spirit of cooperation with the emergence of regional parties at the national level? Has the adoption of a New Economic Policy led to the devolution of more powers to the States? Is there more interaction between the States in this era of economic liberalisation? What role do bodies like the Planning Commission and Finance Commission play in transferring resources to the States in the wake of economic liberalisation? The above-mentioned issues will thus be dealt in the consequent chapters.

Chapter 2

State Participation and Coalitional Process

Party politics in India has been undergoing changes and this is more so in the 1990s, which has been characterised by the growth of coalitional politics. The lack of any party to form a Government on its own has resulted in the rise of coalitional politics, which has been depending on both pre-poll and post-poll alliances. Another interesting feature seen in the 1990s is the rise of regional parties at the Centre. Party politics has been shaping the nature of Indian federalism to a large extent, therefore, it becomes interesting to study the impact of this changing nature of party politics on Indian federalism.

While the performance of the Congress (I) has been declining in the 1990s, what we notice is, the emergence of the Bharatiya Janata Party as a strong force both in the national politics and State level politics. The emergence of regional parties at the Central level politics is also very significant.

1989 serves as a cut-off year in the study of federalism in this dissertation. Firstly, it establishes the base for coalition politics, which has now become more of a trend in every election, be it at the national level or the State level. Secondly, regional parties have come to establish

a mark for themselves at the Central level. Thirdly another significant factor is the adoption of the New Economic Policy, which heralded in liberalisation into the country and where Centre-State relations began to be given a new shape.

Table 2. 1: Performance of Congress since 1980.

Percentage of votes polled in Lok Sabha Polls

	1980	1984	1989	1991	1996	1998	1999
All India	42.7	48.1	39.5	35.31	28.80	25.82	28.30
Andhra Pradesh	56.2	41.8	50.9	45.52	39.66	38.96	42.79
Assam	51.0	23.6	-	27.83	31.64	38.97	33.42
Bihar	36.4	51.8	28.1	20.48	11.26	7.27	8.81
Gujarat	54.8	53.2	37.2	28.99	38.69	36.49	45.44
Haryana	32.6	55.0	46.2	37.22	21.88	26.02	39.35
Himachal Pradesh	52.1	67.6	42.0	46.16	54.33	41.90	39.52
Jammu & Kashmir	18.7	30.2	39.0	-	27.46	19.24	17.83
Karnataka	56.3	51.6	48.9	42.13	30.29	36.22	45.41
Kerala	26.3	33.3	41.7	18.77	38.01	38.67	39.35
Madhya Pradesh	47.2	57.1	37.7	45.34	30.90	39.40	43.91
Maharashtra	53.3	51.2	45.4	48.40	34.78	43.64	29.71
Manipur	23.0	35.0	45.0	38.38	40.17	18.60	25.29
Meghalaya	74.3	62.4	55.4	56.62	53.64	47.62	32.75
Orissa	56.1	57.5	38.4	44.05	44.90	41.04	36.94
Punjab	56.1	57.5	38.4	-	35.10	25.85	38.49
Rajasthan	42.6	52.7	37.0	43.97	40.51	44.45	45.12
Tamil Nadu	31.6	40.5	39.8	42.57	18.26	4.78	11.10
Uttar Pradesh	35.9	51.0	31.8	11.98	5.81	6.02	14.72
West Bengal	36.5	48.2	41.4	11.18	40.09	15.20	13.29

Source: 1980-1989: *India Decides 1952-1989*1989-1999: Election Commission of India: *General Election Reports* to the 10th, 11th, 12th and 13th Lok Sabha Elections.

Table 2.2 Performance of the BJP since 1980

Percentage of votes polled in the Lok Sabha Polls.

	BJS 1984	1989	1991	1996	1998	1999
All India	7.4	BJP 11.4 BJS 0.1	17.10	20.29	35.34	23.75
Andhra Pradesh	2.2	BJP 2.0	4.95	4.04	18.30	9.90
Assam	0.4	-	8.07	14.98	24.47	23.01
Bihar	6.9	BJP-11.7 BJS-0.1	11.83	20.54	24.03	23.01
Gujarat	18.6	BJP-30.5 BJS-0.1	50.37	48.52	48.28	52.48
Haryana	7.5	BJP- 8.3	2.01	19.74	18.89	29.21
Himchal Pradesh	23.5	BJP-45.3 BJS-	42.79	39.62	51.43	46.27
Jammu & Kashmir	1.7	BJP- 7.2 BJS-	-	18.77	28.64	31.56
Karnataka	4.7	BJP- 2.6	27.67	24.61	26.95	27.19
Kerala	1.8	BJP-4.5	-	1.20	8.02	6.56
Madhya Pradesh	30.0	BJP-39.7	41.88	41.32	45.73	46.58
Maharashtra	10.1	BJP-23.7	18.97	21.81	22.49	21.18
Manipur	7.0	BJP-2.3	-	4.47	12.61	1.02
Meghalaya	-	-	-	5.41	9.01	9.45
Orissa	1.2	BJP- 1.3	2.94	11.69	21.19	24.63
Rajasthan	23.7	BJP-29.6	40.88	42.36	41.65	47.23
Tamil Nadu	0.1	BJP- 0.3	0.41	0.92	6.86	7.14
UP	6.4	BJP- 7.6	32.24	33.44	36.49	27.64

Source: 1984-89: *India Decides 1952-89*

1989-99: Election Commission of India: General Election Reports to the 10th, 11th, 12th, 13th Lok Sabha Elections.

Table 2.1 which indicates the performance of the Congress since 1980 shows that there has been a steady decline in the percentage of votes polled by the party in the Lok Sabha Elections . From capturing

42.7% in the 1980 Lok Sabha Election, it went down to 35.31% in the 1991 Lok Sabha Election, and further down to 28.30 % in the 1999 Lok Sabha Election at the all-India level. Even in States where the party has been able to perform well, it started to show a decline by the 1991 Lok Sabha Elections. Assam, Bihar, Uttar Pradesh are some of the few States showing a decline in the performance of the Congress in the 1990s.

Table 2.2 shows the performance of the Bharatiya Janata Party in the various Lok Sabha Elections. The BJP known as the Bharatiya Jan Sangh till 1984 has been showing an improvement in its performance since 1991. From being able to capture 17.10% of the votes polled in the 1991 Lok Sabha Election, it went up to 35.34% in the 1998 Lok Sabha Elections. However the performance of the BJP went down to 23.75% of the votes polled in the 1999 Lok Sabha Election.

While the BJP has been able to improve its performance in the Hindi heartland like Uttar Pradesh, Rajasthan, Gujarat, Madhya Pradesh, it however has been having little impact on the North-Eastern and Southern States.

Table 2.3 Overall Performance of parties in the General Elections since 1980.

Percentage of votes polled in the Lok Sabha Polls.

Parties	1980	1984	1989	1991	1996	1998	1999
BJP	JNP: 19.0	JNP: 6.7	11.4	17.0	20.92	25.51	23.75
	JNPS: 9.4	JNPS 7.4					
CPI	2.6	2.7	2.6	2.37	1.97	1.75	1.48
CPM	6.1	5.7	6.5	6.07	6.12	5.16	5.40
INC	42.7	48.1	39.5	35.31	28.80	25.82	28.30
JP/JD	19.0	6.7	JD 17.8	10.30	6.19	3.24	JD(s) 0.91 JD(U) 3.0
State parties	-	-	5.7	11.17	21.34	18.79	26.93

Source: 1980-1989: *India Decides 1952-1989*

1991-1999: *Report of the Election Commission of India on the 10th, 11th, 12th and 13th General Elections to the Lok Sabha.*

Table 2. 4 Number of seats captured by different parties since 1991.

Parties	1991	1996	1998	1999
BJP	120	161	182	182
INC	232	140	141	114
JD	59	46	6	JD (4) 21 JD (5) 1
CPM	35	32	32	33
CPI	14	12	9	4
Regional Parties	36	85	90	105

Source: Rao, Narashimha G.V.L and Balakrishnan, K. : *Indian Elections : The Nineties*, New Delhi, Har Anand, 1999.

Table 2.3 and 2.4 shows the performance of various national and regional parties in the Lok Sabha Elections. The BJP has been able to improve its performance by capturing 120 seats in the 1991 Lok Sabha Election and going on to capture 182 seats in the 1999 Lok Sabha Elections. The Congress on the other hand has been going down in terms of the number of seats it has been able to capture since the 1991 General Elections. From capturing 232 seats in the 1991 General Elections, it has gone down to a mere 114 seats in the 1999 General Elections. The performance of the other national parties like the CPI(M), CPI, Janata Dal at the national level has not been too significant. Regional parties on the other hand have been showing signs of improvement in their performance since the 1991 General Elections. From capturing 36 seats in the 1991 Lok Sabha elections, the regional parties went on to capture 105 seats in the 1999 General Elections.

Regional parties and Coalitional Politics at the Central Level

The Akali Dal and DMK have been perhaps the strongest regional parties. They have always stood for a change in the existing Centre-State relations. The Sarkaria Commission Report was set up in 1983 by Indira Gandhi on the basis of the Anandpur Sahib Resolution to deal with Centre-State relations, came up with its Report in 1987 and this proved to be a turning point in determining Centre-State relations.

The growing strength of the regional parties at the Central level is very much evident. The fact that the AIADMK of Tamil Nadu and Samata Party of Bihar and UP, could get six Cabinet seats in the BJP led coalition Government of 1998, while being able to capture only 18 and 12 seats respectively in the Lok Sabha, goes to prove it.

The regional parties realised, that in order to nationalise their goals they must be a part and parcel of the Central Government and this is possible if they begin to involve themselves in national politics. The 10th and 11th General Elections have been witnessing the mushrooming of regional parties and their impact on the Indian political scene is evident in the formation of the United Front, a coalitional Government created and sustained by the regional parties. The situation of growing regionalism in the electoral scene became more apparent in the 1998 General Election where out of 176 parties in the fray, 30 were State

based parties. The regional parties have always stood for the interest of the regions they belong to. They are in fact representatives of a special segment of the society.

There are a number of reasons for the emergence of regional parties at the national level. After the Fourth General Elections, a new era of politics at regional and State level started in which the regional parties began to form their independent and coalitional Government for the first time in several States earlier dominated by the Congress Party. According to Arshi Khan,

“People’s mandate for regional parties in several States in the fourth Parliamentary and Assembly elections started a new constructive trend towards the federal process. Despite the failure of the regional parties to sustain Government in States for a considerable period, they emerged as catalyst forces to discourage the Centre towards centralisation process. This could be described as their experiments with federal democracy.”¹

Regional parties have arisen mainly with the idea of promoting the regional interest of the States. This had been felt especially during the rule of the Congress which being a national party had concentrated all the power in the Centre. Thus totally ignoring the demands of the States. It had been during this period that a number of State movements emerged and started demanding for more autonomy and powers to the

¹ Khan, Arshi: ‘Legislation, Political parties, Federal experience in Indian polity’ in Vijapur, Abdulrahim (ed.), *Dimensions of federal nation building*. (Manak Publishers, New Delhi, 1998), p. 185.

States. In other words it is the regional parties which provided impetus in leading the State led movements.

The uneven or lopsided pattern of economic development has been an important factor leading to the growth of regional parties. In India while some States like Maharashtra, Gujarat are industrialised and developed, there are still many others like the North Eastern States, which have been left out of this developmental process. While some States have been able to develop faster because of the kind of financial favours they receive from the Centre; other States development has been stagnating because of the apathy of the Central Government. This issue has often led to conflict between the Centre and the States and even amongst the States themselves.

Chandra Shekhar, former Prime Minister of India, in his opinion said that, the rise of regional parties was mainly due to the failure of the national parties to address adequately the problems of regions in a just and judicious manner². The national parties main objective has been the promotion of the interest of the nation as a whole. On many occasions this has gone against the wishes of the region, because national interest and State interest do not go hand in hand.

² *Statesman*, New Delhi, November 10th, 1997.

Many regional parties have emerged in the national scene. N.T. Rama Rao looked up to the cause of the Telegu pride, C.N. Annadurai came to power in 1967 by contesting against the Congress, AGP came to power in Assam as a party reflecting the sentiments of the Assamese whom they felt has been given a step motherly treatment by the Central Government. Most State parties have risen to prominence by building anti-Congress coalition. In most federal system, State based parties have come to power replacing national parties

Whatever may be the factor for the growth of regional parties, the bottom line is the fact that these parties have arisen because of their need to give representation to the section or region they represent, which they felt have been neglected by the Centre.

A significant development in the 1990's has been the emergence of coalition politics, as no party has been able to obtain an absolute majority to be able to form the Government on its own. After the 1989 General Election as no party was able to get an absolute majority, a National Front Government was formed. The V.P. Singh Government however could remain in power only for 11 months after the withdrawal of support of the Left parties and the BJP. With the fall of the V.P. Singh led Government, Chandrashekhar staked his claim to form the Government, after he had been assured of support from the Congress (I),

AIADMK, BJP, Muslim League, National Conference and a few independent members. The 1996 General Election again resulted in a hung parliament. A United Front (U.F.) led 13 party Government headed by Deve Gowda was installed after a brief 13 days of the Vajpayee Government. Fall of the Deve Gowda Government led to the establishment of another UF coalition Government led by IK Gujral. The 1998 mid-term poll once again gave a fractured mandate with no party or combination getting a majority in the Parliament. The BJP led Government came into existence with the support of a number of regional parties viz. AGP, TDP, National Conference.

The results of the elections from 1989 onwards show not only the breakdown of one party system but also the gradual transition towards a new region based multi party system in which the major national parties compete for power at the Centre. Therefore Centre-State relation once again has come into sharp focus in view of this changing political scenario. The United Front led coalition Government in 1996 marked a paradigm shift in Indian politics. The UF Government have been in fact created and sustained by the regional parties. "The UF contested on the basis of its 17 months of governance around co-operative federalism and

devolution of powers from the central to the State and local Governments.³

Bargaining Powers of the Regional Parties

Bargaining power of the regional parties in the coalition Government has been on the rise. This has been because of the growing strength of the regional parties as a solid block in the Lok Sabha.

The United Front coalition Government, comprising a number of regional parties promised to advance federal principles by implementing the major recommendations of the Sarkaria Commission and by appointing a powerful Commission to review and update the recommendations of the Sarkaria Commission.

“The Common Approach to Major Policy Matters and a Minimum Programme document that was formally released by the Prime Minister H.D. Deve Gowda, on June 5, is an eloquent expression of the clout that regional parties have in the new ruling arrangement. More than control and influence, the real achievement of the ruling parties is that perhaps for the first time a Government in New Delhi has acknowledge the need to recast Centre State relations.”⁴

³ Ahuja, M. L.: *Electoral Politics and general elections in India 1952-1998*, (Mittal., New Delhi, 1998), p.14

⁴ *Hindu* (Madras), June 9th, 1996.

