



Fiscal Federalism: Nature and Features of India's Federal Polity

*Anuraag Mittal**

ABSTRACT

Fiscal federalism is a subject of topical interest in India in view of some recent developments of historical importance, including the introduction of goods and services tax (GST). This paper discusses the three-tier federal structure of India with governments at Union, States and Local levels. It also explains the rationale behind the Centrally biased Constitution, which was envisaged by the founding forefathers as a means to reduce economic disparities and protect India's unity, integrity and sovereignty against external aggression and internal disruption. Federalism with the cultural and ethnic pluralism has given the country's political system great flexibility, and therefore the capacity to withstand stress through accommodation.

Keywords: *Fiscal federalism; Constitution of India; Centre-State relations; Parliament.*

1.0 Introduction to India's Federal Structure

A federal set up creates a multiple polity based on divided functions and powers among central, state and local governments. Fiscal federalism, as a branch of public finance, deals with financial arrangements and their working in a federal polity. Fiscal federalism is a subject of topical interest in India in view of some recent developments of historical importance, including the introduction of goods and services tax (GST) from July 1, 2017.

The Constitution of India which was adopted by the Constituent Assembly on November 26, 1949, became operative on January 26, 1950. It provides for two layers of Government, one at the Central level, and the other at the level of the States. The very first Article of the Constitution defines India, also known as Bharat, as a Union of States. Though the word federation has been deliberately avoided in the Indian Constitution, the

**Associate Professor, Guru Nanak Institute of Management, GGS IP University, Delhi, India.
(Email: anuraag1975@gmail.com)*

political system introduced by it possesses all the essentials of a federal polity. Other important countries of the world with federal set up of government include US, Canada, Australia and Brazil.

India's Constitution, the longest and the most exhaustive Constitution of any independent nation in the world, is the supreme organic law of the land. Both the Centre and State Governments derive their authority from the Constitution. The States are not allowed to secede from the union.

Politically, the country is divided into 29 States and 7 Union Territories (UTs), collectively called the Republic of India. Out of the 7 Centrally-administered UTs, 2 have their own legislatures (Delhi and Pondicherry) and 5 are without legislature (Andaman and Nicobar Islands, Lakshadweep, Dadra and Nagar Haveli, Daman and Diu and Chandigarh). There are wide variations in the size and economic structure among the States. According to 2011 Census, Uttar Pradesh, with 20 crore people, was the largest State, and Sikkim, with 6 lakh people, was the smallest.

The country has a three-tier federal structure with governments at Union, States and Local levels. Below the State Governments, in urban areas there are 96 municipal corporations, 1,494 municipalities, and 2,092 smaller municipalities (called *Nagar Panchayats*). There are 2,47,033 rural local bodies or *panchayats*, of which 515 are at the district level, 5,930 at the block level, and 2,40,588 at the village level. However, the devolution of powers to the third level is uneven among States and their participation in public service delivery is negligible.

Why did the framers of the Constitution opt for a federal set up? Answering this question, the Commission on Centre-State Relations, 1988, observed, "In a country too large and diverse for a unitary form of Government, they envisaged a system which would be worked in co-operation by the two levels of government —national and regional—as a common endeavour to serve the people. Such a system, it was conceived, would be most suited to Indian conditions as it would at once have the advantages of a strong unified central power, and the essential values of federalism."¹

1.1 Division of powers

A federal polity like India requires division of powers and responsibilities between the Centre and the States and generally brings in its wake problems and conflicts in Centre-State relations. Hence, the Constitution describes in detail the legislative powers and functions of the two tiers of Government.

There is a division of legislative, administrative and financial powers and functions between the Union and the State Governments. Under Article 246 read with Seventh Schedule of the Constitution, these powers and functions have been defined

through precise entries in the three lists in the Schedule. Thus, the Centre has exclusive powers to legislate in respect of matters contained in List I (Union List) such as defence, foreign affairs, citizenship, railways, posts and telegraph, telephones, broadcasting, airways, banking, coinage and currency. Entries 82 to 91 and 92A and 92B of this list pertain to taxation powers.

Similarly, the States enjoy the power to legislate on matters mentioned in List II (State List) such as public order, police, public health, local government, agriculture and fisheries. Entries 45 to 63 (excluding 52 and 55) of this list relate to taxation powers of the States.