The Common Minimum Programme commits the Government to the “principle of political, administrative and economic federalism. The document concedes right away a greater freedom to the States in determining the priorities, underdeveloped programmes, greater freedom to their plan. The document also promises to transfer most of the centrally sponsored schemes to the control of the State Government.”⁵

The regional parties now being critical for the survival of the coalitional Government have started bargaining for more powers. Jayalalitha of the AIADMK who joined the BJP coalition Government in 1998 began to use her influence “to make a demand to stall a series of corruption investigation against her.”⁶ She even demanded a reshuffle in the cabinet so as to include a number of the party members. Mamta Banerjee of the Trinamool Congress, a part of the coalition Government also began to make demands whereby she be given the post of the Union Railway Minister.⁷

The regional parties have realised that if they remain united, they would prove to be a strong force because the national parties cannot form a Government on their own. The regional parties have gone to the extent of forming a Federal Front. “The formation of the Federal Front

⁵ Ibid.

⁶ Saz, Lawrence: *Federalism Without a Centre The Impact of Political and Economic Reform on India's Federal System*, (Sage, New Delhi, 2002), p.64.

⁷ *Statesman*, January 10th, 1999.

was a matter of strategy of 58 Members of Parliament to protect regional interests together and to bargain power from the United Front".⁸ The Chief Minister of Andhra Pradesh, one of the chief protagonist of the Federal Front felt that his "prime concern is to restructure the present relationship between the Centre and the States, especially in financial areas, and to have amendment in Article 356 of the Constitution to prevent its misuse to destabilize State Government run by parties different from the one in the Centre."⁹

The formation of the Federal Front in the National Front Government by the regional parties, like the TDP,AGP,DMK,TMC, only goes to show the increasing importance of the regional parties in the Central level.

Every Chief Minister is competing for foreign investment for their State and the Central Government has permitted the State Governments to make their own moves to secure funds for development. It has happened for the first time that the Central Government has permitted the State Government "direct authority to clear foreign investment up to a limit in some projects like power sector. If the investment in a power project is up to Rs.1,500 crores and even if the foreign equity level is 100 percent the State Government can directly negotiate to decide about the

⁸ Gehlot, N.S. : *Current trends in Indian Politics*, (Deep and Deep, New Delhi,1998), pp.437-439.

⁹ Ibid pp.437-439.

investor and investment.¹⁰ Such a thing was never possible in the decades just after independence when centralisation was the main theme.

There has been a growing sense of bargaining by the regional parties. One such instance had been demonstrated “when Mr. Kumaramangalam and the Vajpayee Government issued an ordinance for the establishment of Central Electricity Commission to regulate power tariff, the strong protest came from coalition partners like the Akali Dal and DMK.”¹¹

The regional parties have engaged themselves in a bargaining process so as to reap as much benefit as possible for their region especially in the economic sphere. They realised that the development of their States depend to a large extent on the financial aid of the Centre. So, the best option would be bargaining for development to their States, in return for the support to the Government.

The bargaining power of the regional parties in the 1990s also extends to the usage of Article 356, an emergency power, which has created a great strain in the normal functioning of Centre-State relations. Article 356 of the Constitution authorises the President to issue a proclamation imposing President Rule over a State, if he is satisfied that

¹⁰ Bhambri, C. P.: *Indian Politics since Independence* Vol.2, (Shipra, New Delhi, 1999), p.195.

¹¹ *Ibid.*, p.196.

a situation has arisen in which the Government of the State cannot be carried on, in accordance with the provisions of the Constitution. The President issues such a proclamation when he receives a Report from the Governor of a State.

President Rule was imposed for the first time in Punjab in 1951, because of internal squabbles of the ruling party. Ambedkar while framing the Constitution made it clear that this Article was not to be used as a political weapon, but only when it becomes a necessity. However this did not really happen, Article 356 continued to be used as a political weapon by the Central Government against State Government depending on its whims and fancies.

It had been because of the flagrant violation of this Article, that it became necessary to set up a Commission to review the working of Centre-State relations. The Sarkaria Commission under Justice Sarkaria had been set up to deal with the existing Centre-State relations and it had dealt extensively with Article 356. Amongst the recommendations that had been made, were that Article 356 should be used sparingly as a measure of last resort when other alternatives fail; all attempts should be made to resolve the crisis at the State level before taking recourse to Article 356; a warning should be issued to the erring States that it is not carrying the governance of the State in accordance with the Constitution;

the Governor's Report should be a speaking document containing facts.¹²

The Report did not however say anything about abolishing the Article.

In course of time the courts too have come to the rescue of the States and thus have helped in maintaining a harmonious relation between the Centre and States. One such ruling had been the Bommai Judgement. The three States of Rajasthan, Madhya Pradesh and Himachal Pradesh went to court when their Governments had been dismissed on the ground that they had been ruled by the BJP and so proved to be a threat to the security of the country. They moved the court and the case was heard by a nine Judge Bench. The pronouncement made by this Bench has been historic since President Rule became amenable to judicial review.

The intervention by the President on a number of occasions has also reduced the tension between the Centre and the States. Two such occasions were in UP in 1997 and Bihar in 1998 when President K.R. Narayan sent back the Cabinet's recommendation for reconsideration.

However with the coming of coalition Government, there is a new form of bargaining with regards to Article 356. Since the coalition Government is supported by many regional parties the Central Government is bound to listen to the demands of the regional parties.

¹² *Sarkaria Commission Report*, Vol. I, 1988, pp 179 - 180.

These regional parties do not hesitate in demanding the dismissal of their own State Governments, which are ruled by other parties.

The BJP alliance partners AIADMK, Trinamool Congress and Samata Party have been demanding the dismissal of State Government of Tamil Nadu, West Bengal and Bihar. The Government under pressure from its coalition partners immediately send 'investigating teams' to the three States. "A political storm broke out against the practice of sending central investigating teams and the Vajpayee Government defended its actions by appropriating Article 355 of the Constitution."¹³

The Chief Minister of Tamil Nadu, Ms. Jayalalitha went further by accusing the Home Minister, L.K. Advani on going back on his assurance of having promised her the dismissal of the DMK Government, once the party came to power. This only reflects the bargaining power regional parties are using in return for their support to the Government at the Centre.

Article 356 is now being used more as a bargaining power for the regional parties to gain favours from the Central Government, even to the extent of asking for the dismissal of their own State Government. Article 356 is used much less now, when compared to ten-fifteen years back. Article 356 has been a debatable question since the first time it has been

¹³ Op.cit (Bhambri, C.P. 1999), p. 206.

used. The party in power at the Centre has used it more as a political weapon. The Janata Dal, which came to power after the Emergency in 1977, took no time in dismissing State Governments ruled by the Congress as retaliation for similar dismissals by the Congress. Imposition of President Rule has created much strain in the relation between the Centre and the State.

There has been a change in the attitude of national parties regarding Centre-State relations. Even national parties like the INC and BJP, which have always stood for a strong Centre are now being more flexible. This is because of the fact that they have realised that if they are to improve their performance, they need to improve their records in the States, and this is possible only if they are more flexible in their attitude towards the sentiments of the States. Moreover the joining of regional parties in the coalition Government at the Centre and the State level has brought about this rethinking amongst the national parties.

Realising that it needs to improve its performance in the States, if it is to win more seats the BJP is beginning to show flexibility in its ideology. This change in the BJP's attitude has been more prevalent since the 1980s. The BJP in its reply to the Sarkaria Commission's questionnaire asked for a change in the existing arrangement of Centre-State relations. It argued on "the need for the decentralisation of political

power, since a vast country like India can be administered only through regional Government.”¹⁴ The 1984 Election Manifesto of the BJP talked about Centre-State relations as an important issue. The 1991 election manifesto of the BJP also demanded restructuring of Centre-State relations.

The BJP led Government informed the Rajya Sabha, that, “it stood committed to evolve a broad consensus on devolution of administrative and financial powers to State. The Minister of State for Home, Mr. I.D. Swami said that the Centre was keen to evolve harmonious relations with the States and pointed out that even the Constitution is a cooperative and quasi-federal structure.”¹⁵

The BJP has thus come a long way in being more flexible. It realised that if it is to win power in the States it has to make compromises regarding its rigid stand on centralisation.

The devolution of power has made even the Congress a decentralised party, for “the Congress itself has become a coalition of State parties which in turn are coalitions of quasi-autonomous district organisations.”¹⁶

¹⁴ Op.cit (*Sarkaria Report, Vol. II, 1988*), p. 619.

¹⁵ *Hindu*, August 17th, 2001.

¹⁶ Kochareck, Stanley: *The Congress Party of India: the dynamics of One Party democracy*, (Princeton University Press, Princeton, 1968), p.444.

The former Prime Minister Mr. P.V. Narasimha Rao of the Congress while addressing the Governor's Conference, declared that, "Centre-State relations in the future would be based on a cooperative spirit with the States advising the Union Government on the steps to be taken in various spheres."¹⁷

Other national parties like the Communist Party also talk about devolving more powers to the States- economic, fiscal, administrative, and political through Constitutional amendment, activation of the Inter State Council and empowering the National Development Council with adequate powers on planning.

Coalition Politics at the State Level

This change in the political scene has been witnessed not only in the Centre, but States too. Coalition politics has become the order of the day in the States, whereby both regional and national parties join to form the Government.

¹⁷ *Deccan Herald*, December 29th, 1991.

Table 2.5
Chronology of State Governments 1990-99

		1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
1.	Assam	AGP/PR	Cong. (I) *	Cong (I)	Cong (I)	Cong (I)	Cong. (I)	Cong (I) AGP *	AGP	AGP	AGP
2.	Andhra Pradesh	Cong (I)	Cong (I)	Cong (I)	Cong (I)	Cong (I) TDP *	TDP	TDP	TDP	TDP	TDP TDP/ BJP *
3.	Bihar	JD + *	JD +	JD+	JD+	JD+	PR/JD+ *	RJD +	RJD+	RJD+	RJD+
4.	Gujarat	JD/BJP JD/Cong(I) *	JD/Cong (I)	JD/Cong (I)	JD/Cong (I)	JD/Cong (I)	JD/Cong (I) BJP *	PR/RJP +	PR/RJP +	RJP+ BJP *	BJP
5.	Harayana	JD (S) +	JD(S)/ Cong. (I) *	JD(S)/ Cong. (I)	JD(S)/ Cong. (I)	JD(S)/ Cong. (I)	JD(S)/ Cong. (I)	JD(S) /Cong (I) HVP /BJP *	HVP /BJP	HVP /BJP	HVP/BJP HVP/Cong.(I) BJP/INLD
6.	Karnataka	Cong (I)	Cong (I)	Cong (I)	Cong (I)	Cong (I) JD *	JD	JD	JD	JD	JD Cong (I) *
7.	Kerala	LDF	LDF UDF*	UDF	UDF	UDF	UDF	UDF LDF*	LDF	LDF	LDF
8.	Madhya Pradesh	BJP *	BJP	BJP	PR/ Cong (I) *	Cong (I)	Cong (I)	Cong (I)	Cong (I)	Cong (I) *	Cong (I)
9.	Maharashtra	Cong (I) *	Cong (I)	Cong (I)	Cong (I)	Cong (I)	Cong (I) BJP/SS *	BJP/SS	BJP/SS	BJP/SS	BJP/SS DF *
10.	Orissa	JD *	JD	JD	JD	JD	JD Cong (I) *	Cong (I)	Cong (I)	Cong (I)	Cong (I) BJD/BJP *
11.	Punjab	PR	PR	Cong (I) *	Cong (I)	Cong (I)	Cong (I)	Cong (I)	Cong (I) BJP/SAD *	BJP/SAD	BJP/SAD
12.	Rajasthan	BJP/JD * BJP+	BJP +	BJP+	PR / BJP+ *	BJP+	BJP+	BJP+	BJP+	BJP+ Cong (I) *	Cong (I)
13.	Tamil Nadu	DMK	PR AIADMK/ Cong (I) *	AIADMK	AIADMK	AIADMK	AIADMK	AIADMK DMK *	DMK +	DMK +	DMK +
14.	Uttar Pradesh	JD / Cong (I)	JD / Cong (I) BJP/ BSP *	PR	BSP/SP *	BSP/SP	BSP BSP/ BJP BSP	Hung Assembly *	BSP/ BJP BJP +	BJP +	BJP +
15.	West Bengal	Left Front	Left Front *	Left Front	Left Front	Left Front	Left Front	Left Front*	Left Front	Left Front	Left Front

Sources : Compiled from Frontline, Indian Annual Year Book, Manorama Year Book. .

* = Assembly Elections

PR = President Rule

Notes :

1. Assam : 1990 - PR ; 1991 June Elections - Cong(I) ; 1996 April Elections - AGP
2. Andhra Pradesh : 1989 Election - Cong(I) ; 1994 December Elections - TDP; 1999 September Elections - TDP/BJP alliance
3. Bihar : 1990 February Elections - JD + Left Allies; 1995 March Elections - JD + Left Allies; 1996 - JD split, emergence of RJD, with Cong(I), JMM support.
4. Gujarat : 1990 March Elections - BJP/JD coalition; 1990 October - BJP withdraws; 1990 November - JD/Cong(I) 1995 February Elections BJP; 1996 August Split in BJP; 1996 - PR - RJP with Cong(I) support; 1997 October - Cong(I), withdraws supports to RJP; 1997 November - PR - RJP with Cong(I) support comes back; 1998 February Elections - BJP.
5. Haryana : 1991 May Elections - JD (S)/ Cong(I) Alliance; 1996 April Elections - HVP/ BJP; 1999 - BJP withdraws support joins INLD; 1999 June - HVP and Cong(I) support; 1999 July - BJP/INLD alliance.
6. Karnataka : 1989 Elections - Cong(I).; 1994 December Elections - JD; 1999 September Elections - Cong(I).
7. Kerala : 1987 Elections - LDF led by CPI (M) ; 1992 June Elections - UDF led by Cong(I); 1996 April Elections - LDF.
8. Madhya Pradesh : 1990 February Elections - BJP; 1993 - PR - November Elections - Cong(I).; 1998 Nov. Elections - Cong(I).
9. Maharashtra: 1990 February Elections - Cong(I).; 1995 February Elections - BJP/SS; 1999 September Elections -Democratic Front alliance of Cong(I), NCP
10. Orissa: 1990 February Elections - JD; 1995, March Elections - Cong(I).; 1999 September Elections - BJD/BJP.
11. Punjab : 1992 February Elections - Cong(I); 1997 February Elections - SAD/BJP.
12. Rajasthan : 1990 February Elections-BJP/JD; 1990 October-JD withdraws; 1993-PR-November Elections -BJP and allies; 1998 November Elections-Cong(I).
13. Tamil Nadu: 1991-PR- Elections June- AIADMK/ Cong(I); 1993 - Cong(I); withdraws; 1996 May Elections - DMK led alliance; 1998 - TMC withdraws.
14. Uttar Pradesh: 1991 June Elections-BSP/BJP; 1992 December-PR; 1993 November Elections-SP/BSP; 1995 - SP/BSP falls; 1995 July - BSP/BJP alliance; 1995 October-BJP withdraws; 1996 October Elections- Hung Assembly; 1997 March - BSP/BJP; 1997 October BSP withdraws; 1997 October-BJP wins vote of confidence with support from ULCP etc.; 1998 - withdrawal of ULCP-dismissal of BJP led Government-Court restores BJP led Government .
15. West Bengal : 1991 May Elections- Left Front led by CPI (M); 1996 May Elections - Left Front.

There is a strong existence of coalitional politics at the State level as Table 2.5 indicates. National parties and regional parties alike take part in this coalitional politics.

According to Lawrence Saez, “one of the most salient characteristics of the changes in India’s State party system has been the growth in regional parties as well as national parties with a concentrated regional base.”¹⁸ The national parties too are having regional agenda “the CPI (M) in West Bengal, Janata Dal in Karnataka are two examples of national parties with a concentrated regional appeal. These parties have acted as proxy regional parties in the 1980 and 1990’s, primarily by articulating demands for a more decentralised federal system.”¹⁹

This coalitional politics has often resulted in unstable Government, since the coalition is based more on the urgency of need. Thus we see that while the JD had joined hands with the BJP in the 1990 Assembly Elections in Gujarat, when the BJP withdrew from the coalitional Government, it joined the Cong.(I) and thus a JD/ Cong.(I) alliance was formed. Uttar Pradesh is another case where we see parties switching the alignments to suit their needs. At times it has been the BJP and SP forming the government while at times it has been the BJP and the BSP forming the government. Thus what we see is that it is the need to fulfill

¹⁸ Op. cit (Saez, Lawrence, 2002) p. 54.

¹⁹ Ibid. p. 58.

the goals and objectives that alliances are sort after. The frequency in the use of President's Rule then becomes more as a result of withdrawal of parties from the Government, thus leading to instability and mid-term Elections.

Inter State Council and Centre-State Relations

An important method of promoting cooperative federalism is having well-defined institutions so as to serve as forums whereby the heads of the Central Government and the State Government meet to discuss issues concerning Centre-State relations.

Article 263 talks about the establishment of an ISC or an Inter-State Council, and has assigned certain duties and functions to it, viz.:

- a) the duty of inquiring into and advising upon disputes which may have arisen between States,
- b) investigate and discuss subjects of common interest between the Union and the States or between two or more States,
- c) the ISC is purely an advisory body, which could only investigate, discuss and make recommendations to the President, who is empowered to appoint also lay down the duties to be performed by such a body. This is with respect to Union-State relations.

d) With regards to inter-State affairs, the ISC can enquire into and advise upon disputes arising between the States.

The ISC however is a child of the 1990s, since it was established only on May 28th, 1990 by the V.P. Singh Government, "a centrepiece of his NF policy about federalism in the 1989 General Elections."²⁰ The fact that this institution was established only in 1990, it becomes important to study the role of this body in promoting Centre-State relations in the 1990s.

The Administrative Reform Commission first recommended the setting up of an ISC in 1969. The Rajamannar Commission wanted the ISC to be a supreme body, whose recommendations would help to build in a better relationship between the Centre and the States. The Commission intended to transfer some of the powers presently exercised by the Centre to the ISC. The Sarkaria Commission also did talk in length about the setting of an ISC, but it could take shape only in 1990. The ISC was to have a General Body and a Standing Committee. The General Body would consist of the Prime Minister as the Chairman other members would include Chief Ministers of States, and Union Territories, Union Ministers and Other Ministers to be invited.

²⁰ Ibid p. 117.

The question that often arises is why there is a need for the establishment of an ISC, when there are many bodies and institutions, which have been established to look into Centre-State relations.

One of the reasons given by the Sarkaria Commission Report, for setting up an ISC is that "there is no high level coordinating forum other than the ISC envisaged in Article 263 of the Constitution where such problems can be sorted out."²¹ In a democratic country like ours it is only through discussions and meetings of executive as well as representations of the Union and States that Centre-State problems can be resolved. Thus, "the ISC would be renamed the Inter Governmental Council. The IGC would be charged with the duties set out in Article 263, viz. those dealing with matters other than socio-economic planning and development."²²

Despite its purely advisory role, the Sarkaria Commission believed that it is expected that this ISC, "will be able to build up mutual trust and confidence and will soon emerge as the major instrument for discussing at the national level policies and actions affecting in inter governmental relations."²³

²¹ Op. cit (*Sarkaria Report*, vol. 1, 1988), p. 237.

²² Ibid. p.239.

²³ Ibid. p. 239.

As long as the same party rules the Centre and the States, it becomes easy to solve problems that arise between them, as it can be treated as a party matter. Problems start arising when the party at the State is different from the one at the Centre. Even inter-State clashes are also not ruled out. Thus a forum like the ISC where leaders of the States and the Centre can meet openly to discuss matters of importance would do a great deal of benefit to the promotion of a harmonious relationship between the Centre and the States.

“The main purpose of the Council, would be to coordinate between the States and between the Union and the States. The duties of the ISC would be mainly to enquire into and advise upon the inter-State disputes, to investigate and discuss subjects in which some or all of the States or the Union or one of the States have a common interest to make recommendations upon any such subject for the better coordination of policy and action.”²⁴

The guidelines brought about by the Chief Minister of Tamil Nadu, M. Karunanidhi in the first meeting of the Council on October 10th, 1990 reveals some of the functions that are to be performed by the ISC.

The first guideline related to the empowerment of the ISC was to be able to discuss any subject falling within the scope of Article 263; the ISC, should be informed on all matters of national importance, the decisions of which is going to affect any State or States. Such important

²⁴ Singhvi, L.M.: ‘Cooperative Federalism: A Case for the establishment of an ISC’ in Grover, V. (ed.): *Federal system, state autonomy and centre – state relations in India*, (Deep & Deep, New Delhi, 1990), p.43.

matters would include foreign relations, national security, internal politics; the Council may periodically review certain matters in which States have a common interest which include taxation, market borrowings, inter State trade etc. The Council may also be consulted on matters in which the States needs to be taken into account. Such functions include admission of new States, amendment of Constitution, taxation, finance and planning etc. Other specific issues include that the ISC should be consulted on all decisions proposed to be taken by the Union Government, matters relating to minorities, Schedule Castes, Schedule Tribes; ISC should be consulted before the declaration of Presidents Rule etc.²⁵

An overview of the functions and role as given down by the Chief Minister of Tamil Nadu shows that a lot of importance has been attached to the role of the ISC in dealing with Centre-State relations.

The States too in their replies to the questionnaire submitted by the Sarkaria Commission had shown great enthusiasm in the establishment of such a Council. The Government of Jammu and Kashmir in its reply said, that, "we maintain that the setting of an ISC would far better serve

²⁵ Arora, Balveer and Verney, Douglas, V.: *Multiple identities in a single state*, (Konark, New Delhi, 1995), pp. 357-360.

the purpose of reducing frictions and eliminating the mutual grievances between the Union and the States inter se.”²⁶

The Government of Karnataka too in its reply to the questionnaire, is of the view that the ISC should become a forum for discussing problems of Centre-State relations and also the problems that arise among the States. The role of the ISC has also assumes importance because of the existence of a complex multi-party system. The ISC should also serve as a forum where issues like regional imbalance, mutual cooperation among States may be discussed.

The Bharatiya Janata Party too in its memorandum submitted to the Sarkaria Commission felt that formation of an ISC under Article 263 should be made mandatory. The Council should include the Prime Minister and all the Chief Ministers.

The Indian National Congress memorandum however states that there is difficulty in establishing such a Council, since the State will make it a point to take each and every matter to the Council .

The role of the ISC is at best advisory. “ Institutionally the ISC would be the principal forum of inter-State and Union-State consultation. The

²⁶ Op. cit (*Sarkaria Report, 1988*), pp. 207-221..

ISC would also provide basic background data for research on federal problem.”²⁷

The Constitution framers intended through the ISC to provide for a standing arrangement for mutual consultation between the Centre and the States on subjects of common interest. “The Council can be an important forum for keeping the States informed and thereby involved in national policy initiatives.”²⁸

The ISC, which was constituted in 1990 was supposed to have its first meeting in August, but it however did not take place as such. The V.P. Singh Government was itself embroiled in a series of agitation caused by its reservation policy. “When it finally did meet on October 10th, its lackluster agenda and desultory discussion were a source of disappointment to those who had expected much more from this long – awaited Council.”²⁹ During the setting up of the ISC in June 1990, it had been decided that the Council would have a General Body and a Standing Commission. The General Body would consist of the Prime Minister as its Chairman and other members would include all Chief Ministers of States and Union Territories, six Union Ministers and Other

²⁷ Op. cit (Grover, V., 1990), p.44.

²⁸ Arora, Balveer: ‘Political parties and the party system’ in Kashyap, S.C., Khanna, D.D., and Kueck, G.W.: *Reviewing the Constitution* (Shipra, New Delhi, 2000), p.279-80.

²⁹ Arora, Balveer: ‘India’s federal system and the Demands of Pluralism: Crisis and reform in the Eighties’ in Sengupta, J.: *Economic reforms: The role of the state and future of Centre -State relation*, (Observer Research Foundation, New Delhi, 1996), p.178.

Ministers to be invited. The meeting of the Standing Committee was however held only on December 1996.

By the time the second meeting of the Committee took place there had been a decline in the number of Chief Ministers attending the meetings. Apart from Gujarat, Orissa and Rajasthan other States, were represented by Cabinet Ministers. This just reflects the faith the Chief Ministers have in this Council. Thus, what started in a positive way, turned out to be just another body that has been set up without really making much progress.

The second meeting of the full Council took place only on July 17th, 1997. The time frame itself shows the lack of seriousness of the ruling Government under P.V. Narasimha Rao, who made little efforts to convene meetings of the ISC. "During 1996-1997, the Council, was asked to enquire and advise upon the dispute between Andhra Pradesh and Karnataka over the height of the Almatti dam on the river Krishna, and also to discuss disputes between Karnataka and Tamil Nadu over the distribution of the Cauvery water. It also discussed the issue of imposing a consignment tax on the inter-State movement of goods."³⁰

³⁰ Mukhopadhyay, Asok: 'India's Federal Polity: Emerging Trend in the Nineties' in Jana, Anil Kamal (ed.): *Indian politics at the crossroads*, (Commonwealth Publishers, New Delhi, 1998), p. 87-88 .

The Sixth meeting of the ISC was held in 2000. This time the meeting was taking place after a lapse of more than one and a half years. Some Chief Ministers had been of the view that the Council should be convened more regularly, one at least every year. The meeting of this Council though not particularly productive, "served an important objective, namely of mutual discussion between the Centre and the State on important issues in Centre-State relations."³¹

On many occasions in the meetings of the Councils the issue of Article 356 had been raised. In the recently held meeting of the ISC (November 2001), discussions had been going on over the role of the Governor. The Governor plays a vital role in acting as a link between the Centre and the States. It is on his recommendation that President's Rule is imposed on a State. The States often complain that Governors have been acting as 'agents of the Centre'. This is because of the fact that, a Governor is appointed by the Central Government. On a number of times the highhandedness of the Governor has been a cause of strain relationship between the Centre and the State. The States have therefore repeated their demand for a neutral Governor who would look into the problems of the States rather than merely act as 'agents of the Centre'.

³¹ EPW, May 27th, 2000, p. 1780.

The Seventh Meeting of the ISC (November 2001) discussed a proposal made by several States that instead of directly appointing a Governor, the Centre should choose from a panel of three names suggested by the concerned States. The regional ruling parties of Andhra Pradesh, Tamil Nadu, West Bengal have been advocating a new system of appointment for Governors, so that the scope of Centre's interference in regional politics is limited. In a far reaching decision, the ISC decided that a Governor after leaving office, would be debarred from returning to active politics and that it would be mandatory for the Centre to consult the Chief Minister on the appointment of the Governor.³²

The other decisions taken during the Seventh Meeting of the ISC has been the shifting of taxation powers to the Concurrent List, which all this while had been in the Union List, so that the States could mobilise resources. States will now be allowed to impose local or municipal taxes of industrial or commercial properties owned by the Centre. Another important decision was to allow the Centre to retain power to set up a Commission of Inquiry against any Minister of a State, but with appropriate safeguards to prevent misuse. The Chief Ministers led by those from Himachal Pradesh, West Bengal, Tamil Nadu, Madhya Pradesh wanted Doordarshan's regional channels under their control.

³² *Times of India*, November 17th, 2001.

Further, another important decision taken at the ISC meeting had been the transfer of all residuary powers of legislation, including taxation matters from the Union List to the Concurrent list.³³

The fact that the Prime Minister, Mr. A.B. Vajpayee, raised the Prevention of Terrorism Ordinance (POTO) issue at the Seventh Meeting of the ISC even though the matter had not been listed in the agenda only goes to show the growing importance attached to the ISC of late. Vajpayee advised the Chief Minister attending the Meeting that they should have an open mind on the issue thereby striking a reconciliatory note on the proposed controversial issue.³⁴

The ISC in the meetings it has had has often dealt with issue of prime importance concerning Centre-State or inter-State like the Almatti dam case. Though the ISC is an advisory body; yet the composition of the ISC gives weightage to it since it includes not only the Chief Ministers of all States, but also the Prime Minister and other Cabinet Ministers. The most important factor upon which, the successful working of the institution depends are, the regular holding of meetings and a more sincere attempt to fulfil the promises made by such meetings.

The NCRWC, "while endorsing the recommendations of the Commission on Centre-State relations (Sarkaria Commission),

³³ *Hindustan Times*, November 17th, 2001.

³⁴ *Hindustan Time*, November 18th, 2001.

recommends that in resolving problems and coordinating policy and action, the Union as well as the State should more effectively utilise the forum of Inter State Council. This will be in tune with the spirit of cooperative federalism requiring proper understanding and mutual confidence and resolution of problems of common interests expeditiously.³⁵

Party system in India has been undergoing a complete change in the 1990s. The national parties are being more federalised to meet the new demands. Coalition politics is the order of the day both at the Central and the State level. National politics now have to turn to regional parties for support and this is increasing the prestige of the regional parties, which had all the while remained in the dark. Coming in of regional politics to the national level has brought in a new phase in the chapter of Centre-State relations. Focus now is shifting to regional politics. There is nationalisation of regional politics, since the regional parties are now able to bring in regional issues to the national level. The regional parties on their part try to promote federal ideas as much as they can. Even the national parties have joined the regional parties in the formation of coalitional Government at the State level. Thus, this process of coalition politics is revamping Centre-State relations to a great extent.

³⁵ Website of NCRWC, www.ncrwc.nic.in, Final Report, accessed on 5.3.2002.

Another prominent feature of politics in the 1990s is the inability of any party to form a Government on its own and thus has to seek for allies. In this process a number of bargain is made by parties providing support, each party trying to meet their own needs. A number of issues, earlier tackled at the State level, are now being raised at the national level. Besides regional parties raising it, the national parties too, to please their allies take up the issue. What, therefore becomes important is the fact that such issues should be dealt with in a serious manner, not just to please a particular party, or else the existing Centre-State relations which seemed to be cordial would be destroyed once again.

C.P. Bhambri felt that coalition Government has not brought any change for the cooperative working of the federal system. In fact the regional leaders are using it for their own purpose to promote their own interest. "The coalition era of politics has disturbed the delicate balance between Central and State Government because Central Government have become weak owing to shifting politics of coalition and alliances."³⁶ Setting up of institutions like the ISC to promote cooperative federalism would be of little use unless there is a more sincere effort by the parties to fulfil the commitments.

³⁶ Op. cit (Bhambri, C.P., 1999 , p.208.

The political scenario of India in the 1990s has been undergoing tremendous change. National parties that had been having a centralist outlook are now restructuring their ideology to meet the needs of the present time. Centre-State relations have assumed great importance in the present day context because of the changing political scenario both at the national and the State level. For a better coordination between the Centre and the State what therefore is needed is a more committed Government.