The Parliament and the State Legislatures have concurrent powers to make laws on any matters in List III (Concurrent List). The framers of the Constitution recognised that there was a category of subjects of common interest which could not be allocated exclusively either to the Union or the States. Some of the items included in the Concurrent List are marriage and divorce, forests, economic and social planning, population control and family planning, legal, medical, and other professions. This list does not contain any head of taxation.² Residuary powers of legislation including taxation belong to the Centre as per Entry 97 of List I.

The foregoing three-fold division of subjects of legislation rests on the ground that matters of national concern are placed in List I and those of purely State or local significance in List II. Matters of common Centre-State interest are included in List III.

The Supreme Court stands at the head of India's judiciary to guard this distribution of powers and to invalidate any action which violates the limitations imposed by the Constitution.

According to Article 254 of the Constitution of India, if any provision of a State law is repugnant to any provision of a Central law, then the Central law shall prevail and the law made by the State shall be void to the extent of repugnancy.

The most common application of Article 254 arises when both the Central and State Governments enact legislation on the same matter contained in List III of the Seventh Schedule of the Constitution. In such a situation, if there is repugnancy then Central law prevails over the State law.

Indian Constitution has a strong Central bias. The financial powers of the Central Government are overwhelming. According to some scholars, the Constitution of India is neither purely federal nor purely unitary but is a combination of both. India's constitution is sometimes described as federal in times of peace and unitary in times of war.

2.0 Centrally Biased Constitution and its Justification

From its very inception, the Constitution is loaded in favour of the Centre. Constitutional amendments effected subsequently have tilted the balance further in favour of the Centre. The concept of a strong Centre has been incorporated in the anatomy of the Constitution through a variety of devices, among which the following are noteworthy.

2.1 Supremacy of union legislative power

Article 246 (2) and (3), and Article 254 (1) establish the supremacy of Union legislative power. Thus, where with respect to a matter, there is irreconcilable conflict or overlapping as between the three lists of the Seventh Schedule, the legislative power of the States must yield to that of the Union. This is how the non-obstante provisions of clauses (1) and (2) of Article 246 are interpreted. Similarly, Article 254 (1) states that a law made by a State legislature, repugnant to a law made by the Parliament or an existing law applicable in that State, in regard to any matter enumerated in the Concurrent List, shall be void to the extent of repugnancy.

2.2 Union control over state legislation

Articles 200 and 201 establish control of the Union executive over State legislation. Article 200 provides that a Bill passed by a State Legislature shall be presented to the Governor who may give his assent, withhold his assent or return the same for reconsideration by the legislature. However, if it is again passed by the State legislature, with or without amendment, he shall not withhold his assent. The Governor may also reserve the Bill for consideration of the President (in effect the Union Council of Ministers) who may in turn signify his assent, withhold the same or return it for reconsideration. However, in contrast to the position of the Governor, the President need not give his assent when such a Bill is returned with or without amendment after reconsideration by the legislature of the State (Article 201).

2.3 Emergency provisions

Articles 352 and 360 provide for certain emergency provisions. Article 352 provides for proclamation by the President of a grave emergency whereby the security of India is threatened by war or external aggression or armed rebellion. When such a proclamation is in operation, the Union may assume for its organs all the legislative and executive powers of the States. A proclamation of emergency has the effect of converting the State List into Concurrent List and, therefore, if the Parliament legislates

on any subject in the State List, the State laws, to the extent of repugnancy, shall be null and void and the law made by the Parliament shall prevail.

Article 360 envisages yet another type of emergency, i.e. financial emergency. If the President is satisfied that a situation has arisen whereby the financial stability or credit of India or of any part of its territory is threatened, he may proclaim a financial emergency. When such an emergency is in operation, the executive authority of the Union extends to directing any State for the purpose of securing observance of canons of financial propriety.

2.4 Restrictions on taxation powers of the states

Constitution also imposes certain restrictions on the taxation powers of the States. Although a State legislature enjoys the power to levy any of the taxes mentioned in List II, in the case of certain taxes, this power is subject to restrictions imposed by substantive provisions of the Constitution. For example, a State legislature is empowered to levy a tax on professions, trade, calling or employment vide entry 60 of List II. However, the total amount payable in respect of any one person to the State by way of such tax is not to exceed Rs. 2,500 per annum [Article 276(2)].