CHAPTER 3

COORDINATION OF ECONOMIC POLICY

The entire Indian economy went through a restructuring phase through the introduction of a set of economic reforms programme by the minority Government under P.V. Narasimha Rao with Manmohan Singh as the Finance Minister. The new economic reforms introduced in 1991 brought about liberalisation and globalisation in the country.

The liberalisation policy had not been something new; it had been there since the 1980's. In fact Rajiv Gandhi had introduced considerable measures of liberalisation. The Narashimha Rao Government had taken this up in a big manner.

The Indian economy had not been performing too well. For the past few decades India was adopting a closed economy where privatisation was not much encouraged. The poverty level was still high, industrialisation was restricted to a few region of the country, most of the Public Sector Units were declared sick and on the verge of being closed down; investment from abroad was lacking. The overall economic situation in India was grim.

By 1990-91 inflation was crossing the double figure mark. "Inflation reached a peak level of 16.7% in August 1991."¹ Foreign exchange reserves were at rock bottom and fell to almost \$1 billion, Balance of Payment turned uncomfortable by the end of 1988, and foreign debt was rising. Then came the Gulf War, which led to a sharp rise in oil prices. Fiscal deficit was very high and the Eight Five Year plan could not be presented in February.

To add to this economic crisis was the political crisis of having unstable Governments at the Centre. Before the minority Government of Narasimha Rao came to power, there was a series of coalition Governments, which fell down due to instability. More and more money was thus drained towards the conduct of General Elections. The Narasimha Rao Government though a minority Government had to take up the huge task of introducing such reforms as there was no other alternative. "Economic Reforms or liberalisation became inevitable with the near financial bankruptcy of the Central and State Government."²

The Indian Government had to approach the IMF for financial help worth \$1.8 billion. The IMF agreed to grant such financial help on the ground that the Government restructured the economy through the

¹ *Economic survey 1991-92, Part I, p.1.*

² *Hindustan Times, September 9th, 1994.*

introduction of a Structural Adjustment Programme, which amongst other things, included, the opening up of the Indian economy.

The reforms that were to be short-term measures to correct the economic crisis aimed at putting the economy “back on the path of sustainable growth with equity and social justice.”³

One of the most important feature of the economic reforms programme had been the adoption of liberalisation, and a market friendly economy. The ‘license-permit raj system’ was abolished. It became easier for investors to start up any new industry. They no longer had to undergo the long ordeal of having to get permits or licenses to start their business. The task was made much easier as red-tapism was reduced. This liberalised policy not only attracted domestic investors but also foreign investors. Multi National Companies began to come in a big way as India began to show signs of being a favourable place for investment. Markets for consumer goods proved to be more attractive. We thus see Indian towns and cities being flooded by giant American companies like Pepsi, Coca Cola, Nike, Adidas etc. Japan too had not been far behind. Their emphasis however has been more in the electronic sector.

There were sweeping reforms in the industrial sector too. The industrial licensing system except for 15 industries was abolished; the

³Op.cit (*Economic Survey* 1991-92) p. 1.

number of industries reserved for the public sector was reduced to six; easy access to foreign technology and inputs; confinement of public sector to strategic and core areas; approval of FDI upto 51% equity in 34 high priority industry; boards of public sector companies was to be made more professional and given more autonomy; MRTP Act to be amended; thrust of the policy to be more on controlling and regulating monopolistic and unfair trade practices; number of industries reserved for public sector to be reduced from 17 to 8.

Reforms were also introduced in the public sector units. Most of the public sector units were industrially sick and on the verge of being closed down. Management-worker dispute was on the rise and there was constant lock-out in the factories. Therefore in order to revive them back, a set of reforms was introduced.

- (1) Public sector enterprises, including banks, were encouraged to raise fresh equity directly from the public rather than from the Government.
- (2) Partial disinvestments of equity of selected enterprise. Though, it is very small, it is an important step in the commercialisation of enterprises, thus making them subject to public scrutiny.

- (3) Steps have been taken to make the institutional relationship between the Government and commercial enterprises more contractual and less ad-hoc.

The tax reforms introduced in 1992 under the Chelliah Committee on Tax Reforms had brought about structural shifts in the composition of tax revenues, marked by an increase in the share of direct taxes in total taxation revenue.

Foreign Policy investment was also geared up to promote capital inflow. Some of the policy changes were as follows:

- (1) FERA was amended to remove obstacles for foreign investment in India and to make it easier for Indian businessmen to operate abroad.
- (2) Foreign investment approvals upto 51% of equity in a specified list of 34 priority industries made automatic.
- (3) Investment above 51% equity also permitted subject to approval by specially constituted Foreign Investment Promotion Board.
- (4) Procedures for Indian companies to invest abroad made easier.
- (5) India signed the Multilateral Investment Guarantee Agency Convention with many other developing countries to promote foreign investment.

The Committee on the financial system headed by Mr. M. Narasimha submitted a Report to the Finance Ministry in December 1991. Amongst the recommendations that had been made were that there should be no bar to new banks being set up in the private sector; no further nationalisation of banks; public sector banks with profitable operations should be allowed to tap the capital market for enhancement of their share capital; foreign banks should be subjected to the same requirements as are applicable to the Indian banks and RBI policies should be more liberal in respect of allowing the foreign banks to open branches or subsidiaries; joint ventures between Indian banks and foreign banks should be permitted in regard to merchant banking; investment banking, leasing etc.

The economic reforms programme thus touched a wide range of sectors. "The economic reforms are designed to create the basic conditions for accelerated growth and to enable the country to become self reliant in the true sense of the term."⁴

Economic Reforms at the State Level

The economic reforms that had been introduced have been having a major impact on the nature of Indian federalism. This has been because of the fact that the policies introduced under the economic

⁴ Chelliah, Raja, J.: *Towards sustainable growth: Essays in fiscal and financial sector reforms in India*, (OUP, New Delhi, 1996), p.21.

reforms programme touched the States as well. Until and unless the States implement the policies, the reform programme would not really work out. However uniformity in the implementation of the policies in different States cannot be guaranteed – the major reason being the fact that different parties rule the States. Therefore, the implication of the reform would vary from State to State.

In this entire process of liberalisation, the States however have been the ultimate beneficiary. Location of an industry in any State would benefit the particular State Government most, in terms of taxes, revenues and above all employment of the local people, thus helping the per capita income to rise up.

Since implementation of the policies depend to a great extent on the attitude of the State Government, it becomes important for the Central and State Government to work hand in hand for the successful implementation of the programme.

With the opening up of the economy, more and more private investment, both domestic as well as foreign have been flowing into the States. But there are a number of factors upon which such investment are determined, amongst them are the availability of infrastructure and the attitude of the State Government in terms of being business – friendly. Availability of natural resources is not the only factor for

attracting investment. In fact a more important factor is played by the availability of a proper infrastructure so that the resources are well tapped. The low rate of private investment in North-Eastern States due to lack of proper infrastructure is one such instance. Another important factor is the prevailing law and order. Unless the State is peaceful, investors would not like to invest. Profit being the main motive of private investors, it therefore becomes important that the investor sees the pros and cons before starting the project. A State with a history of law and order problem will be unattractive to any investor. The prevalence of political stability in a State is also important to attract investors. No investors would want to invest in a State where the political leadership changes hand, from time to time. Corrupt States are less attractive to investors and this is more so with the case of foreign investors.

The role of the State therefore is to make available the needed infrastructure. As stated above the implementation of the economic reforms vary from State to State, it is but obvious that while some States would adopt it, others would be critical. States, which are already developed, in terms of industries, per capita, living standards etc. like Maharashtra, Gujarat, Tamil Nadu accepted the reforms package. "Gujarat led the league by attracting 30% of total investment over the

same period.”⁵ However, States like West Bengal did not accept it initially. West Bengal, which has always been ruled by the Communist Party had been critical of this entire Structural Adjustment Programme. They felt that this had been a sell out to the IMF and World Bank. The Communist Party had all the while been critical of the entire economic reforms programme saying that the industrial policy would benefit only the big business houses. “The budget (1991-92) and the Industrial Policy were thus condemned for being anti people.”⁶

The most important implication of economic reforms on Indian federalism is the growing competition among States. The States are fighting hard in trying to attract investment especially foreign investment, as this would imply coming in of more money into the State coffers. The pattern of industrial and foreign investment has further widened the existing regional disparity.

As different States have responded in different manner to the economic reforms programme, it thus becomes obvious that the implication would also vary from State to State. While some States already developed and industrialised have reacted favourably to the reforms programme, not much move has been made by States, which are

⁵ Bhargava Sandeep: 'Industrial Liberalisation: Policy Issues at State Level', *EPW*, (August 26th, 1995), pp. M117-M123.

⁶ Gupta, Indrajit: *New Age*, (August 11th, 1991), p.6.

less developed. This has also to do with the fact that there has been overemphasis on industries, while agriculture, which is an important occupation of the less developed States have been completely ignored. Being industrially under developed these States therefore did not have much of a role to play in the entire economic reforms programme. This has further led to an increase in the regional imbalance between the States.

Since the time of the British rule in India, development has been concentrated only in a few regions of the country. After independence, the Central Government tried correcting such regional imbalance through the adoption of a Five Year Plan Programme, setting up bodies like the National Development Council and Planning Commission, regional imbalance however has not been removed. While States in the western and southern region like Maharashtra, Punjab, Gujarat, Haryana are developed, States in the north and eastern sides are backward, BIMARU States (Bihar, Madhya Pradesh, Rajasthan, Uttar Pradesh), Orissa, North Eastern States are few of them. This division between developed and backward States have often led to conflict time and again and this becomes important when we study the implication of economic reforms on the States.

“Balanced growth is necessary for the harmonious development of a federal State such as India. However, India presents a picture of extreme regional variations, in terms of

such indicators of economic growth as per capita income, the proportion of population living below the poverty line, working population in agriculture. Some States are economically advanced, while others are relatively backward. Even within each State, there are some regions more developed while others are primitive. The co-existence of relatively developed and economically depressed States and even regions within each State is known as regional imbalance. Regional imbalance may be inter State or intra-State, they may be total or sectoral.”⁷

⁷ Datt, Ruddar and Sundaram, K.P.M.: *Indian Economy*, (S. Chand and Co. Ltd., New Delhi, 1999), p.435.

Table 3.1 Per Capita Net State Domestic Product

(Figures in Rupees at 1980-81 prices)

Sates/ UTs	1981-82	1983-84	1991-92	1993-94	1997-98
Andhra Pradesh	1,525	1,585	2,099	2,240	2,550
Arunachal Pradesh	1,725	1,809	2,953	3,267	3,571
Assam	1,262	1,455	1,579	1,592	1,675
Bihar	945	999	1,120	1,038	1,126
Goa	3,143	2,881	5,081	5,281	5,640
Gujarat	2,038	2,350	2,738	2,932	3,918
Haryana	2,455	2,464	3,521	3,482	4,025
H.P.	1,738	1,720	2,268	2,254	2,556
J& K	1,800	1,779	1,815	1,832	1,932
Karnataka	1,584	1,668	2,215	2,393	2,866
Kerala	1,502	1,405	1,876	2,112	2,490
Madhya Pradesh	1,387	1,415	1,636	1,743	1,922
Maharashtra	2,485	2,558	3,615	4,189	5,032
Manipur	1,466	1,527	1,847	1,824	1,948
Meghalaya	1,390	1,348	1,734	1,650	1,804
Nagaland	1,604	1,639	2,119	2,164	—
Orissa	1,278	1,399	1,480	1,549	1,666
Punjab	2,846	2,884	3,873	4,019	4,389
Rajasthan	1,282	1,524	1,916	1,763	2,226
Sikkim	1,686	1,799	3,432	3,461	—
Tamil Nadu	1,570	1,587	2,303	2,528	3,141
Tripura	1,318	1,248	1,671	1,751	2,117
Uttar Pradesh	1,318	1,359	1,648	1,601	1,725
West Bengal	1,749	1,869	2,257	2,413	2,977
Andaman & Nicobar	2,667	2,736	2,744	3,214	3,213
Delhi	4,341	4,161	5,972	6,094	6,478
Pandicherry	2,862	2,820	2,889	2,655	3,208
All India	1,671	1,790	2,213	2,337	2,840

Note 1. Per Capita State Domestic Product (NSDP) calculated as a three year moving average, using CSO's (New Delhi) compilation of State NSDP data at constant 1980-81 prices, centres around 1981-82, 1991-92 and 1997-98, unless specified otherwise.

2. For Goa, Jammu & Kashmir, Manipur and Andaman & Nicobar Island, a 2-year average around 1997-98 and for Sikkim a 2 year average around 1991-92 has been taken.

3. For 1983-84 and 1993-94 NSDP is an annual data to facilitate a correspondence with the National Sample Survey estimates of Per Capita Average Consumption Expenditure for those years.

For All India a 3-years moving average of Per Capita Net National Product (NNP) at constant 1980-81 prices has been taken for the years 1981-82, 1991-92, and 1997-98. For 1983-84 and 1993-94 the figures are annual.

Source : Central Statistical Organisation for NSDP and National Accounts Statistics, various issues, in *National Human Development Report, 2001*.

Table 3.2 Per Capita Consumption of Electricity

(kWh)

State/UTs	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Andhra Pradesh	227	245	191	312	345	374	368	346
Arunacha Pradesh	58	68	58	54	67	66	78	81
Assam	78	84	90	97	95	98	98	104
Bihar	102	110	108	117	126	134	138	138
Goa	396	452	495	541	588	602	707	724
Gujarat	399	469	504	538	587	608	671	694
Haryana	365	400	455	507	491	467	503	504
Himachal Pradesh	180	209	210	208	219	254	288	306
Jammu & Kashmir	178	193	189	188	195	196	201	218
Karnataka	273	296	296	303	328	364	363	340
Kerala	164	188	196	200	215	237	249	241
Madhya Pradesh	205	247	267	281	311	335	367	367
Maharashtra	405	411	434	439	459	500	545	556
Manipur	80	97	107	104	111	107	118	128
Meghalaya	108	115	125	129	110	140	143	135
Mizoram	57	69	69	91	101	112	128	128
Nagaland	17	75	78	73	68	59	79	88
Orissa	181	271	295	297	313	333	370	309
Punjab	639	606	616	684	703	759	760	792
Rajasthan	201	201	231	246	256	270	297	301
Sikkim	96	119	20	114	123	143	173	172
Tamil Nadu	295	323	335	369	386	430	459	468
Tripura	51	57	53	59	60	66	73	80
Uttar Pradesh	159	166	174	179	186	204	207	197
West Bengal	139	148	151	158	171	175	186	194
Andaman & Nicobar	105	117	118	162	168	178	202	210
Chandigarh	584	708	755	715	626	676	717	795
Dadra & Nagar Haveli	879	905	980	1175	1392	1574	1811	2379
Daman & Diu				1015	1182	1548	2016	2335
Delhi	651	704	758	823	733	747	608	577
Lakshadweep	171	154	172	183	207	185	209	234
Pandicherry	618	720	782	856	843	969	958	867
All India	236	253	268	283	299	320	336	334

Source : Annual Reports on the Working of State Electricity Boards and Electricity Departments, Planning Commission, Government of India in *National Human Development Report, 2001*.

Table 3.3 State level Coverage of Roads

(Road length in kilometers per 100 sq.km/million population)

State/UTs	1981		1991		1997	
	100 sq.km	Million Pop	100 sq.km	Million Pop	100 sq.km	Million Pop
Andhra Pradesh	43.38	22.28	54.32	22.50	64.72	24.25
Arunachal Pradesh	8.18	108.35	12.77	118.80	16.83	128.11
Assam	75.33	29.70	83.57	29.39	87.23	27.04
Bihar	48.08	11.96	49.12	9.90	50.81	9.28
Goa	198.14	0.00	192.97	61.33	224.51	57.09
Gujarat	29.63	17.04	41.26	25.22	46.37	19.59
Haryana	52.00	17.79	59.85	16.23	63.70	15.65
Himachal Pradesh	35.21	45.79	45.13	49.26	54.23	48.70
Jammu & Kashmir	5.67	21.04	5.09	17.01	9.65	23.06
Karnataka	57.31	29.60	68.57	29.35	75.09	28.63
Kerala	268.24	40.96	348.84	46.75	374.92	46.26
Madhya Pradesh	23.62	20.07	31.58	21.18	45.13	26.33
Maharashtra	57.38	28.12	72.07	28.14	117.62	40.98
Manipur	23.75	37.32	29.85	37.02	49.00	47.57
Meghalaya	22.49	37.76	28.90	36.01	37.81	38.55
Mizoram	10.90	45.62	17.70	53.31	22.91	53.66
Nagaland	35.25	75.41	88.98	122.93	110.72	122.37
Orissa	76.98	45.45	125.84	62.20	168.72	75.27
Punjab	91.18	27.35	107.74	26.86	127.78	27.04
Rajasthan	19.65	19.63	35.80	27.91	37.89	25.43
Sikkim	14.94	33.50	22.46	39.85	25.85	36.68
Tamil Nadu	93.23	25.05	151.23	35.37	158.78	34.25
Tripura	55.92	28.56	134.18	32.11	140.46	43.32
Uttar Pradesh	49.84	13.23	68.21	14.45	86.77	15.90
West Bengal	64.03	10.41	69.50	9.07	85.00	9.91
Andaman & Nicobar	7.90	45.54	10.91	30.00	15.97	32.93
Chandigarh	139.47	3.52	1,350.88	25.67	1,537.72	21.91
Dadra & Nagar Haveli	44.40	21.03	64.15	31.50	108.55	26.65
Daman & Diu	0.00	0.00	0.00	0.00	2.65	10.10
Delhi	937.56	22.35	1,406.14	22.18	1,792.45	21.27
Lakshadweep	0.00	0.00	0.00	0.00	3.13	0.10
Pandicherry	428.89	35.12	511.52	31.65	485.86	24.05
All India	45.13	21.68	61.27	23.88	74.93	25.82

Note Road coverage in this table refers to all category of roads (both surfaced and unsurfaced) including National Highways, State High ways, major district roads, other district roads and rural roads. Data as on 31st March of the indicated year.

Source: Planning Commission, as also reported in Basic Road Statistics of India, 1995-96 in *National Human Development Report, 2001*.

Table 3.1 indicates the regional disparities prevailing in India. While States like Goa, Haryana, Punjab, Maharashtra, Delhi have a high per capita Net State Domestic Product, this is not so with States like Assam, Orissa, Manipur, Bihar, Uttar Pradesh.

Table 3.2 shows that consumption of electricity varies from State to State. Industrialised States like Maharashtra, Karnataka and Punjab have a high rate of consumption of electricity. Consumption of electricity by a State also depends on the ability of the State to produce hydroelectric power. A small State like Meghalaya, having natural resources for producing hydro-electricity has a higher consumption rate than Assam, which is a bigger State.

Table 3.3 shows the area of land accessible by roads in a State. States like Goa, Kerala, Delhi, Chandigarh have been able to bring a large area under the coverage of roads. While States like Jammu & Kashmir, Mizoram, Sikkim, Andaman & Nicobar Island have very small area accessible by road.

Table 3.1, 3.2, 3.3 are but few indicators to show the prevailing regional disparities of the States in terms of per capita Net State Domestic Product, per capita consumption of electricity and coverage of land by road in a State.

Some states have complained that underdevelopment in their States is because of the Centre's step – motherly treatment, especially in the case of finance. The complain has been more when the Government ruling at the Central level is different from the one ruling at the State level.

The degree of urbanisation, industrialisation, electric consumption, development of roads being important indicators of development, it is no doubt that the Central Government is asking the State Government to restructure their State Electricity Boards and Road Transport Corporations. Reforms in the power sector have been introduced so as to correct the State Electricity Boards. State Electricity Boards though meant to earn huge revenue are always at a loss. Distribution of power is not confined to one State alone. Since it is inter regional there are better chances of cooperation between regions. Power Sector Reforms include most importantly the reform of State Electricity Boards through privatisation of these State Electricity Boards. Many State Governments have already taken the initiative by passing the Electricity Reforms Bill. The Ministry of Power has signed Memorandum of Agreement with Karnataka, Uttar Pradesh and Madhya Pradesh. Amongst the recommendation made, was the 100 percent electrification of all villages. Plan Allocation to the Accelerated Power Development Programme has been stepped up in the Budget 2001-2002. It has also been decided to

wipe out the outstanding dues of the State Electricity Boards. "The Electricity Regulatory Act, 1998 and State Acts had enabled the regulators to be appointed at the national and State levels."⁸ Reforms in the power sector becomes important since it would allow the tapping of natural resources of a State capable of producing hydro – electric power.

The increasing level of competition among States can be seen from the tax concessions offered by various States to attract investors. For instance, "on January 17, 1999, over 200 industry and State policy makers met in Calcutta to discuss West Bengal State Government's effort to attract investment there."⁹ Some States have scrambled to become more competitive by undertaking special initiatives. For instance the State of Orissa took the initiative of privatising its State electricity boards in 1996.

With the granting of more power by the Central Government to the State Governments, the Chief Ministers felt free to take initiative to woo investors, both domestic and international. The most noted one being the Chief Minister of Andhra Pradesh, Chandrababu Naidu, where in the recent World Economic Forum, he was part of the Indian contingent. He was successful in wooing investors for his two new projects at Genome Valley near Hyderabad and the Andhra Pradesh Special Economic Zone

⁸ Baijal, Pradip: 'Restructuring Power Sector in India', *EPW*, (September 25th, 1999), pp.2795-2803

⁹ Mitra, Sumit: 'Speed breakers Ahead', *India Today*, February 24th, 1999, p.45.

being set up at a 9,000-acre duty-free, commercial enclave near the port city of Vishakapatnam. Naidu was successful in clinching a series of Memorandum of Understanding with biotech companies, kicked off his road show for the APSEZ project, signed an agreement with North Carolina State for setting up a State of the art biotech park, got investment commitments from chemical companies including Pfizer.¹⁰ In fact Andhra Pradesh has been one of the State, which has gained immensely from the economic reforms programme, especially with regards to foreign investment in the information-technology sector. This has a lot to do with the over enthusiastic zeal of the Chief Minister, Mr. Chandra Babu Naidu who often toured abroad to attract investors.

Incentives by States to attract foreign investors include:

Maharashtra

- Sales Tax relief of 60% of fixed capital investment for five years.
- Sales tax relief of 80% of fixed capital for new units for five years

Gujarat

- Sales tax deferment up to 125% of fixed capital investment for nine years.
- Sales tax relief upto 100% of fixed capital investment for seven years.

Tamil Nadu

- Investment subsidies of 20% of fixed assets upto Rs. 10 lakhs for units such as electronics and leather industry enterprise.
- Investment subsidies of 20% of fixed assets upto Rs. 10 lakh for units in backward areas.

¹⁰ Padmanabhan, Anil: 'Naidu Scores in New York' in *India Today*, (February 18th, 2001), p.20.

Bihar

- Sales tax exemption for 10 years on purchase of raw materials.
- Sales tax exemption on finished goods up to 100% of fixed capital investment.

Uttar Pradesh

- 20% rebate upto 5 years on electricity bills.
- 75% subsidy in the cost of transportation of raw materials.¹¹

The backward States have realized that if they are to move ahead in the developmental race they should try to provide incentives to woo investors to their States. With the opening up of the economy, the number of foreign investors touring the States, have also increased.

¹¹ Op.cit. (Saez, Lawrence, 2002), pp. 151-153.

Table 3.4 Ratio of FDI, Public Investment and Domestic Private Investment as a proportion of Total Investment per State (1997)

States	FDI/total Investment Ratio	Public Investment /Total Investment Ratio*	Domestic Private Investment/Total Investment ratio*
Orissa	33.5%	19.9%	37.5%
Tamil Nadu	27.2%	43.9%	24.4%
Maharashtra	21.0%	48.2%	25.3%
Karnataka	18.3%	24.7%	35.9%
West Bengal	17.9%	38.3%	26.0%
Andhra Pradesh	15.8%	44.2%	36.3%
Gujarat	10.2%	31.9%	45.5%
Bihar	0.8%	75.9%	23.3%
Assam	0.0%	68.8%	4.4%
Jammu and Kashmir	0.0%	81.2%	18.8%
Nagaland	0.0%	95.0%	5.0%

Source: Rukmini Parthasarathy 'The Best States To Invest In', *Business Today* 7 (December 1997) pp. 84-85

Note : * means that joint sector investment has been excluded from calculation

Table 3.4 shows that while foreign investment is high in States like Tamil Nadu, Maharashtra, Karnataka, it is nil in Assam, Jammu and Kashmir, Nagaland. This is the case with private investment too, where it

is very low in States of Assam, Jammu and Kashmir and Nagaland. However in States where private investment, both domestic and foreign, is low the public investment is high. This is an effort of the Central Government to see that with privatisation backward States are not left behind.

Another important indicator we get from table 3.4 is that regional imbalance continues to exist especially more after the economic reforms have been introduced “The last four years of globalisation of the Indian economic have further deepened the difference between the developed States like Maharashtra, Karnataka and the underdeveloped States like Bihar, U.P. Similarly North Eastern States have further pushed towards underdevelopment because the foreign investors are attracted towards developed States and not really towards backward States.”¹²

¹² Bhambri, C.P: *The Indian State: Fifty years*, (Shipra, New Delhi, 1997), p.221.

Table 3.5 Annual Rates of Growth of per capita Gross State Domestic Product.

	1980-81 to 1990-91 (% per annum)	1991-92 to 1997-98 (% per annum)
Bihar	2.45	1.12
Rajasthan	3.96	3.96
Uttar Pradesh	2.60	1.24
Orissa	2.38	1.64
Madhya Pradesh	2.08	3.87
Andhra Pradesh	3.34	3.45
Tamil Nadu	3.87	4.95
Kerala	2.19	4.52
Karnataka	3.28	3.45
West Bengal	2.39	5.04
Gujrat	3.08	7.57
Haryana	3.86	2.66
Maharashtra	3.58	6.13
Punjab	3.33	2.80
Combined SDP of 14 States	3.03	4.02

Source : SDP and population data obtained from CSO in Ahluwalia, M.S. 'Economic Performance of States in Post-Reforms Period' in *EPW*, (May 6, 2000), pp. 1637-1648.

Table 3.5 shows that there is a considerable variation in the performance of States. Some States like Tamil Nadu, Gujarat, Maharashtra, Kerala, West Bengal have been showing an improvement in their performance in the post-reform era, States like Bihar, Orissa, Uttar Pradesh, have however been showing a decline in the rate of performance. This shows that economic reforms have been having different impact on the States.

One important trend that has emerged in the post reform period is the widening of regional disparities. The developed States continue to be further developed, while the underdeveloped or backward States continue to remain underdeveloped. Their lack of proper infrastructure has failed to attract the attention of the investors. This becomes important while studying the changing trends in Indian federalism and how the impact of economic reforms has brought about a change on the nature of Indian federalism.

With the adoption of a New Economic Policy, what we notice is an increasing role being given to the States. The Centre has curtailed a number of its function, "With the reform programme already in process, the entire gamut of Centre-State relations is in a flux... The States must use the greater freedom of action that they have acquired wisely. It is necessary that the States should change their attitude to one another and recognise more clearly their inter-dependence and mutual

interests".¹³ States can now interact directly with foreign funding bodies like Asian Development Bank, World Bank for financial help to carry out their structural programmes. States are not solely dependent on the Centre for financial aid, they have the potentials of raising their own revenue.

While this is true of the industrialised States, it cannot said to be true of the backward and less developed States. Therefore, constant push by the Centre is needed. Economic reforms have brought with it privatisation and the main motive of the private entrepreneurs is to try to make profit as much as possible. They would avoid taking risk by investing in areas lacking proper infrastructure and having law and order problem. Most of the backward States, which lack a proper infrastructure, are therefore deprived of such investments. It therefore becomes important for the Centre to see that these States are not left behind. In the entire process of having a market friendly economy, we should not forget the role to be played by the Central Government to bring about development in the backward States or else this would lead to serious inter regional conflicts. "...in a country with sharp regional inequalities in development and levels of living, the Centre has a role in

¹³ Op.cit (Chelliah, Raja J., 1996), p.23.

'redistribution' to enable the poorer States to provide basic public services at a reasonable comparable level,¹⁴

An important sector, which has been neglected by the New Economic Policy, is agriculture. While the restructuring programme has dealt at length with industry, trade, power, banking etc., agriculture has been ignored. Therefore States having agriculture as their main occupation have not reacted favourably to the economic reforms programme. Until and unless, reforms are introduced in the agricultural sector too, the performance of the backward States would continue to be dismal. The developed States have been able to make the most of these economic reforms programme because the entire package has been industrial friendly.

Economic reforms no doubt have led to the increase in the level of competition amongst various States, but at the same time it has led to a kind of cooperation amongst the States. "In this context, the Chief Minister of North Indian States at the annual session of Council of North Indian States for Cooperation and Regional Development organised by the northern region of Confederation Indian Industries CII, have agreed

¹⁴ Bagchi, Amaresh: 'Rethinking Federalism' in *EPW*, (August 19th, 2000), pp. 3025-3036.

in principle to form regional trade alliances for optimum productive use of resources with minimum of wastage ... Regional cooperation is necessary for free trade to flourish. To accelerate progress and speedier free movement of goods, the non-tariff barriers are needed to be removed within the regions so that strong bonds gets established.”¹⁵

Economic reforms have restructured the nature of Indian federalism to a great extent. While on one hand it has led to competition amongst the States, on the other it has led to regional cooperation. Again, while the role of the Centre is being curtailed, the role of the State is expanding. In all this, however, we cannot deny the fact that cooperation between the Centre and the State is a necessity if the policies are to be implemented and carried out. Adoption of a market economy does not undermine the role of the Centre; in fact the Centre has to play a far bigger role to see that the underdeveloped States are not lagging far behind.

¹⁵ Khanna, Kewal: *Current economic issues and trends*, (Printwell, Jaipur, 1997), p. 46

CHAPTER 4

STATES POWERS AND RESPONSIBILITIES UNDER ECONOMIC REFORMS

The division of powers between the Centre and the State is provided by the Constitution under the Central List, Concurrent List and State List. Matters falling under the jurisdiction of the States like law and order, health, social service and maintenance of roads, among others have to be taken up by the State Government. This means the incurring of a huge expenditure by the State Government. The larger the States, the larger would be the expenditure pattern. Accordingly, the Constitution has provided means and measures by which there will be transfer of resources from the Centre to the States. In this matter the Planning Commission and the Finance Commission has been set up with the purpose of looking into the allocation of resources from the Centre to the States.