2.5 Restrictions on borrowing powers of the states

Under Article 292 the executive power of the Centre extends to borrowing, either within or outside India, upon the security of the Consolidated Fund of India, within such limits, if any, as may from time-to-time be fixed by Parliament. However, the borrowing power of a State (Article 293) is subject to a number of restrictions: (i) it cannot borrow outside India; (ii) it can borrow within the territory of India subject to the following conditions (a) limitations as may be imposed by the State Legislature, (b) consent of the Union Government to raise fresh loan if the Union has guaranteed an outstanding loan of the State, (c) consent of the Union to raise fresh loan if a Union loan to the State remains outstanding. Since all the States are in debt to the Centre, they have to obtain Centre's permission for raising loans. These restrictions are meant to avoid uncontrolled borrowings by the States and thus to prevent the possibility of any State becoming defaulter or insolvent. In short, the Centre enjoys almost unlimited powers to borrow from internal and external sources while the borrowing powers of the States are subject to various restrictions

2.6 President's rule

Lastly, there is the controversial Article 356. According to it, if the President on receipt of a report from the Governor of a State, or otherwise, is satisfied that a situation

has arisen in which the Government of the State cannot be carried on in accordance with the provisions of the Constitution, he may by proclamation assume to himself all or any of the functions of the State Government. He may also declare that the powers of the Legislature of the State shall be exercised by or under the authority of the Parliament.

In view of the above provisions of the Constitution, some experts call it unitary in extraordinary situations, such as war (or emergency), and federal in normal times. It is also called as a quasi-federal Constitution.

Similarly, a scrutiny of the taxation powers contained in the Union List and the State List reveals that major and elastic sources of tax revenue belong to the Centre while relatively inelastic sources of revenue come under the purview of State Governments.

Why is there a need for a strong Centre? According to the Commission on Centre-State Relations, 1988, "The primary lesson of India's history is that, in this vast country, only that polity or system can ensure and protect its unity, integrity and sovereignty against external aggression and internal disruption, which ensures a strong Centre with paramount powers, accommodating, at the same time, its traditional diversities. This lesson of history did not go unnoticed by the framers of the Constitution. Being aware that, notwithstanding the common cultural heritage, without political cohesion, the country would disintegrate under the pressure of fissiparous forces, they accorded the highest priority to the ensurance of the unity and integrity of the country."³

Moreover, the founding fathers were aware that several regions or areas of India were economically and industrially far behind in relation to others, a situation which exists even today. Revenue-raising capacities and revenue needs of various States also differ. To reduce these economic disparities, a policy of regional balanced development was necessary, and which could be effectively implemented by a financially and otherwise strong Centre.

3.0 Political and Governance Structure

The Constitution of India provides for a Parliamentary form of government which is federal in structure with certain unitary features. The constitutional head of the Executive of the Union is the President. As per Article 79 of the Constitution, the Council of the Parliament of the Union consists of the President and two Houses known as the Council of States (Rajya Sabha) and the House of the People (Lok Sabha). Article 74(1) of the Constitution provides that there shall be a Council of Ministers with the Prime Minister as its head to aid and advise the President, who shall exercise his/her functions in accordance to the advice. Thus, real executive power is vested in the

Council of Ministers with the Prime Minister as its head.

The Union and individual State Governments consist of executive, legislative and judicial branches. At the Centre, the executive branch is headed by the President, who is the Head of State and exercises his powers directly or through officers subordinate to him. The legislative branch or the Parliament consists of Lok Sabha and Rajya Sabha, as well as the President. The judicial branch has the Supreme Court at its apex, High Courts at the state level, and numerous civil, criminal and family courts at the district level.

Every State has a Legislative Assembly. Certain States have an Upper House (also called State Legislative Council). There is a Governor for each state who is appointed by the President. Governor is the Head of the State and the executive power of the State is vested in him. The Council of Ministers with the Chief Minister as its head advises the Governor in the discharge of the executive functions. The Council of the Ministers of a state is collectively responsible to the Legislative Assembly of the State. The system of government in states closely resembles that of the Union.

Union Territories are administered by the President through an Administrator appointed by him.