With the adoption of a liberalised policy by India in the early 1990s, there has come to exist a stiff competition between the Centre and the States, in providing service to the people. Privatisation has brought about a lopsided development of the States, as the private entrepreneurs refuse to invest in States where no profit is likely to be

derived. Therefore it is upto the Government to take upon itself the developmental task.

TABLE 4. 1 EXPENDITURE PATTERN OF THE STATE GOVERNMENTS

Rupees in Crores

Year	Total Expenditure (3+4)	Revenue Expenditure	Capital Expenditure	Of which		Developmental Expenditure	Of which		Non-development al Expenditure	Of which		
				Capital Outlay	Loans & Advances by State Government		Economic Services	Social Services		Interest Payments	Admn. Services	Pension and Misc. General Services
1	2	3	4	5	6	7	8	9	10	11	12	13
1989-90	76,782	60,217	16,565	7,963	4,826	53,150	27,376	25,774	19,253	7,186	5,975	931
1990-91	91,088	71,776	19,312	9,223	5,756	63,370	33,410	29,960	22,600	8,655	7,018	3,593
1991-92	107,929	86,186	21,743	10,096	6,463	74,588	40,900	33,688	27,143	10,944	7,810	4,479
1992-93	119,335	96,205	23,129	10,655	7,045	80,567	43,235	37,332	32,104	13,210	9,344	5,272
1993-94	134,649	109,376	25,272	12,450	6,752	89,388	47,408	41,979	38,020	15,801	10,473	6,999
1994-95	161,554	128,440	33,114	17,351	9,416	104,348	55,475	48,873	49,556	19,413	11,664	11,927
1995-96	177,584	145,004	32,580	18,495	8,231	114,819	56,984	57,835	55,380	21,932	13,391	12,834
1996-97	202,769	168,590	33,819	17,540	9,545	132,008	66,548	65,459	62,095	25,576	14,950	13,515
1997-98	228,135	186,634	41,501	22,802	10,557	145,268	71,748	73,520	71,767	30,113	16,955	15,004
1998-99 (RE)+	279,321	229,609	49,712	26,005	12,201	175,246	80,407	94,839	88,796	36,921	21,819	18,109
1999-2000 (BE)+	311,287	260,878	50,409	28,683	11,232	187,502	85,056	102,446	109,422	44,946	28,432	24,443

RE Revised Estimates. BE Budget Estimates.

+ Data are provisional.

Note : Data for capital expenditure prior to 1991-92 have been adjusted for remittances (net).

Source: Budget Documents of the State Governments.

In, *Hand book of Indian statistics on Indian Economy 1999*, RBI.

Table 4.2: Developmental and Non-Developmental expenditure of Central and State Governments

Rupees in crores

Year	Centre #		Total	States		Others*	Total	Centre and States Combined			Total
	Developmental Expenditure	Non-Developmental Expenditure		Developmental Expenditure	Non-Developmental Expenditure			Developmental Expenditure	Non-Developmental Expenditure	Others \$	
1989-90	54,204	41,020	95,224	53,150	19,253	4,406	76,809	89,420	54,267	1,452	145,139
1990-91	58,645	49,349	107,994	63,370	22,600	5,272	91,242	98,686	63,397	1,590	163,673
1991-92	59,313	55,170	114,483	74,588	27,143	6,915	108,646	109,372	72,319	4,214	185,905
1992-93	65,479	60,584	126,063	80,567	32,104	6,664	119,335	118,202	82,795	2,046	203,043
1993-94	72,464	73,586	146,050	89,388	38,020	7,241	134,649	129,042	100,261	3,347	233,650
1994-95	82,803	82,402	165,205	104,348	49,556	7,650	161,554	150,367	119,322	3,185	272,874
1995-96	84,427	98,632	183,059	114,820	55,379	7,385	177,584	165,361	135,274	2,951	303,586
1996-97	94,197	112,217	206,414	130,822	63,281	8,666	202,769	185,368	154,900	3,280	343,548
1997-98	110,994	127,820	238,814	145,269	71,767	11,099	228,135	208,993	178,311	5,085	392,389
1998-99 (RE)	139,014	151,080	290,094	175,246	88,796	15,279	279,321	254,894	215,620	7,412	477,926
1999-2000 (BE)	124,139	168,990	293,129	187,501	109,422	14,363	311,286	269,965	247,930	5,695	523,590

RE = Revised Estimates. BE = Budget Estimates.

Includes commercial Department in respect of Central Government's Revenue Account

* Comprise discharge of internal debt, repayment of loans to the Centre and compensation and assignments to Local Bodies and Panchayat Raj institutions.

\$ These figures related to State Governments are adjusted for repayment of loans by State Governments to Centre as given in Central Government Budget documents.

Note: 1. Data do not cover Union Territories with legislature. From 1993-94 onwards data relate to 26 State budgets including National Capital Territory of Delhi.

Source: Budget documents of the Government of India and State Governments.

In, *Handbook of Indian statistics on Indian Economy, 1999*, RBI.

As indicated in table 4.1 the expenditure pattern of the State Government in both development and non-development sector has further widened the expenditure pattern of the State Governments. Total expenditure went up from 107,929 in 1991-92 to 1,19,335 in 1992-93 to 279,321 in 1998-99 (Rupees in Crores).

Table 4.2 show the States as well as the Centre's development and non-development expenditure. An interesting feature to note is that while total expenditure (both development and non development) has been rising, the expenditure on development sector was high till 1992-93. However, from 1995-96 there has been a shift in the expenditure pattern. The expenditure is more in the non-development sector rather than in the development sector. With regards to the State expenditure however, it is different, as they spend more on the development sector.

Table 4.3 Deficits of State Governments
(As per cent of GDP at current market prices)

	Fiscal Deficit	Primary Deficit	Revenue Deficit
1989/90	3.2	1.7	0.8
1990/91	3.3	1.8	0.9
1991/92	2.9	1.2	0.9
1992/93	2.8	1.0	0.7
1993/94	2.4	0.6	0.4
1994/95	2.7	0.8	0.6
1995/96	2.6	0.8	0.7
1996/97	2.7	0.9	1.2
1997/98	2.9	0.9	1.1
1998/99	4.2	2.2	2.5
1999/2000	4.6	2.3	2.7
2000/2001	4.3	1.9	2.4
RE			

Average

1991/92 to 1996/97	2.7	0.9	0.8
1997/98 to 2000/2001	4.0	1.8	2.2

Source: RBI, *Handbook of Statistics on the Indian Economy 2000*.

Notes 1. Data for 1999/2000 are provisional

2. RE: Revised Estimate

Table 4.3 shows the deficits (fiscal, primary and revenue) of State Governments. Which is the result of a huge expenditure and lack of adequate resources amongst the State Governments. There has also been a sharp increase in the average fiscal deficit from 2.7% in 1991/92 – 1996/97 to 4.0% in 1997/98 – 2000/01. Likewise there has been a rise in the primary and revenue deficit. Thus the State which “seemed to be managing their finances relatively better, but in the 1990’s, they began to run revenue deficits which increased the gross fiscal deficit to 3% of GDP.”¹

State Finance

In studying the expenditure and deficit level that the State Government faces, it therefore becomes important to analyse the sources of State finance. The States apart from raising their own revenue in the form of sales tax, according to N.J. Kurian, “the other major components of States own tax revenue according to their revenue share are State excise registration and stamp duty, motor vehicles and passengers tax, electricity duty, land revenue, profession tax, entertainment tax and other sundry taxes.”² While larger States have no problem in raising

¹ Sethuram, S.: ‘Indian Economy – A New Dawn’ in *Manorama Year Book*, 2002, p.56.

² Kurian, N.J.: ‘State Government Finances’ in *EPW*, (May 8th, 1999), pp. 1115-1125.

such revenue, this is not the case with small and underdeveloped States. Again, another area where the small and underdeveloped States lack is with regards to the attraction of private investors. As such they lose a major share of the revenue. Therefore, they have to depend to a large extent on the Centre for the transfer of financial resources.

With a view to remove regional imbalances, some States have been placed under the special category status and as such they receive special treatment from the Centre. The criteria for placing such States under this category includes underdevelopment, lack of proper infrastructure, hilly terrain. Under the special category status, the States receive grants from the Planning Commission. According to the Gadgil formula, which forms the basis for the allocation of funds to the States, 30% of the State's total is earmarked for the special category States. The special category States receive 90% plan assistance as grants and just 10% as loans.

“Transfer of resources from the Centre to the States has been taking place through the Finance Commission (statutory) and Planning Commission and Central Ministries (discretionary).”

³ Sastry, M.L. and Reddy, G.R : *Centre- State Financial Relations - A study in levels of development of States*, (Concept, New Delhi, 1988), p. 25.

The Planning Commission has been set up with a view to lessen the regional disparities that exist amongst various States. "The Planning Commission helps the States in their efforts through the transfer of resources for their operational Annual Plans."⁴ The Planning Commission allocates resources to the States on the basis of two methods (1) formula based assistance (2) discretionary plan assistance. With the adoption of the Gadgil formula, "distribution of Central assistance for State plans greatly reduced the area of discretion of the Planning Commission and brought about a considerable measure of objectivity into the process. Further the formula did away with the existing cumbersome schemetise pattern of grants and loans and introduced the system of block loans and grants."⁵

Since 1969, Central Assistance for the State plans has been distributed to the States as per the Gadgil formula, some marginal changes have been made from time to time but the emphasis has always been on channelising larger Central assistance to the backward States. "The Gadgil formula, was devised to bring more objectivity and predictability into the allocation of Central aid to the State Plans."⁶

⁴ *Draft Mid Term Appraisal of Eight Five Year Plan 1992-97*, (9.2).

⁵ *Op.cit* (Sastry, Reddy, 1988), p. 29.

⁶ Ruijter, Arie De: *The Purse and the power: Aspects of Centre-State relations in India*, (B.R. Pub. Corp., 1998), p.185.

The National Development Council has laid down the manner in which Central assistance is to be distributed. "According to the latest formulation which was approved by the NDC in 1991, after taking away the requirement for Special Area Programme, TSP and externally aided projects, 30% of the Central assistance remaining is to be given to the special category States and balance 70% to be distributed among the non special category States on the basis of formula which include criteria like population, per capita income"⁷ Again "the Special Central Assistance which is given for hill areas is 90% grant and 10% loan."⁸

There has been continuous debate between the Centre and the States regarding the allocation of financial resources. While the special category States justify the allocation of huge Central assistance on the ground that they are unable to raise the revenue themselves, the developed States on the other hand argue that they need to be rewarded for maintaining a good fiscal discipline. The fact that they can create huge sums of revenues by themselves does not imply that Central assistance needs to be cut down. Being larger States they need more funds as their expenditure level is also high.

⁷ Op.cit (Draft Mid-term Appraisal of the Eight Five Year Plan) 9.7.

⁸ Ibid, 9.20.

The States have been undergoing continuous financial strain as the gap between the expenditure and revenue receipt is continuously widening. The revenue received from the Centre and those raised on their own, is never sufficient to meet the expenditure incurred on both development and non-developmental sectors. "A number of States started experiencing fiscal imbalances from the second half of the 80's subsequent to the central pay revision on the basis of the Fourth Pay Commission recommendation."⁹

The Mid Term Appraisal of the Ninth Five Year Plan undertaken by the Planning Commission has shown that finances of the States have been under considerable stress, particularly during the last few years. "There has been a growing mismatch between revenue and expenditure of the States with the resultant determination in revenue and fiscal deficits."¹⁰

Though the States have been given power to tax, the yield is not enough to serve the purpose of the States. The Constitution, therefore to meet the needs of the States makes special provision:

⁹ Op.cit (EPW May 8th, 1999), pp. 1115-1125.

¹⁰ *Approach Paper to the Tenth Five-Year Plan.*

- (i) Some duties are leviable by the Union; but they are to be collected and entirely appropriated by the States after collection.
- (ii) There are some taxes levied and collected by the Union, but the proceeds are then assigned by the Union to those States within which they have been levied.
- (iii) Again, there are taxes which are levied and collected by the Union, but the proceeds are distributed between the Union and the States.¹¹

The National Commission to Review the Working of the Constitution (NCRWC) has taken into consideration the need of the States to enhance their revenue so as to meet their developmental expenditure. Certain services should be kept explicitly for the State Government to levy taxes, as this will increase their resources. "The Commission recommended an appropriate amendment to the Constitution in this behalf to include taxes, now levied and collected by the Union to be enabled to be levied and collected by the States."¹²

¹¹ Basu, D.D. : *Introduction to the Constitution of India*, (Prentice, New Delhi, 1999), p. 319

¹² Website of NCRWC, www.ncrwc.nic.in, Final Report (8.5) accessed on 5.3.2002.

The sales tax collected by various States also varies from State to State. For instance, according to N.J. Kurian,

“the sales tax revenue collected in West Bengal is less than 50% of that collected in Tamil Nadu, though the two States are of comparable size. While sales tax accounts for about 60% or more of the revenues of most of the States, its share is as low as 40% in Punjab. Similarly, Uttar Pradesh collects less amount as motor vehicles tax than Haryana or Orissa though it is well known that the potential tax revenue in Uttar Pradesh on this account could be much more than Haryana or Orissa.”¹³

Besides the revenue tax, States also receive non-tax revenue and grants. The non-tax revenue includes duties, interest receipts, dividends and profits, charge for economic services, social services and other general services. “Grants from the Centre comprises of the grant components of Central assistance for State plans and centrally sponsored schemes, grants under Finance Commission dispensation for meeting the special needs of the states, natural calamity and relief grants and other sundry grants.”¹⁴ “Besides revenue receipts the States receive non debt capital receipts on account of recovery of loans and other miscellaneous capital receipts.”¹⁵

¹³ Op. cit (*EPW*, May 8th, 1999), pp. 1115-1125.

¹⁴ Ibid.

¹⁵ Ibid.

TABLE 4.4 REVENUE RECEIPTS OF ALL STATES 1990 -1999

REVENUE

Rupees in Lakhs

Total all States/Year	TAX REVENUE			NON TAX REVENUE			
	Revenue from State Taxes (a)	Share in Central Taxes	Total (Col. 2+3)	Grants from Centre	Other non tax revenue	Total (std)	Total Revenue (4+7)
1	2	3	4	5	6	7	8
1990-91 Accounts	3034483	1424147	4458636	1264329	923719	2188048	6646678
1991-92 (R.E.)	3510687	1682665	5193352	1605164	1178124	2783288	7976640
1992-93 (B.E.)	4029990 *(3955311)	1982363 *(1832363)	6012353 *(5787674)	1717397	1263610 *(1250992)	2981007 *(12968389)	8993360 *(8756063)
1993-94 (Account)	4642407	2239482	6881881	2117600	1556883	3674483	10556372
1994-95 (R.E.)	5441683	2485007	7926690	2229079	2174387	4403466	12330156
1995-96 (B.E.)	6169777 **(6074317)	2907193	9076970 **(8981510)	2417738	2151380 **(2150210)	4569118 **(4567948)	13646088 **(13549458)
1996-97 (Accounts)	7110152	3503761	10613913	2315467	2354258	4669725	15283638
1997-98 (R.E.)	8495888	4003917	12499805	2775226	2433328	5208554	17708359
1998-99 (B.E.)	9821489	4667891	14489380	2843189	2691204	5534393	20317597 (20023773)

Note: * figures in brackets relate to 1991-92 rates of taxation.

** figures in brackets relate to 1994-95 rates of taxation

RE = Revised Estimates

B.E. = Budget Estimates.

Source: Report Currency and Finance 1991-92 to 97-98, Statistical Statements.

Table 4.4 shows the revenue received by all States in the form of tax and non-tax revenue. Tax Revenue through revenue from State taxes and share in Central taxes has been rising. Grants from the Centre to the States have also been rising. The revenue both tax and non-tax has been rising in the case of all States. The revenue has been more in the case of non-tax revenue. Maharashtra has been heading the table in tax revenue from 1990-93 to 1996-99. Uttar Pradesh has been following Maharashtra in both tax and non-tax revenue. In most of the developed States like Gujarat, Maharashtra, Karnataka, the revenue from the State taxes is more than the share from Central taxes.

However, in underdeveloped States like Assam, Jammu and Kashmir, Manipur, Meghalaya, Nagaland, the share in Central taxes and grants is higher. This is because the States being backward fail to attract investment and as such it becomes important for the Centre to provide funds to these States. "For instance, about 61.6% of the expenditure requirements of these States was financed by transfers from the Centre during 1990-2000."¹⁶

¹⁶ *State Finances: A study of Budgets, 2000-2001*, (RBI, December 2000), p. 26.

Table 4.5: States' Fiscal Position: A Summary View

(As per cent of GDP at current market prices)

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/1999	1999/2000 RE	2000/2001 RE
Revenue receipts	11.7	12.3	12.2	12.3	12.1	11.5	11.2	11.2	10.0	11.0	11.2
Tax Revenue (Net to Centre)	7.8	8.1	8.1	8.0	8.0	7.8	7.8	8.0	7.3	7.7	8.1
Non-Tax Revenue	3.8	4.3	4.1	4.3	4.1	3.7	3.4	3.2	2.7	3.3	3.1
Expenditure	16.0	16.5	15.9	15.7	16.0	14.9	14.8	15.0	15.1	16.6	16.1
Revenue Expenditure	12.6	13.2	12.9	12.7	12.7	12.2	12.3	12.3	12.5	13.9	13.3
Capital Expenditure	3.4	3.3	3.1	2.9	3.3	2.7	2.5	2.7	2.6	2.8	2.8
Revenue Balance (1-5)	-0.9	-0.9	-0.7	-0.4	-0.6	-0.7	-1.2	-1.1	-2.5	-2.9	-2.1
Fiscal Balance	-3.3	-2.9	-2.8	-2.4	-2.7	-2.6	-2.7	-2.9	-4.2	-4.8	-4.1

Source: RBI, *Handbook of Statistics on Indian Economy, 2000*.

Notes: RE: Revise Estimate BE: Budget Estimate

The Revenue Expenditure of States as given in Table 4.5 shows that it has been fluctuating between 11 to 13% of GDP since 1990/91. If we compare the revenue receipts between 1990/91 and 1998/1999 we see a decline from 11.7% to 10.0%. Again, the tax revenue has also gone down from 7.8% in 1990/91 to 7.3% in 1998/99. The non-tax revenue has also gone down from 3.8% in 1990/91 to 2.7% in 1998/99.

It would therefore be interesting to study the role being played by the Finance Commission in transferring financial resources to the States.

The Finance Commission has been set up primarily with the purpose of making periodical assessment of the fiscal needs of the States and making recommendations regarding the transfer of resources from the Centre to the States. The Finance Commission has been assigned the task of making recommendations regarding the distribution of the net proceeds between the Centre and the States. "The Finance Commission in the past had also looked into the debt position of the States and recommended a scheme for general debt relief for all States, linked to fiscal performance and specific relief for States with high fiscal stress, the special category States and the States with debt problems warranting special attention."¹⁷

¹⁷ *Ninth Five Year Plan, 1997-2002*, (6.14).

Moreover, "...the Constitution stipulated that the Finance Commission to be set up every five years should decide the quantum of shareable tax revenues to be assigned to the States and horizontal distribution of the same across the States." ¹⁸

Article 270, 273, 275 and 280 provide for the constitution of a Finance Commission to recommend to the President measures relating to the distribution of financial resources between the Union and the States. The constitution of the Finance Commission has been laid down in Article 280.

The Finance Commission since its inception in 1951, looks into the distribution of funds between the Centre and the States. The States bring out their financial problems before the Finance Commission, so that by the time the Report is prepared by the Commission, the needs of the States are looked after.

The Commission in its Report prepares the procedure for which the Centre can transfer funds to the States. "An important focus of the Tenth Finance Commission is the need to consider the extent to which the Union budget succeeds in the important task of devolution of resources to the States which is important for the strengthening of the federal

¹⁸ Kurian, N.J: 'Growing Inter State Disparities' in *Seminar* 509, (January 2002), pp.62-66.

structure and character of the Indian constitution.”¹⁹ Moreover the Tenth Finance Commission recommended “an alternative scheme wherein 29% of the gross revenue from all Central taxes pooled together, may be given to the States. This has been supported by the Central Government also.”²⁰

Following the Tenth Finance Commission, the Eleventh Finance Commission, constituted on July 3rd 1998, “states that 28 percent of the net proceeds of all shareable Central taxes and duties may be distributed amongst all States. In addition 15% of the net proceeds of all shareable Central taxes and duties may be distributed amongst such States, which do not buy and collect sales tax on sugar, textile and tobacco; a National Calamity Contingency Fund to replace the National Fund for Calamity Relief; grants in aid under Article 275(ii) amounting to Rs. 35,359 crore may be provided to such States which still have deficit on the non Plan revenue.”²¹

The Eleventh Finance Commission, recommended higher share to the backward states and also proposed the revision of the Gadgil Formula. As the function of the States is becoming wider with time, the Eleventh Finance Commission has also recommended “an overall macro

¹⁹ Ghosh Arun, ‘Economy and the Budget’, *EPW*, (May 6th –13th 1995), pp.1073-1077.

²⁰ Op.cit (*Ninth Plan*, 3.50).

²¹ *RBI Annual Report*, 2000.

balance between the Centre and the States, with improved distribution of resources vertically from the Centre to the States.”²²

The NCRWC has acknowledged the fact to ensure the successful working of the Finance Commission, “it has been suggested that it would be desirable to associate the States more actively in deciding the additional terms of reference, preferably by having the NDC (comprising the Prime Minister and Chief Ministers of State) to endorse the additional terms of reference.”²³ It has also recommended that the “terms of reference of the Finance Commission should be broader and comprise of matters which would take care, in a comprehensive way, aspects of financial relations between the Union and the States. The broadening of such terms of reference could also be discussed earlier by the NDC.”²⁴

Thus, seeing the important role the Finance Commission plays in the distribution of financial resources between the Centre and the States, the NCRWC has called for the enlargement of the scope of the Finance Commission.

The Reserve Bank of India has also been taking initiatives to strengthen the finances of the State Government. “Some of the recent

²² Op.cit (A Study of Budgets, December 2000), p.1.

²³ Op.cit, (www.ncrwc.nic.in, Final Report) (8.3.5).

²⁴ Ibid (8.3.5).

RBI initiatives on State Finance include constitution of Technical Commission of Finance Secretaries on State Government Guarantee, setting up of a Commission of State Finance Secretaries on Voluntary Disclosure Norms for State Budgets, setting up of a Consolidated Sinking Fund, advising the State Government on cash management techniques relating to upholding of accounts, data analysis technology, improve updating of financial account etc.²⁵

The opening up of the economy in the early 1990's has meant the flooding in of Multi-National Companies to the country. The States, which have been taking up a number of projects, are now in a position to approach foreign countries and bodies for loans.

The States feel that they do not get enough resources from the Centre to meet their needs. To add to this is the fact that they are unable to raise enough resources, so the other alternative that they have found is turning to the markets for funding their projects. An aspect of the economic reforms has been the increasing reliance on market forces and private investment. Private investment since 1991, have been flowing mainly into those States, which are more developed with better infrastructure and efficient administration.

²⁵ Op.cit, (A Study of Budgets, 2000), p.10.

One significant feature of State financing in the 1990s has been the role played by foreign funding agencies like the Asian Development Bank, (ADB) World Bank, (WB) and other foreign countries. They are now taking part directly in the funding of State based projects. The role that is being played by the Asian Development Bank is laudable.

The main objective of the ADB has been to support States, which are undertaking the reform programme through loans and the technical assistant. The three States that have been selected by the ADB are Gujarat, Madhya Pradesh and Kerala on the basis of their willingness to undertake the reform programme. Several States, including Andhra Pradesh, Gujarat, Madhya Pradesh and Uttar Pradesh, are now implementing comprehensive reforms, supported through ADB and World Bank public resources management programmes and sector development assistance.²⁶

The Bank seeks to assist States in addressing their development issues. In 1995, Gujarat was selected as the first State for ADB supported State level operations. The ADB Board had approved the \$250 million, Gujarat Public Sector Resource Management Programme Loan in

²⁶. Website of ADB, www.adbindia.org, accessed on 4th June 2001.

December 1996. This was significant since it had been the first externally adjustment loan to a State. Madhya Pradesh on the basis of its social and economic backwardness had been selected as the second State by the ADB for financial assistance. The ADB's Board had approved the \$250 million Madhya Pradesh Public Resource Management Programme Loan in December 1999. The Programme aimed at fostering public finance reform, public enterprise restructuring.²⁷

Adoption of economic reform programme by the country therefore helped in opening the floodgates of the country. States are now in a position to approach foreign lending institutions and countries for financial assistance to the projects that are being undertaken. These foreign lending-institutions are more than willing in investing in such projects, which are profitable. Thus an important criteria for funding by the ADB, is that such States should be implementing their economic reforms programme. This to a certain extent helps in the reduction of the burden on the Central Government for finances. Now, the Centre can give more attention to the underdeveloped and backward States. Besides such foreign institutions, foreign countries have also been coming forward in giving financial aid to States either through financial assistance or undertaking of the projects.

²⁷ Ibid.

“In October 1990, two agreements on bilateral cooperation were signed with the Australian Government. These were (i) Agreement on developmental Cooperation and (ii) MOU relating to Small Activity Scheme. Australian Aid to India is extended under the aegis of the above agreements.”²⁸

America, France, European Committee, OPEC countries and a host of other countries are extending financial aid to India. Even institutions like the International Bank for Reconstruction and Development (IBRD) are coming forward in extending financial aid. “The total value of assistance extended by IBRD by way of loans up to 31.12.1999 for which agreements signed is around US\$ 21, 964 million. The commitments were against projects in various sectors like Agriculture, Irrigation, Power...”²⁹

Financing of States – Taxation Measures

The other means to raise revenue for the Centre and the States alike, is the raising of revenue through taxes. The legislative power to make laws for imposing a tax is divided between the Union and the States by means of specific entries in the Union and State legislative list as maintained in Scheduled VII.

²⁸ *Budget 1999-2000*, p.41.

²⁹ *Ibid.* p.49.

Imposition of taxes vary from State to State, For instance, the imposition of sales tax depends on the State Government, therefore the levying of taxes would vary from State to State, depending on the Government in power at the State. Again, the taxes introduced by the Central Government will have different impact in different States. A larger and developed State will be in a position to pay taxes, in other words, in a State where the living conditions is high, the people will be in a position to pay the taxes to the Government. But this is not so in the case of a State with poor living conditions. Taxes should therefore be imposed in such a manner where it would cater to the needs of the society in a uniform manner.

Again there is distribution of taxes between the Centre and the States. While there are certain taxes levied and collected by the Centre and then distributed between the Centre and the States, there are again some taxes, which are levied by the Union, but collected and appropriated to the States.

Such distribution of taxes has been introduced with a view to finance the States, while the revenue of the Centre comes from excise tax, custom tax, income tax and tax on capital gains, the source of revenue for the States comes from sales tax, excise duty on alcohol, tax on profession, trade, taxes on lands and buildings, entry tax on goods entering the States, taxes on vehicles, entertainment tax, agriculture tax,

income tax and stamp duty. The Centre has been entrusted with more revenue raising power than required, to meet its expenditure needs. The States on the other hand no matter how much the taxation power always falls short of its expenditure. The distribution of taxes should also be done in such a manner, wherein the less developed and underdeveloped States get a larger share of the taxes. This would be of great help in reducing the regional disparities that exist between the States. This can be done if the Centre has more power to tax, and as such redistribute in favour of the backward States.

The Tax Reform Commission had been set up in 1991 just at the same time when the economy was being liberalised. The Tax Reform Commission came up with its final Report in 1992. The Commission had recommended a full-fledged VAT (Value Added Tax) system at the Central level. "The Commission to bring about a smooth change to VAT at the Centre have recommended the making of tax base comprehensive, by giving limited exemption and bringing more commodities under the tax net; replace specific taxes by ad-valorem duties; reduce the multiplicity tax rates to two or three rates; give credit to taxes on inter regional trade such as Central sales tax and consignment tax when provincial tax such as sales taxes are levied by the importing State."³⁰ "The Tax Reform Commission (Interim report, 1991 and Final Report 1992) had

³⁰ Murty, M.N: 'Value Added Tax in a Federation' in *EPW*, (March 18th, 1995), pp. 579-584.

recommended a full-fledged VAT system at the Central level covering all commodities and services with the exception of raw produce of agriculture.”³¹

The introduction of VAT in India has been considered earlier by the L.K. Jha Commission on indirect taxation in 1987, Tax Reform Commission headed by Raja J. Chelliah in 1991 and more recently by the Economic Survey Report of 2001-2002.

Tax reform is one of the key elements of the economic reform process in India. “International experience has shown that a successful implementation of the VAT will require determination of the VAT rates by the Centre and a Centrally determined VAT should replace the cascading turnover sales tax levied by the State.”³²

“ A Value Added Tax levied on the value added in each stages of the production and distribution process can be aptly defined as the ultimate form of consumption tax. In fact VAT is an alternatives way of accelerating a tax on consumption expenditure.”³³

VAT is a tax on value added by any economic activity to the commodities and services it buys from other economic activities. A comprehensive form of VAT involves value added at all the three levels of

³¹ Op.cit (*EPW*, March 18th, 1995), pp 579-584.

³² Gurumurthi, S.: ‘Fiscal Federalism’ in *EPW*, (October 2nd, 1999), pp. 2875-2888.

³³ Gurumurthi, S.: ‘VAT and Fiscal Federalism’ in *EPW*, (May 29th, 1993), pp. 1108-1120.

activity viz. when the commodity is manufactured, at the wholesaling stage and finally at the retailing stage.

The VAT could be levied in three ways, derived from different concepts of measurement of income.

- (i) Tax could be levied on sale of goods and services put to final consumption – consumption type of VAT, which exempts capital.
- (ii) The VAT may be gross product types in that case no capital outlay, depreciation allowance etc. will be deductible from the base.
- (iii) The net income of VAT-depreciation as deductible for the purpose of estimation of base.