3.1 Parliamentary government

Parliament is the supreme legislative body of India. The Indian Parliament is bicameral and consists of the President and the two Houses: upper house called the Rajya Sabha (Council of States) and the lower house called the Lok Sabha (House of the People). The President has the power to summon and prorogue either House of Parliament or to dissolve Lok Sabha.

3.1.1 Rajya Sabha

The origin of Rajya Sabha can be traced back to 1919, when in pursuance to the Government of India Act, 1919, a second chamber known as the Council of States was created. This Council of States, comprising of mostly nominated members was a deformed version of second chamber without reflecting true federal features. The Council continued to function till India became independent. Rajya Sabha (Hindi nomenclature of Council of States) was adopted on August 23, 1954.

Rajya Sabha is a permanent body and is not subject to dissolution. However, one third of the members retire every second year, and are replaced by newly elected members. Each member is elected for a term of 6 years. Rajya Sabha has 250 members. 238 are elected indirectly by the States and Union Territories. The rest 12 are nominated by the President.

The Vice-President of India is the ex-officio Chairman of Rajya Sabha. The House also elects a Deputy Chairman from among its members. Besides, there is also a panel of Vice-Chairmen in the Rajya Sabha. The senior most Minister, who is a member of Rajya Sabha, is appointed by the Prime Minister as Leader of the House.

3.1.2 Lok Sabha

Parliamentary institutions in India, with all their modern ramifications, owe their origin to India's British connections. Until 1853, there was no legislative body distinct from the Executive. The Charter Act of 1853, for the first time provided some sort of a legislature in the form of a 12 member Legislative Council. The Indian Independence Act, 1947 declared the Constituent Assembly of India to be a full sovereign body. Apart from being a Constitution drafting body, it also assumed full powers for the governance of the country. With the coming into force of the Constitution on 26 January, 1950, the Constituent Assembly functioned as the Provisional Parliament until the first Lok Sabha, then known as the House of People, and was constituted following General Elections in 1952. Lok Sabha (the Hindi nomenclature of House of People) was adopted on 14 May, 1954.

The Lok Sabha is composed of representatives of people chosen by direct election on the basis of Universal Adult Suffrage. Presently, the strength of the House is 545 members. 543 of the Lok Sabha's 545 members are directly elected by popular vote to represent individual constituencies for a 5 year term. The other 2 members are nominated by the President from the Anglo-Indian community if the President is of the opinion that the community is not adequately represented. The term of the Lok Sabha, unless dissolved, is 5 years from the date appointed for its first meeting. However, while a proclamation of emergency is in operation, this period may be extended by Parliament by law for a period not exceeding 1 year at a time and not extending in any case, beyond a period of 6 months after the proclamation has ceased to operate.

3.1.3 Functions and powers

The cardinal functions of the Parliament include overseeing of administration, passing of budget, ventilation of public grievances, and discussing various subjects like development plans, international relations, and national policies. The Parliament can, under certain circumstances, assume legislative power with respect to a subject falling within the sphere, exclusively reserved for the States. The Parliament is also vested with powers to impeach the President, remove judges of Supreme and High Courts, the Chief Election Commissioner, and Comptroller and Auditor General in accordance with the procedure laid down in the Constitution. All legislation requires the consent of both

Houses of Parliament. In the case of Money Bills, the will of the Lok Sabha prevails. The Parliament is also vested with the power to initiate amendments in the Constitution.

India's parliamentary system of government is based largely on that of the United Kingdom (Westminster system).

4.0 Commission on Centre-State Relations, 1988

Government of India appointed in 1983 a Commission on Centre State Relations under the Chairmanship of Mr. Justice R.S. Sarkaria, a retired judge of the Supreme Court. The Commission was set up to review the whole gamut of Centre-State relations in their legislative, administrative, and financial aspects.

The monumental report of the Commission, submitted in 1988, basically accepted the existing framework of the Constitution. It disfavoured any major changes in the provisions of the Constitution including the financial arrangements. It stood for a strong Centre to preserve the unity and integrity of the country.

An important recommendation of the Commission pertained to the residuary power of legislation under the Constitution. Article 248 read with entry 97 of List I (Union List) of the Seventh Schedule vests in Parliament the residuary powers of legislation with respect to any matter not enumerated in List II (State List) or List III (Concurrent List). Such residuary powers include the power of making any law imposing a tax not mentioned in these Lists.

Regarding residuary powers of legislation, the Commission recommended, "that residuary power of legislation in regard to taxation should advisedly remain with Parliament. But, the residuary field other than that of taxation may be transferred to the Concurrent List....The Constitution may be suitably amended to give effect to this recommendation."⁴

Thus, the Commission recommended partial transfer of entry 97 to the Concurrent List. Unfortunately, no action has been taken so far to implement this recommendation of the Commission.

As regards financial relations between the Centre and the States, the Commission recommended as follows.

- The Commission disfavoured any major modification in the basic scheme of the Constitution dividing the fields of taxation between the Centre and the States.
- It rejected almost all the suggestions to shift the taxation powers of the Centre to the States. Such suggestions pertained mainly to the shifting of terminal taxes on goods and passengers carried by railways, estate duty, and banking etc.
- The Commission was not in favour of making the devolution of funds from the

Centre to the States automatic. In its view the existing division of functions between the Finance Commission and the Planning Commission was reasonable and must continue.

- In its opinion the terms of reference of the Finance Commission should be drawn up in consultation with State Governments.
- Significantly, the Commission recommended the sharing of corporation tax between the Centre and the States. Most other suggestions for enlarging the divisible pool were turned down.
- It recommended legislation to levy consignment tax and constitutional amendment to enable levy of tax on advertisements in broadcasting.
- As regards agricultural income tax, the Commission observed that as opinions are divided the matter should be examined further in depth.
- The Commission recommended the setting up of an expert committee to examine taxation reforms and resource mobilisation.
- Some other recommendations of the Commission included: review of the royalty paid to the States, modernisation of treasury systems, making available foreign borrowings by States from the banks, the issue of tax free municipal bonds, and assistance for natural calamities, shifting of additional excise duty from fabric to yarn, and setting up of special courts for economic offences.

5.0 Conclusion

To sum up, although the term *federation* has nowhere been used in the Indian Constitution, the federal character of the Constitution is one of its salient features. Constitution has provided for a structure of governance which is essentially federal in nature. It contains all the usual features of a federation, namely two-tier government, division of powers, supremacy of Constitution, independent judiciary and bicameralism. However, the Indian Constitution also contains a large number of unitary or non-federal features, viz. a strong Centre, single constitution, single citizenship, integrated judiciary, appointment of State Governors by the Centre, all-India services, emergency provisions, and so on.

Article 1 of the Constitution describes India as a *Union of States* which implies two things: 1. Indian federation is not the result of an agreement by the States. 2. No state has the right to secede from the federation. Hence, the Indian constitution is often described as *federal in form but unitary in spirit*.

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

Federalism with the cultural and ethnic pluralism has given the country's political system great flexibility, and therefore the capacity to withstand stress through accommodation. However, continuation of the same requires not simply federalism, but cooperative and constructive federalism. A strong Centre is necessary for strong States and vice versa is the essence of cooperative federalism. Indian federation should be seen in the context of its democratic system of governance at the national, state and local levels and the pluralities of its culture in terms of ethnic, linguistic, religious and other diversities which cut through the States. India's federal polity ensures that governance is distributed spatially and a strong Central Government enables that the *unity amidst diversity* is maintained. It is through federation that the country mobilizes all its resources to maintain its harmony and integrity and marches ahead to progress.

It has been a trend in Indian political history that so long as the Central and State Governments are ruled by the same political party, the co-operative framework works very well. However, when different political parties are in power at the Centre and the States—and more recently when coalition governments are in power—there are signs of stresses and tensions in inter-governmental relations.

The post-Independence changing dynamics and the varied experiences that India has had—like rise of regional parties, formation of coalition Governments, active role of the Judiciary—have shaped the trajectory of federalism by swinging the pendulum from co-operative to confrontationist and vice versa.

Endnotes

1. Government of India, *Report of the Commission on Centre-State Relations* (Chairman: Justice R. S. Sarkaria) Part I, 1988, p. 8.
2. It is noteworthy that Article 246A of the Constitution confers concurrent powers to both Parliament and State Legislatures to make laws with respect to goods and services tax (GST).
3. *Report of the Commission on Centre-State Relations, op. cit.*, p. 7.
4. *Ibid.*, p. 31.