A VAT is to be imposed at uniform rates across the nation and the revenue that is collected from the tax is to be shared by the Government at different levels viz. Central, State and further down at local levels. This is done on the basis of an agreed formula, which depends largely on the negotiation between the Central and State Government.

“Maharashtra was the first State to introduce a VAT in its true spirit covering the entire spectrum of manufacturing and trading in the State.”³⁴

³⁴ Op.cit (EPW, October 2nd, 1999), pp.2875-2888.

In a federal country like India different ways are 'there for implementing a VAT – at the Central level and the State level. Firstly, the Vat being a Central levy, the rates would be levied and controlled by the Centre while the collection would be shared between the Centre and the States. Secondly, the VAT being a State VAT, the Centre would completely withdraw from the field of domestic indirect taxes. Thirdly, dual Centre- State VAT with well defined spheres of responsibilities. One form of dual VAT would be that Central VAT is levied at the manufacturing stage, while States would collect and retain revenue at the wholesale level.

In a country as wide as India, imposing a uniform VAT raises a lot of question. First and foremost, all the States do not have the same level of economic development and as such, the regional disparities are wide. Therefore imposing a uniform rate of tax will lead to further widening of regional disparities because while the richer States will become richer, the poorer States will become poorer. Another issue between the Centre and the States, which has been raised while imposing the VAT, is over the dominating tendency of the Centre. The States feel that if such a uniform Central tax were introduced, the Centre would be encroaching upon the States sovereign powers of sales taxation and in fact would challenge the superiority of the sales tax.

India being a federal country, it therefore becomes important to see that both the Centre and the States levy the VAT at different levels. A Central VAT is necessary at the manufacturing level, and the revenue that is collected by the Centre should be distributed to the States. Again the States would be empowered to levy a full-fledged State VAT in the country.

“In a federal country, Government at all three levels, may levy taxes on commodities and services so that a tax reform leading to the introduction of VAT by the Government at one level can have fiscal consequences for the Government at the other levels also.”³⁵

Bagchi, suggests “a concurrent VAT at two levels of Government, viz. both at the Centre and the States, but integrated in the sense that the base will be laid down at the national level while allowing the State to fix the rates. The rates could be flexible.”³⁶ In such cases then VAT would be applicable both at the Central and the State level.

The Tax Reform Commission (TRC) had strongly underlined the need to switch over to a VAT system in India. “The Tax Reform Commission (Final Report, Part I) has suggested that we could have an admixture of VAT (called MODVAT) at the Central level extended to most

³⁵ Op.cit (*EPW*, March 18th, 1995), pp.579-584.

³⁶ Op cit (*EPW*, October 2nd, 1999), pp, 2875 – 2888.

commodities and rationalised sales tax system at the State level. The Union Government would collect MODVAT at the level of the manufacturer and State could collect it at the wholesale level. In addition, a sales tax would be collected from the manufacture or wholesale depending upon the structure of the sales tax in the State.”³⁷

“In the Conference of Chief Ministers held on 16th November, 1999, it was decided to implement uniform floor rates of sales tax in the entire country. It was also decided to phase out sales tax based incentive schemes for industries, reform the Central Sales Tax Systems and simplify the tax system as prevailing in the States by the introduction of Value Added Tax (VAT). It has now been decided that all States and Union Territories would implement VAT from April 2003.”³⁸

The Committee of State Finance Minister has come up with a number of steps to ensure the introduction of VAT- passing of VAT legislation and framing of rules and regulations; compensation for dealers who fall within the ambit of VAT; training of tax officials etc; implementation of VAT by assigning identification numbers to tax payers.

The State Government would ensure the reform of the States by:

³⁷ Purohit, Mahesh: 'Adoption of VAT in India', *EPW*, (March 6th, 1993), pp.393-404.

³⁸ Website of Ministry of Finance, www.finmin.nic.in, Economic Survey 2001-2002, (2.38).

- (a) Converting sales tax into VAT by moving over to a multi-stage system of sales taxation with rebate for tax on all purchases with one minimal exception.
- (b) Replace the structure of tax rates with two or three rates within specified bands, applicable in all States and Union Territories.
- (c) Tax inter-States sales to non-registered persons as local sales.

Thus, "it is expected that with the introduction of the VAT regime by the States and Union Territories, a uniform common market will develop in the country."³⁹

The VAT, is intended to be introduced with a view to provide a uniform rate of taxation in the entire country. The idea of VAT being collected by the States could sound attractive to the States as this would mean that they do not have to depend on the Centre. But VAT is best collected at the Central level for "experience with federalism, part large federalism has shown that any system which involves commodity taxation at two levels viz. federal and provincial, cannot ensure implementation of the VAT in its true spirit."⁴⁰

The gap between the expenditure incurred and revenue raised is ever widening. Proper channelling of resources from the Centre to the

³⁹ Ibid (2.40).

⁴⁰ Op cit. (*EPW*, October 2nd, 1999), pp. 2875-2888.

States in a country like India is to take place if a balanced regional development is to be ensured. The States depend to a great extent upon the Centre for financial aid. It is upon the Central Government to see that all States receive fair amount of revenues for development. It is for this reason, that some States have been placed under the special category. By placing such States under the special category status, they are given the means and opportunities to develop further. The Planning Commission and Finance Commission have been set up with a view to ensure the overall development of all the States.

A significant feature of the economic reform period is the involvement of foreign lending bodies and even foreign countries in providing financial loans to the States. Now, these bodies can enter into direct negotiations with the States and they are enthusiastically taking part in State level projects, more so in areas where the economic reform package has been introduced. This is doing a great deal of help in reducing the burden of the Centre. But, however this does not undermine the role of the Centre. A major share of revenue for States come from the Centre and the role has further increased with the adoption of a liberalised economy. And it is this financial transfer or resources between the Centre and the States that shapes the financial relation between the Centre and the State to a large extent.

Chapter 5

Conclusion

New Federalism: Promises and Reality

Article 1 of the Constitution declares India to be a 'Union of States'. Nowhere is the word federal explicitly mentioned. But what has come to emerge is a Constitution containing the basic features required in a federal Government. Indian federalism has been evolving according to time, the nature changing according to the Government in power.

There has been a remarkable change in the nature of the party system in India, and this has brought about a change in the nature of the Indian federal system. With the decline of the Congress Party in the Centre in the 1990's, there was a lack of any party being able to form a Government on its own. What, therefore came to emerge is a system of coalitional government and alliances. At the Centre none of the national parties, including the BJP, have been able to form a government on its own. They therefore had to depend on the support of other parties. It was under such circumstances, that the regional parties began to play an important part in shaping national politics. This thus brought about a change in the nature of the Indian federal system.

The regional parties began to bring issues of local importance to the national level. As a result of the involvement of the state parties at the national level, interaction between the Centre and the States began to increase. The regular holding of meetings of bodies like the Chief

Minister's Conference, Governor's Conference, Conference of the Inspector General of Police have to a large extent helped in the improvement of relations between the Centre and the States, as these bodies serve as forums whereby leaders of the Central and State Government meet and discuss issues concerning Centre - State relations.

The national parties too, are beginning to change their stand on State related issues. They have come to realise that they cannot ignore demands of the regional parties, especially so, when their survival depends to a large extent on the support of the regional parties.

This system of coalitional politics at the Central level has helped in forging closer links between the Centre and the State. Various Prime Ministers heading the coalitional Government have emphasised upon the need for maintaining a closer link between the Centre and the States. For instance, it was only under the leadership of V.P. Singh, heading the National Front Government, that the Inter-State Council, came to be established in 1990. Again, Deve Gowda introduced the Common Minimum Programme with a view to forge closer links between the Central and State Governments. Meetings of institutions like the Inter-State Council, Chief Ministers Conference, Governor's Conference have been called more frequently so as to deal with issues relating not only to Centre-State but also inter-State relations.

Cooperative federalism does not imply only vertical federalism, that is cooperation between the Centre and the States; but also horizontal

cooperation, that is cooperation between States. With the adoption of a liberalised economy the need for the existence of cooperation between the States has become all the more important, as this would ensure free flow of trade.

The adoption of a more deregulated market-based economy has led to a shift in decision-making powers to private investors, both domestic and foreign. The main motive of such investors being profit, it is but natural that these investors would invest in areas where there is proper infrastructure so that they make maximum profit. In this context then, the question of regional disparities sets in. States, which, are already developed, would attract such investors, while underdeveloped States lacking a proper infrastructure and market would fail to attract such investment. Therefore, the developed and industrialised States will continue to move up, while the underdeveloped States will be further pushed back.

In order to attract investors, especially foreign investors, States introduced tax cuts and, Chief Ministers toured abroad to project their States as safe havens for investment. This has only heightened the competition between different States. While liberalisation, has been having a great impact on industrialisation, not much of an impact has been felt on the agricultural sector. Therefore, the impact of liberalisation is also restricted to certain regions of the country. While States like Maharashtra, Gujarat, Karnataka, having an industrialised economy, are

the greatest beneficiaries; liberalisation has had little impact on North-Eastern States, Bihar, Orissa, which are not much industrialised. This regional imbalance has often created a strain relation between the Centre and the States.

Globalisation talks about the increasing role of the market forces and rolling back of the role of the Government. However, in a country like India where so much of regional disparities exist this is not feasible. Therefore alongside the market forces, the Government both Central and State should be actively taking part in the developmental efforts of the State. Such efforts will ensure some measure of balanced development, and as such reduce feeling of alienation arising from regional disparities. This also would help in leading to a harmonious relation between the Centre and the States, for it has been seen in the past that the question of economic underdevelopment has often led to the rise of sub-regional feelings.

Liberalisation has brought about an increasing role of the State Governments. They take part directly in negotiations with foreign countries or bodies for funding development projects in their States. This no doubt has benefited both the Central and State Government, but it has its own repercussions too. The Government, both Central and State, have to agree to the terms and conditions set forth by the lending agencies or countries, which may go against the interest of the entire nation.

Globalisation calls for the opening up of the economy and as such free flow of inter-State trade is encouraged. In such a situation then it is not inter-State competition, but cooperation that needs to be emphasised upon. The State Government should try to remove barriers, which exist in the form of levying of taxes on goods entering the States. Though a uniform rate of taxation is not possible, however efforts should be made to reduce the disparities.

Again, with the ever-increasing role of the State Government in development expenditure in the 1990s, relations between the Centre and the States with regards to transfer of resources becomes crucial. Therefore, a proper mechanism for the allocation of resources between the Centre and the States should be made.

Introduction of a globalised economy has therefore brought about certain changes in the nature of Indian federalism, Firstly, the powers of the States has increased to a large extent in various forms. Secondly, inter-State competition has been on the rise. Thirdly, globalisation has to a large extent, increased the friction among the States and the Centre. This only goes to show that Indian federalism faces a number of challenges in this globalised world.

In this study 1990 has been taken as a cut-off year to analyse the nature of Indian federalism since a number of factors have been taking shape viz. in the form of emergence of coalitional politics, rise of regional parties at the central level and the adoption of a New Economic Policy. It

therefore becomes interesting to study whether any changes in the nature of Indian federalism has been taking place or not. Federalism in India has been going through different phases. The nature of federalism depends to a great extent on the party in power. The presence of a centralised form of Government had been possible during the presence of a dominant One-Party system. But in this present era of coalitional politics and globalised market economy it is not feasible to talk of a centralised form of Government. Cooperation between the different levels of Government is required, and this is possible only if the Central Government is willing to shed off its powers and transfer it to the States.

There have been certain changes in the nature of Indian federalism, both positive and negative. The concept of 'cooperative federalism' has come to be used more often as it has been realised that a strict division of power between the different levels of Government is not possible. The Centre under the leadership of coalitional Government has been making efforts to improve the relations between the Centre and the States. With the involvement of regional parties at the Central Government, States are beginning to be more involved in the national decision-making policy. The Centre and the States are becoming more dependent upon each other. While the States depend to a great extent on the Centre for financial resources to carry on their developmental projects, the Centre on the other hand cannot go ahead with its policies, until and unless the States are willing to implement them. With the

transfer of more powers to the States, the doubts regarding the ambitious designs of the Central Government in the minds of the State Governments are being removed.

The negative aspect of the nature of federalism is that during this period, as the market forces are being strengthened, we notice a growth in inter-State competition. Cooperative federalism is thus giving way to competitive federalism. This would only further worsen the situation by widening the regional disparities.

A negative effect of the rise of regional parties on the nature of Indian federalism is the growth of the bargaining power of the regional parties. The regional parties join the national Government keeping their regional issues in mind. Local issues are thus nationalised. The regional parties having a narrow support base think of the interest of their region and not of the nation as a whole. By joining the national Government, they try to get more favours from the Central Government for their States. For instance, when Mamata Banerjee of the Trinamool Congress was the Railway Minister, she tried to introduce more trains for West Bengal. This bargaining politics has a negative effect on the country.

Regional Parties when they enter into national politics are to work keeping in mind the larger interest of the nation as a whole and not confine themselves to narrow regional politics. The presence of narrow-minded partners in the coalitional Government would benefit certain regions only. However, such benefits are restricted to States ruled by the

same regional parties. For instance the BJP alliance partners AIADMK, Trinamool Congress and Samata Party have at different times demanded the dismissal of the State Governments of Tamil Nadu, West Bengal and Bihar who had been ruled by different parties.

Commissions after Commissions have been set to look into Centre-State relations, the Administrative Reforms Commission, Rajamannar Commission, Sarkaria Commission are but few of them; the Sarkaria Commission being the most important. However, there is a lack of serious effort on the part of the Government to implement the various Commissions Report. Thus, most of them have gathered dust. The NCRWC which has been set up by the BJP led National Democratic Alliance (NDA) Government and which came out with its Final Report in 2002 also talks about issues concerning Centre-State relations namely Article 356, role of the Governor, treaty-making powers, role of the Finance Commission, Inter State Council. It talks about the need to strengthen bodies like the Finance Commission, Planning Commission, Inter State Council so as to ensure a cooperative existence between the Centre and the States.

To ensure that the spirit of cooperation exists, meetings of bodies like the Chief Minister's Conference, Governor's Conference, Inter- State Council, Conference of Inspector's General, should be held more regularly. The Finance Commission should be given a greater role as opposed to the Planning Commission, since the Planning Commission is

a political body, susceptible to the Central Government. There is a need to strengthen the National Development Council by consulting the States more frequently and reducing the interference of the Planning Commission. This would thus help in bringing about a spirit of cooperation amongst the various levels of Government.

What we notice in the nature of the Indian federal system is the fact that it is constantly evolving. To talk of a strict centralised form of government is not possible in the present era. Centralisation was possible when there was one party ruling the Centre and the States. The 1990s has been witnessing the emergence of coalitional politics, rise of regional parties, adoption of a liberalised economy and this has brought with it new areas of tension and cooperation between the Centre and the States. Development of a competitive spirit between the States is on the rise. This unhealthy trend of competition should be nipped at the bud, before it becomes a dominant feature in the nature of federalism. The Central Government therefore has to take an active role in controlling the widening regional disparities and not leave all the decision-making powers with the States. Emphasis should be put on the spirit of cooperation not only between the Centre and the States, but also amongst the States themselves and this to a large extent depends on the Government in power at the Centre.

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